

EOS Russia – MRSK Newsletter 06/08/21

MRSK earnings clearly improving

MRSKs posted their first-half 2021 RAS financial statements in the last days of July.

The numbers show Y/Y improvements across the board. For the most part, these improvements are material, and with the positive trend accelerating in the second quarter. While some of the Y/Y acceleration stems from the weak comparable period numbers as Russia experienced its most significant lockdowns in 2q20, some is attributable to improving industrial demand in Russia, and some, especially as regards bad debt recovery, to improved management actions.

RAS	EBIT margin		Net margin		Revenue, Y/Y
	1H21	1H20	1H21	1H20	1H21
MRSK Center-Volga	17,2%	14,4%	12,7%	10,8%	11,1%
MRSK Volga	-1,5%	-2,1%	-1,7%	-2,1%	5,6%
MRSK Urals	7,3%	3,0%	9,8%	1,3%	10,2%
MRSK North-West	7,1%	6,0%	4,7%	2,5%	5,3%
Lenenergo	32,2%	27,1%	24,2%	19,3%	17,9%

Source: Companies, EOS Russia

RAS	EBIT margin		Net margin		Revenue, Y/Y
	2q21	2q20	2q21	2q20	2q21
MRSK Center-Volga	13,7%	7,2%	10,0%	4,5%	14,3%
MRSK Volga	-3,9%	-10,7%	-3,4%	-9,1%	9,2%
MRSK Urals	6,4%	-3,0%	15,9%	-0,2%	13,9%
MRSK North-West	3,1%	-1,0%	1,3%	-3,9%	4,1%
Lenenergo	34,2%	22,0%	25,1%	18,3%	25,4%

Source: Companies, EOS Russia

	EBIT 1H21	Net profit 1H21
	growth Y/Y	growth Y/Y
MRSK Center-Volga	32%	31%
MRSK Volga	22%	17%
MRSK Urals	166%	719%
MRSK North-West	25%	97%
Lenenergo	40%	48%

Source: Companies, EOS Russia

It is worth noting that the large jump in MRSK Urals' bottom-line is mainly due to a large recovery of receivables from Mechel-Energo of a previously written-down debt. In general, impairments for MRSKs should from now on be lower than they have been in the past owing to the more hands-on approach by Rosseti, the gradual introduction of smart metering, the increased use of legal procedures, and further improvements in the regulation of the sector.

If the companies continue operationally on the current trajectory and dividend payouts remain at around 40% of IFRS net profits, the dividends that may reasonably be expected on 2021 earnings

would imply the following dividend yields at current share prices: MRSK Center-Volga 13-15%, MRSK Urals 17-22%, MRSK North-West 4-10% and Lenenergo pref 12.8% (this based on Lenenergo's preferred dividend formula). MRSK Volga's dividends will likely be still zero or very modest as the company reported a loss in the first half, although it still has a fair chance to break even for the full year. MRSK Volga's results should improve at least somewhat on the back of rising industrial activity in the region.

Rosseti's new 2030 strategy

On 11 June, the business newspaper *Kommersant* reported on the Rosseti 2030 strategy that had been approved by a Government Commission on Electricity on 10 June.

According to the strategy, in the base case scenario, Rosseti's net profit would increase from R61bn in 2020 to R224bn in 2030 and the dividends from MRSKs would increase from R16bn to R76bn (by a factor of 4.75x). It goes without saying that such predictions ten years forward involve considerable uncertainties; but, at the same time, they highlight the significant earnings and dividend potential of the MRSKs.

The base scenario assumes tariff growth of 'inflation minus 1%' until 2024 and 'inflation minus 0.1%' after that, and the introduction of payments for reserve capacity and technological connections.

The strategy spoke about the necessity to maintain Rosseti's shareholdings in its subsidiaries as they are today, i.e. the strategy assumed no privatisation of MRSKs or their consolidation into Rosseti.

Valuations and share prices

MRSK share prices have been mostly quite flat in the recent months. MRSK Center-Volga's shares rallied quite a lot ahead of their ex-dividend date in June, but ended up falling more than the dividend amount would have warranted afterwards.

The MRSKs continue to be attractively valued. They are currently trading at substantial discounts of 65-84% to emerging market peers on EV/EBITDA multiples based on 2020-22e earnings.

	P/E			EV/EBITDA		
	2020e	2021e	2022e	2020e	2021e	2022e
MRSK Average	N/A	2.9	3.6	1.4	1.3	1.1
GEM Average	12.9	13.4	10.2	7.1	8.0	6.9
MRSK Discount	N/A	-79%	-65%	-80%	-84%	-84%

Note: MRSK average: Center-Volga, Volga, North-West, Urals; GEM average: Light (BRA), Equatorial Energia (BRA), Manila Electric (PHI).

Note: Ratios exceeding 25 have been excluded. Source: Companies, Marketscreener, EOS estimates, Date: 1 August, 2021