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Research

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Price (p)	678.00
Shares in issue (m)	401
Mkt Cap (£m)	2,719
Net debt (£m)	1
EV (£m)	2,720
BVPS (p)	337.6

Share price performance

1m	9.1%
3m	-5.3%
12m	13.0%
12 m high/low	845/467.6
Ave daily vol (30D)	1,197,484

Shareholders

Invesco Ltd	7.0%
Vanguard Group	5.9%
Blackrock Inc	5.1%
Orbis Allan Gray Ltd	3.9%
Dimensional Fund	3.7%
Schroders Plc	3.5%
Abrdn Plc	3.3%
Aviva Plc	2.9%
M&G Plc	2.6%
Deutsche Bank Ag	2.3%
Total for top 10	40.1%
Free float	99.8%
Source: Bloomberg	21 Dec 22

Next news Finals Q1

Business description

Integrated biomass, hydro and storage IPP



THE GOVERNMENT GIVETH

The mitigation of the Electricity Generator Levy to take account of exceptional fuel costs is clearly positive for Drax and reflects the need for policy to support dispatchable generation in an increasingly volatile energy system. We have updated our forecasts to reflect this change and to update for current pricing. Our central case valuation rises to 1,030p from 963p.

Mitigation of exceptional fuel costs now included in EGL

The UK government has issued technical advice on the Electricity Generator Levy (EGL) which confirms that exceptional generation fuel and feedstock costs can be set against the exceptional revenues targeted by the tax. For Drax this delivers a major mitigation against the levy with biomass costs in excess of £65/MWh now allowed as a deduction against the tax. The actual legislation says that the baseline will be the lower of £65/MWh or historic cost levels but for Drax we think the £65/MWh level is the effective point. With biomass pellet costs in FY23 expected to be above £100/MWh, this is a positive outcome for Drax.

Cruachan remains unaffected

Additionally, the costs of buying back electricity from the grid to replace contracted output not generated will be allowed as a deduction removing a potential risk point under the new tax. Escalation of the EGL baselines has been confirmed to rise with CPI. Drax's pumped hydro generation remains excluded from the tax. With the recent trading update showing this business performing strongly we continue to see this as a major positive and reflective of the contribution the service provides to the UK energy system.

£,000 Dec	2020a	2021a	2022e	2023e	2024e	2025e
Sales	4,235	5,174	4,537	5,746	5,991	6,070
EBITDA	379	370	682	1,100	1,124	1,233
PBT	119	101	364	761	785	912
EPS	24.3	22.3	84.8	99.9	101.1	173.4
CFPS	48.8	34.7	87.6	134.8	149.7	216.7
DPS	17.1	18.8	21.0	23.1	25.4	27.9
Net Debt (Cash)	806	1,170	967	594	167	-539
Debt/EBITDA	2.1	3.2	1.4	0.5	0.1	-0.4
P/E	27.9	30.4	8.0	6.8	6.7	3.9
EV/EBITDA	9.3	10.5	5.4	3.0	2.6	1.8
EV/sales	0.8	0.7	0.8	0.6	0.6	0.6
FCF yield	7.2%	5.1%	12.9%	19.9%	22.1%	32.0%
Div yield	2.5%	2.8%	3.1%	3.4%	3.7%	4.1%

FINANCIAL MODEL

FORECAST CHANGES

We have revised our forecasts for FY 23 and beyond to bring into line with the detailed EGL guidance. Our existing forecasts already included an assumption of the revenue impact of the levy so the mitigation on fuel costs is positive. We have also fully updated FY 23 and FY 24 for the pricing signals given in the recent trading update.

Key forecast changes

	2023 Old	2023 Revised	2024 Old	2024 Revised	2024 Old	2024 Revised
EBITDA	881	1,100	981	1,124	912	1,233
EPS	93.2	99.9	90.1	101.1	120.5	173.4
DPS	23.1	23.1	25.4	25.4	27.9	27.9

Source: Longspur Research

VALUATION IMPACT

Our base case includes the full impact of the windfall tax on revenue. We have also modelled scenarios to include a return on the CCS element of the UK BECCS units, overseas BECCS plants and the Cruachan expansion. Our base case valuation rises to 887p from 809p per share on better pricing and if we add new pellet capacity this rises to 1,030p which we see as a sensible central case. Full economics for UK CCS, overseas BECCS and the Cruachan expansion all contain elements of regulatory uncertainty but factoring in sensible scenarios could see a valuation of 1,249p.

Valuation scenarios

p per share	Incremental	Cumulative
Revised base case	887	887
Pellet expansion – central case	143	1030
CCS on two UK units	62	1092
Cruachan expansion	26	1118
Global BECCS – high case	131	1249

Source: Longspur Research

RISK

The key risks to our valuation are driven by potential policy changes, competition and commodity price risk. The windfall tax is a crystallisation of policy risk but there are others notably around the carbon capture and long duration storage consultations currently underway. We see the signs on both of 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 the upgrading of our price forecasts today but there is two way risk and we have remained cautious further out.

