

EOS Russia – MRSK Newsletter 7/11/17

Strong profit growth continued in third quarter of 2017

MRSKs reported their 9m17 RAS results at the end of October, showing strong year-on-year increased profitability across the board.

	EBIT margin		Net margin		Revenue
RAS	9m17	9m16	9m17	9m16	growth
MRSK Center-Volga	16,3 %	10,5 %	12,2 %	4,0 %	16,4 %
MRSK Volga	9,6 %	6,6 %	6,1 %	2,0 %	10,8 %
MRSK Urals	10,0 %	6,6 %	7,4 %	3,9 %	10,4 %
MRSK North-West	5,1 %	4,7 %	1,0 %	-0,7 %	7,2 %
Lenenergo	20,4 %	15,4 %	13,3 %	10,4 %	14,3 %

Source: Companies, EOS

New Rosseti CEO commits to increasing market capitalisation

The Russian government replaced the CEO of Rosseti in the beginning of September, when Pavel Livinsky took over. Livinsky is 37 years old with a background of management positions at the Moscow city government and Moscow electricity grid companies.

Deputy Prime Minister Arkady Dvorkovich commented on the new appointment at the beginning of September by saying that the focus on cost-cutting as well as regional consolidations with TSOs (non-MRSK distribution grids) will continue. In addition, he also mentioned that the published Government Grid Strategy includes a section on the possibility of privatizing some MRSKs or placing them under external management contracts. He said that these issues will be again studied.

In October 17, Livinsky met with President Putin. According to the meeting transcript, the bulk of the meeting discussion covered winter preparations and cost-cutting.

On the same day, Livinsky said in a tariff regulation conference that Rosseti should be freed from paying dividends, which would enable lower tariff growth. At the same time, he said that Rosseti is aiming for share price growth and that the market capitalization of Rosseti should be RUB 1,000-1,500bn vs RUB 224bn at the time of the speech.

The dividend statement resulted in a fall in the share prices of Rosseti and MRSKs, and on the following day Rosseti IR department was already in damage control mode saying that this story is not about refusing to pay dividends but about the tariff calculations, which currently do not include a dividend component.

Livinsky's statement was further contradicted by the Deputy Minister for Energy, Vyacheslav Kravchenko, who said that Rosseti should keep on paying dividends in the same way as other state-owned infrastructure companies such as Gazprom, Transneft and Rosneft. In his view the dividend payments stimulate an improvement in operational performance.

Further on October 27, Deputy CEO of Rosseti Evgeny Olhovich said that Rosseti will continue to pay dividends in accordance with the current policy, but would like to develop an even better policy to increase the market capitalisation.

It is encouraging that the new management of Rosseti clearly has a goal of increasing the share prices, and has even given an implicit target 4.5-6.7x the current market valuations with the estimate of fair market capitalization of R1,000-1,500bn for Rosseti.

Valuations and Share Prices

MRSK share prices fell following Mr Livinsky's dividend comments in October 17. Although a number of people have walked back and clarified Mr Livinsky's misunderstood statements, the share prices have not yet fully recovered.

With this year's MRSK earnings growth continuing at a strong pace, MRSKs are again trading at substantial discounts of 71-80% to Emerging Market peers on 2017 estimated P/E and EV/EBITDA multiples.

	P/E			EV/EBITDA		
	2015	2016	2017e	2015	2016	2017e
MRSK Average	10.6	9.3	3.4	3.5	3.3	2.4
GEM Average	24.4	16.2	17.1	10.7	9.1	8.2
MRSK Discount	-57%	-42%	-80%	-67%	-64%	-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:2 November, 2017