EOS Russia – MRSK Newsletter 04/03/21

MRSKs close a difficult year

MRSKs posted their full-year 2020 RAS financial statements in the last days of February and first days of March.

These full-year numbers show generally a slight operational improvement in the EBIT margin trends compared with the margin trends indicated by the results for the first 9 months of 2020. However, MRSK North-West's traditional seasonal fourth-quarter bounce has been operationally slightly weaker than usual; and, below the operational lines, there is a major non-cash item that has pushed its full-year result into a loss.

Generally, the MRSK managements are characterizing 2020 as a very difficult year. It started with a historically warm winter quarter followed by the coronavirus outbreak that depressed industrial demand for electricity. For instance, MRSK Urals Deputy CEO, commented on the company's results by saying that the company lost 5.8% of its volume, which includes a 13% volume loss within the industrial users, and a 9-10% loss within the oil and oil refining sectors.

	EBIT margin		Net margin		Revenue, Y/Y
RAS	2020	2019	2020	2019	2020
MRSK Center-Volga	13,0%	15,1%	7,3%	5,5%	0,3%
MRSK Volga	-1,1%	5,9%	-1,6%	4,2%	-4,0%
MRSK Urals	2,7%	4,6%	0,0%	2,3%	-19,1%
MRSK North-West	4,4%	7,1%	-3,1%	1,2%	-2,6%
Lenenergo	26,7%	29,0%	17,1%	15,4%	0,3%

Source: Companies, EOS Russia

	EBIT	Net profit
	growth Y/Y	growth Y/Y
MRSK Center-Volga	-14%	33%
MRSK Volga	na	na
MRSK Urals	-66%	na
MRSK North-West	-40%	na
Lenenergo	-8%	11%

Source: Companies, EOS Russia

Dividend outlook

Following this difficult year, MRSK dividends are generally likely to be substantially lower than in the previous years.

In terms of the individual companies:

MRSK Center-Volga

- If the company pays out 50% of its RAS net profit, which is a realistic assumption given that its IFRS profit was 7% higher than the RAS profit in 9m20 and that the company did not pay any dividend for 4q19, its dividend yield would be 12.4%.

MRSK Urals

- The RAS full year net profit was close to a break-even, but the IFRS is likely to show a small profit, which could realistically lead to a dividend yield of around 1%.

MRSK Volga

- The company improved operationally somewhat from the 9m trend, but still posted a loss under RAS and is likely to record a small loss also under IFRS. No dividend expected.

MRSK North-West

- The non-cash item has pushed the company's full-year numbers to a loss. If the same deduction will be made also under the IFRS, which is likely, no dividend should be expected.

Lenenergo

- The company grew its RAS net profit by 11.3% Y/Y, which should mean a preferred dividend of R15.15/share and a dividend yield of 9.8%.

Rosseti new CEO

In the middle of January, the former CEO of Lenenergo, Andrey Ryumin, was appointed as the new CEO of Rosseti. The departure of the previous CEO, Pavel Livinsky, was linked to his appointment as head of the energy department in the federal government staff. Ryumin had been the CEO of Lenenergo CEO since January 2018. In the preceding years, he was an entrepreneur with various business interests, and in 2011-13 he worked for Moscow electricity companies together with Livinsky.

Regulatory changes in the works

Tariff unification

In November, the Russian government approved a move to single electricity distribution tariffs within a few regions and unifying the tariffs between certain 'macro' regions. In the initial implementation phase, this tariff unification concerns the following regions that are joining together to form macro regions in this respect:

1) Kurgan and Tyumen

2) Upper Altai and Altai Oblast

3) Kalmykia and Rostov Oblast

4) Tuva and Irkutsk Oblast

5) St Petersburg and Leningrad Oblast

The effect of this change in, for instance, the new macro region comprising the city of St Petersburg and the surrounding Leningrad oblast would be to raise tariffs in the city by around 2% on average while reducing tariffs in the Oblast by 6%. Tariffs in Upper Altai would increase by 45% and fall by 4% in Altai Oblast.

Rosseti has been lobbying for such single tariffs for many years and this would generally mean higher tariffs for MRSKs and lower tariffs for TSOs (non-MRSK electricity distribution grids), as the tariffs typically enjoyed by TSOs have historically been higher than MRSK tariffs. TSO owners may respond to this relative deterioration in their business climate by selling their grids to MRSKs at reasonable valuations.

This tariff unification policy will tend to increase the degree of cross-subsidisation in Russian electricity distribution tariffs – in the sense of industrial customers paying more and residential customers paying less despite the fact that it generally costs much more to distribute electricity to residential users than to industrial users.

The pilot regions do not to cover much of the operating regions where MRSKs in which EOS has ownership other than Lenenergo, but nevertheless this is generally a very positive development for MRSKs.

Reserve capacity

The Russian government has been working on and considering various tariff reforms for the electricity grids in the past years. The furthest along are the idle or reserve capacity payments for the grids. They were endorsed by a Duma committee in January and the preparatory work continues. If approved, this would likely be very positive for MRSKs.

Long-term tariffs

In 2019, Russia passed laws for starting the long-term tariff regulation system on January 1, 2023. This would mean tariffs that are set in stone for 5 or 10 years, and should be a game changer for the sector facilitating significant cost-cutting, investment, and improved profitability.

Valuations and share prices

MRSK share prices have generally been quite flat in the past months. Since the second half of 2020, the ruble has been weak relative to the oil price that has increased rapidly on the prospect of Covid-19 vaccinations leading to a return of normal economic activity.

The MRSKs continue to be attractively valued. They are currently trading at substantial discounts of 80-82% 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	5.0	3.9	1.6	1.5	1.3
GEM Average	16.4	11.3	10.5	8.8	7.5	6.9
MRSK Discount	N/A	-56%	-63%	-82%	-80%	-82%

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: 3 March, 2021