Profit and Loss Account

£m, DEC	2020a	2021a	2022e	2023e	2024e	2025e
Turnover						
Power Generation	3,646	4,682	3,778	4,601	4,627	4,581
B2B Energy Supply	2,119	2,360	2,607	2,791	2,989	3,201
Pellet production	231	450	528	789	871	846
Central, int gp and depn	-1,761	-2,318	-2,376	-2,435	-2,496	-2,558
Total	4,235	5,174	4,537	5,746	5,991	6,070
Operating profit						
Power Generation	400	352	580	817	775	908
B2B Energy Supply	-39	6	24	13	15	17
Pellet production	52	86	159	391	460	437
Central, int gp and depn	-224	-273	-321	-377	-383	-388
Operating profit	189	170	441	845	867	973
P&L Account	2020a	2021a	2022e	2023e	2024e	2025e
Turnover	4,235	5,174	4,537	5,746	5,991	6,070
Operating Profit	189	170	441	845	867	973
Investment income	0	0	0	0	0	0
Net Interest	-69	-70	-77	-85	-82	-61
Pre Tax Profit (UKSIP)	119	101	364	761	785	912
Goodwill amortisation	0	0	0	0	0	0
Exceptional Items	-354	21	-25	0	0	0
Pre Tax Profit (IFRS)	-235	122	339	761	785	912
Tax	40	-12	-26	-362	-381	-220
Post tax exceptionals	37	-30	0	0	0	0
Minorities	0	1	0	0	0	0
Net Profit	-158	80	313	399	404	692
Dividend	-65	-71	-80	-89	-98	-107
Retained	-223	9	233	310	306	585
EBITDA	379	370	682	1,100	1,124	1,233
EPS (p) (UKSIP)	24.29	22.31	84.76	99.86	101.11	173.40
EPS (p) (IFRS)	-39.79	20.01	78.50	99.86	101.11	173.40
FCFPS (p)	48.84	34.66	87.62	134.84	149.71	216.66
Dividend (p)	17.10	18.80	21.00	23.10	25.40	27.90

Source: Company data, Longspur Research estimates

KEY POINTS

- Flattish EBITDA in FY 21 reflects loss of income from gas assets now sold
- Strong recovery in FY 22 as new pellet income contributes for a full year
- FY 22 also benefits from stronger generation market
- COVID 19 impact on customers' business in FY 20 but recovery in FY 21 and FY 22
- Overall recovery sustained in FY 23 with stronger pricing
- 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

£m, DEC	2020a	2021a	2022e	2023e	2024e	2025e
Fixed Asset Cost	3,484	4,166	4,409	4,616	4,755	4,895
Fixed Asset Depreciation	-1,543	-1,855	-2,096	-2,350	-2,607	-2,867
Net Fixed Assets	1,941	2,311	2,313	2,266	2,148	2,028
Goodwill	248	416	416	416	416	416
Other intangibles	182	189	189	189	189	189
Investments	292	125	145	145	145	145
Stock	348	501	439	556	580	587
Trade Debtors	525	642	563	713	743	753
Other Debtors	367	1,324	1,324	1,324	1,324	1,324
Trade Creditors	-907	-1,211	-1,062	-1,345	-1,402	-1,421
Other Creditors <1yr	-394	-966	-966	-966	-966	-966
Creditors >1yr	-364	-767	-767	-767	-767	-767
Provisions	-91	-86	-86	-86	-86	-86
Pension	-1	0	0	0	0	0
Capital Employed	2,146	2,476	2,507	2,444	2,323	2,201
Cash etc	290	317	545	986	1,479	1,669
Borrowing <1yr	7	56	56	56	56	56
Borrowing >1yr	1,089	1,431	1,457	1,524	1,590	1,074
Net Borrowing	806	1,170	967	594	167	-539
Share Capital	48	48	48	48	48	48
Share Premium	430	432	432	432	432	432
Retained Earnings	153	198	432	741	1,047	1,632
Other	709	607	607	607	607	607
Minority interest	0	22	22	22	22	22
Capital Employed	2,146	2,476	2,507	2,444	2,323	2,201
Net Assets	1,339	1,307	1,540	1,850	2,156	2,741
Total Equity	1,339	1,307	1,540	1,850	2,156	2,741

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

Cashflow

£m, DEC	2020a	2021a	2022e	2023e	2024e	2025e
Operating profit	189	170	441	845	867	973
Depreciation	190	199	241	254	257	260
Provisions	20	0	0	0	0	0
Other	-23	-42	-25	0	0	0
Working capital	37	27	-31	-329	-25	153
Operating cash flow	413	355	625	771	1,099	1,386
Tax paid	-48	12	-12	-26	-362	-381
Capex (less disposals)	-171	-209	-244	-207	-139	-139
Investments	0	-20	-20	0	0	0
Net interest	-59	-60	-77	-85	-82	-61
Net dividends	-65	-71	-71	-80	-89	-98
Residual cash flow	70	7	202	374	427	706
Equity issued	1	2	0	0	0	0
Change in net borrowing	-67	363	-202	-374	-427	-706
Adjustments	-3	-359	0	0	0	0
Total financing	-70	7	-202	-374	-427	-706

Source: Company data, Longspur Research estimates

KEY POINTS

- Working capital modestly negative assuming no change in payment timings
- Capex slightly down in FY 20 as signalled by company
- Windfall tax outflows in FY 24 and FY 25
- Net investment outflow in FY 21 as gas asset sales offset by pellet acquisition
- Cash positive from FY 22
- Further capex on pellet business expansion

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