EOS Russia – MRSK Newsletter 07/08/17

Outstanding results continued in 1H17

In the end of July, MRSKs reported their 1H17 RAS results that continued to be outstanding across the board.

RAS	EBIT margin 1H17	1H16	Net margin 1H17	1H16	Revenue growth
MRSK Center-Volga	17,3 %	9,4 %	13,8 %	2,6 %	15,0 %
MRSK Volga	9,4 %	5,6 %	5,6 %	0,4 %	10,0 %
MRSK Urals	10,5 %	5,6 %	8,6 %	3,9 %	12,0 %
MRSK North-West	7,2 %	6,0 %	2,5 %	0,8 %	9,1 %
Lenenergo	22,3 %	13,9 %	14,2 %	11,0 %	16,3 %

Source: Companies, EOS

This year on year improvement in 1H17 results is exceptionally impressive.

Why are MRSKs improving now ?

Over the last two and half years there has been a general improvement in results every quarter. There has been a further outstanding leap this year.

One trigger was the oil price collapse in 2014 that resulted in the government demanding bigger dividends and better operational management to help to balance the state budget.

Further, the tariff regime has been predictable and unchanged since 2014 with clearly smaller tariff increases than before. All MRSKs have received a tariff increase slightly below inflation every July. This has forced the companies to cut costs and investments to safeguard government dividend demands.

There has been a much more hands-on approach to management by the Ministry of Energy since 2014. After the creation of Rosseti in 2013, the management and the government became more focused on operational issues rather than corporate structure changes.

There is also a very clear positive impact from the work of minority shareholders. Minority shareholder pressure is helping to bring about substantial improvements and this is showing up particularly in a number of our holdings.

Despite the improvements, it is clear that the companies are still very inefficient, and continue to have large potential in cost management and in improving corporate governance.

Valuations and Share Prices

MRSK share prices have been doing well during the summer and rallying strongly especially at the end of July and beginning of August on the back of the 1H17 result announcements.

With this year's MRSK earnings growth continuing at such a strong and accelerating pace, they are again traded at massive discounts of 71-79% to Emerging Market peers on 2017 estimated P/E and EV/EBITDA multiples.

	P/E			EV/EBITDA		
	2015	2016e	2017e	2015	2016e	2017e
MRSK Average	9.7	8.4	3.1	3.8	3.5	2.3
GEM Average	24.5	15.8	14.9	10.5	9.0	7.9
MRSK Discount	-60%	-46%	-79%	-64%	-61%	-71%

Note: MRSK average: Center-Volga, Volga, North-West, Urals; GEM average: Light (BRA, Equatorial Energia (BRA), Manila Electric (PHI). Note: Ratios exceeding 30 have been excluded. Source: Companies, 4-Traders, EOS estimates, Date: 1 August, 2017