

## EOS Russia – MRSK Newsletter 03/26/20

### **MRSK results generally declined Y/Y in 2019**

MRSKs reported the 2019 IFRS financials in the third week of March. They were in line with expectations after the earlier quarterly results that showed declines in Y/Y earnings.

IFRS	EBIT margin		Net margin		Revenue growth
	2019	2018	2019	2018	
MRSK Center-Volga	11,1%	18,1%	6,9%	12,4%	2,5%
MRSK Volga	8,1%	11,3%	6,2%	9,0%	-1,1%
MRSK Urals	4,2%	1,9%	2,6%	0,6%	5,8%
MRSK North-West	5,2%	4,3%	2,2%	1,8%	-24,2%
Lenenergo	20,8%	20,7%	14,5%	13,6%	6,0%

Source: Companies, EOS

	EBIT growth Y/Y	Net profit growth Y/Y
MRSK Center-Volga	-37%	-43%
MRSK Volga	-29%	-31%
MRSK Urals	129%	331%
MRSK North-West	-8%	-6%
Lenenergo	7%	13%

Source: Companies, EOS

There are several possible explanations for this earnings decline, including the increase in wholesale prices at the beginning of the year, the mild winter at the end of the year, the increase in provisions against bad debts and various one-off items. However, there is no getting around the fact that the numbers were operationally disappointing after several years of earnings growth on the back of cost-cutting measures.

It may be that the most important reason for lower earnings was that the companies had been expecting a 10-year tariff regulation system to start in 2020, and that they had little incentive to manage the costs just before the start. The relevant enabling legislation has now been approved – and provides that the new tariff system will start from 1 January 2023 with at least 5-year tariffs starting then. The delayed launch of the fixed tariff system combined with the economic setback due to the coronavirus and the oil price slump will probably give the companies more incentive this year to control costs.

## **2019 results point to attractive dividend yields**

These 2019 financial results point to attractive dividend yields:

### **MRSK Center-Volga**

- If the company matches the previous year's payout by paying out 50% of the RAS net profit (which was 38% of the IFRS net profit), the full-year total yield would be 16.1% (of which a 11.5% yield was paid after 9m19).

### **MRSK Volga**

- If the company were to pay out 44% of its IFRS net profit as it did last year, the full year total yield would be 14.9%. If it matches the 59% of RAS payout, the total yield would be 13.4%. Of this prospective total, the company already paid out a 8.8% yield after 9m19.

### **MRSK North-West**

- If the company repeats last year's payout of 62% of the RAS net profit (which would also again roughly equal the 33% IFRS payout), the full year total yield would be 8.2%, of which the company paid a 4.2% yield after the 9m19 results.

### **MRSK Urals**

- If the company matches last year's IFRS earnings payout of 41%, the full year total dividend yield would be 9.7%. If the company matches the RAS payout of 33%, the yield would be 6.1%. The company already paid out a 2.5% yield after 9m19.

### **Lenenergo**

- Lenenergo's preferred dividend projection based on its 2019 RAS results is Rb13.62/share, which translates currently to a 11.6% yield.

## **Rosseti-FSK merger discussed**

On 11 March 2020, Federal Grid Company (FSK) CEO Andrey Murov said that the company is carrying out possible consolidation discussions with Rosseti. If the companies were merged, this would make the combined Rosseti-FSK the parent company of the MRSKs.

There has also been talk of carrying out a share issue on the Rosseti level, in which also the MRSK shareholders would be offered a chance to convert their shares into new Rosseti shares. This was mentioned for instance by Rosseti's General Director of Strategy, Yegor Prokhorov, in an interview in October 2019.

## Positive regulation changes in the making

As mentioned above, in August 2019, the Russian parliament approved a law mandating a move to at least 5-year tariff contracts for the grids from 1 January 2023.

In addition, the government continues to consider various other regulatory improvements that include payments for unused grid capacity, significantly increased tariffs for the largest industrial users, reforms of connection fees and the reference tariffs. The reference tariffs would make tariffs equal within one region, and generally benefit MRSKs.

## Valuations and share prices

MRSK share prices have declined recently quite significantly due to the global coronavirus developments and the oil price decline.

The companies continue to be attractively valued. They are currently trading at substantial discounts of 77-90% to emerging market peers on P/E and EV/EBITDA multiples based on 2018-20e earnings and earnings forecasts.

	P/E			EV/EBITDA		
	2018	2019	2020e	2018	2019	2020e
MRSK Average	1.7	2.7	2.7	0.9	0.7	0.6
GEM Average	16.2	14.5	11.6	6.3	6.0	5.9
MRSK Discount	-89%	-82%	-77%	-87%	-88%	-90%

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: 21 March, 2020