

EOS Russia – MRSK Newsletter 07/08/18

MRSKs reported good performance in the first half

In late July, MRSKs reported their first half 2018 RAS results. These show generally good operational performance that was all the more encouraging given that the equivalent 1H period in 2017 was very strong, especially for MRSK Center-Volga and MRSK Volga.

	EBIT margin		Net margin		Revenue
RAS	1H18	1H17	1H18	1H17	growth
MRSK Center-Volga	18,4 %	17,3 %	14,3 %	13,8 %	12,7 %
MRSK Volga	7,6 %	9,4 %	5,8 %	5,6 %	11,2 %
MRSK Urals	11,6 %	9,4 %	-0,9 %	8,6 %	8,6 %
MRSK North-West	7,6 %	7,2 %	3,3 %	2,6 %	35,8 %
Lenenergo	21,2 %	22,3 %	16,1 %	14,3 %	9,6 %

Source: Companies, EOS

Based on these results, the dividend prospects for these MRSKs remain strong with a 15% dividend yield as a reasonable target for MRSK Center-Volga, MRSK Volga, MRSK North-West and Lenenergo preferreds for 2018.

MRSK Urals incurred a major cost-item below the operating lines under 'other costs' that increased to Rb8bn in 1H18 from Rb1.6bn in 1H17. This is evidently a write-down related to the years-long problem with non-payments that seems to resolve the problem fully. Nevertheless, MRSK Urals could still reasonably yield 4-6% for 2018 as its operating profitability has improved.

In July, we sold all our common shares in Lenenergo. However, we continue to hold the previously held preferred shares in the company.

Interview by Rosseti CEO

There was a long interview of Rosseti CEO Livinsky in *Kommersant* on July 15. The following key points came up:

- Rosseti is working with the government to introduce a new long-term tariff regulation by the end of this year. The new system could be in place from 2019 or 2020.

- Livinsky spoke about adding a dividend component to the tariffs, but said that he would be also fine with the long-term regulation as a means of ensuring dividend payment capacity.

- On the subject of MRSK privatizations, he said that, in order not to sell at low valuations, the government should first introduce the long-term tariffs and resolve the problem of tariff cross-subsidization [that is, residential consumers being subsidized by corporate consumers]. After that the privatizations could be discussed with the benefit of carrying them out at high valuations.

- When asked about the MCAP target of R1.5trn, he said that the MCAP should equal at least the sales (Rosseti sales in 2017 were R948bn, while Rosseti's MCAP at the time of the interview was R156bn). He said that it is realistic to achieve that target within 5 years. He indicated that the key drivers would be cost-cutting and dividend payments. He also mentioned that Rosseti aimed to increase the group's revenues from non-regulated services to one third of the aggregate top line by 2030.

- He also discussed the digitalization program (that is set to invest R1.3trn (\$21bn) over the next 14 years in grid digitalization) by re-iterating that it is a self-financing project and said that the goal is to have already next year 20% of the group capex directed to the project.

Valuations and share prices

MRSK shares went ex-dividend in June, which has been reflected in the share prices. Adjusting for the dividends, the shares have been largely flat in the past 2-3 months with MRSK North-West shares significantly up, while the shares of MRSK Volga and MRSK Urals somewhat down.

MRSKs continue to be very attractively valued. They are currently trading at substantial discounts of 74-75% to emerging market peers on 2018 estimated P/E and EV/EBITDA multiples.

	P/E			EV/EBITDA		
	2016	2017	2018e	2016	2017	2018e
MRSK Average	10.1	3.8	3.4	3.4	3.8	2.1
GEM Average	18.6	20.4	13.5	10.2	8.8	8.3
MRSK Discount	-45%	-81%	-75%	-67%	-57%	-74%

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: 6 August, 2018