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Good finish to the year indicates high dividend yields

MRSKs reported their full-year 2017 RAS results on 22-26 February, showing generally solid performance in the last quarter, and strong year-on-year profit growth.

	EBIT margin		Net margin		Revenue
RAS	2017	2016	2017	2016	growth
MRSK Center-Volga	16,6 %	13,7 %	12,1 %	4,0 %	15,7 %
MRSK Volga	11,0 %	8,8 %	7,8 %	2,6 %	11,1 %
MRSK Urals	9,4 %	7,7 %	6,4 %	5,1 %	8,6 %
MRSK North-West	7,0 %	7,3 %	-5,5 %	1,1 %	4,4 %
Lenenergo	27,7 %	19,5 %	16,8 %	12,3 %	21,9 %

Source: Companies, EOS

The final quarter results of Lenenergo were especially strong and surprised positively on all lines.

On the negative side, MRSK North-West posted a major bad loss provision of R3.2bn in the last quarter, as Arkhangelsk Elektrosbyit (Arkhangelsk Electricity Supply Company) has lost its authorisation to supply electricity on the wholesale electricity market, and bankruptcy procedures have started. It appears that this write-down now reflects the full extent of problems at the Arkhangelsk company as MRSK North-West had already set aside a bad debt provision of R2.5bn at the year-end 2016, and as the total receivables from Mezhhregionsoyuzenergo (the parent company of Arkhangelsk Elektrosbyit) stood at R4.3bn at the beginning of April 2017.

Strong results point to attractive dividends

For 2016 MRSKs paid as dividends 50% of the IFRS net profits adjusted for connection fee profits/losses . In practice, this meant dividend payout ratios of 37-54% for MRSKs Volga, Urals and Center-Volga, while the payout from MRSK North-West was a more modest 19%.

If the 2016 individual IFRS payout ratios were repeated for each of the companies on 2017 earnings, we estimate that the portfolio weighted average dividend yield on our key holdings would be around 10%.

Dividend yields	2017	Total weighting
MRSK Volga	12,3%	35%
MRSK Center-Volga	11,8%	32%
MRSK Urals	9,4%	19%
MRSK North-West	0,0%	10%
Lenenergo	3,9%	3%
Lenenergo pref	13,3%	1%
Weighted yield	10,2%	100%

It is important to stress that these numbers make several assumptions in addition to the payout ratios and the IFRS net profits. One such assumption is the scale of full-year 2017 IFRS net profits, which have yet to be released.

In 9m17, all these companies with the exception of MRSK Urals reported somewhat larger IFRS net profits than RAS net profits.

Because of the Arkhangelsk write-down, it is likely that MRSK North-West will not pay dividends for 2017.

Rosseti digitalisation plans

Rosseti is planning to invest R1.3trn (\$23bn) in digitalisation over the next 14 years. The funding is planned from cash flow generation as well as borrowed funds.

The project is designed to produce a significant increase in efficiency and thereby cash flow generation. According to the plan, group companies' OPEX and CAPEX should both decline by 30% by 2030 as a result of the program.

Rosseti states that the program will have recovered its costs within 14 years with an IRR of 13%. Among other things it is set to reduce electricity losses from 9.05% to 6.5%, increase the speed of making new connections from 192 days to 120 days, and shorten the average cut-off time from 4.7 hours to 2.4 hours.

The program also envisages an increase in Rosseti's market capitalisation to R1.5trn (\$26.5bn), compared with the current market capitalisation of R161trn (\$2.8bn).

While the program looks good and well-prepared, there are concerns that it might cause a reduction in dividend payout levels in the short-run.

Valuations and share prices

All in all, MRSK share prices have been relatively flat in the past 3-4 months, although MRSK Urals has been trending higher. Good dividend yields should provide support for share prices in the coming months.

MRSKs are trading at substantial discounts of 73-75% to Emerging Market peers on 2017-18 estimated P/E and EV/EBITDA multiples.

	P/E			EV/EBITDA		
	2016	2017e	2018e	2016	2017e	2018e
MRSK Average	10,6	4,4	3,4	3,6	2,6	2,2
GEM Average	17,5	16,7	13,5	10,0	9,1	8,5
MRSK Discount	-39%	-73%	-75%	-64%	-72%	-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:2 March, 2018