## EOS Russia – MRSK Newsletter 20/03/17

### Strong 2016 RAS results

Over the past weeks, MRSKs have reported strong full-year 2016 RAS (Russian Accounting Standards) results that have continued on the improvement trajectory started about two years ago. In 2016, profit margins and revenues were mostly up quite significantly.

| | EBIT margin | | Net margin | | Revenue |
|---|---|---|---|---|---|
| RAS | 2016 | 2015 | 2016 | 2015 | growth |
| MRSK Center-Volga | 13,7 % | 7,2 % | 4,0 % | 1,4 % | 14,0 % |
| MRSK Volga | 8,8 % | 4,6 % | 2,6 % | 0,1 % | 11,0 % |
| MRSK Urals | 7,7 % | 7,4 % | 5,1 % | 4,1 % | 8,0 % |
| MRSK North-West | 7,3 % | 7,5 % | 1,1 % | 1,6 % | 7,0 % |
| Lenenergo | 19,5 % | -0,8 % | 12,3 % | -13,5 % | 40,0 % |

Source: Companies, EOS

The improvement in the financials is mainly driven by the improved cost management at the companies and an increasing demand for electricity connections.

### Dividend payouts may be taking a step backwards

On February 20, Interfax reported that the Energy Ministry is in favour of dividends amounting to 25% of the RAS net profits for MRSKs. Under this framework, larger payments will still be a possibility, depending on decisions by the Boards of Directors.

This approach would be somewhat disappointing and a step backwards as all our MRSKs paid 50% payouts of the larger of the RAS or IFRS net profits for 2015.

Nevertheless, even if all our MRSKs paid dividends at the lower end of the expected range, the dividend yields would still be significant.

| Estimated 2016 dividend yield | | |
|---|---|---|
| | 25% payout | 50% payout |
| MRSK Center-Volga | 4.7% | 9.3% |
| MRSK Urals | 6.5% | 13.1% |
| MRSK Volga | 3.7% | 7.4% |
| MRSK North-West | 2.9% | 5.7% |
| Lenenergo | 4.6% | 9.2% |
| Lenenergo pref | 16% | 16% |

Source, EOS; 13 March, 2017

**Privatisations**

We believe that the MRSK privatisations will be ultimately driven by the need to build a significant amount of new grid connections that MRSKs will not have the funding to pay for. This need may increase quite suddenly, as happened in 2006-07, when the Russian government was forced to introduce connection fees as a quick measure to deal with the need for new electricity connections.

However, the existence of European sanctions continues to keep the privatisation plans on the back-burner. We also believe that the Russian government will not be actively working on the privatisations before the Russian presidential elections in March 2018.

**Valuations and Share Prices**

MRSK share prices have declined in the past weeks after the news on the Energy Ministry's dividend plan appeared. However, MRSKs continue to trade at low valuations in comparison with their Emerging Market peers. For instance, they are currently traded at discounts of 64-79% on 2015-17e P/E and EV/EBITDA multiples to the peers.

| | P/E | | | EV/EBITDA | | |
|---|---|---|---|---|---|---|
| | 2015 | 2016e | 2017e | 2015 | 2016e | 2017e |
| MRSK Average | 5.2 | 4.3 | 3.4 | 3.9 | 2.9 | 2.6 |
| GEM Average | 24.5 | 16.9 | 16.0 | 10.8 | 9.3 | 8.0 |
| MRSK Discount | -79% | -75% | -79% | -64% | -68% | -68% |

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: 13 March, 2017