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MRSKs reported good performance in the first 9 months

In late October, MRSKs reported their 9-month 2018 RAS results. The results continued on the good track set by the 1H18 performance.

	EBIT margin		Net margin		Revenue
RAS	9m18	9m17	9m18	9m17	growth
MRSK Center-Volga	16,9 %	16,3 %	12,1 %	12,2 %	7 %
MRSK Volga	8,8 %	9,7 %	6,6 %	6,1 %	10 %
MRSK Urals	11,3 %	10,0 %	1,8 %	7,5 %	19 %
MRSK North-West	4,9 %	5,1 %	1,0 %	1,0 %	38 %
Lenenergo	23,3 %	20,6 %	17,2 %	13,4 %	12 %

Source: Companies, EOS

In late August, the companies reported 1H18 IFRS results, which to some extent differ from the RAS numbers.

	EBIT margin		Net margin		Revenue
RAS	1H18	1H17	1H18	1H17	growth
MRSK Center-Volga	20,7 %	21,5 %	14,6 %	14,9 %	14 %
MRSK Volga	11,3 %	10,4 %	8,8 %	7,5 %	12 %
MRSK Urals	-2,6 %	10,4 %	-2,8 %	7,5 %	9 %
MRSK North-West	6,9 %	6,8 %	3,7 %	2,8 %	34 %
Lenenergo	16,1 %	15,8 %	10,6 %	11,6 %	17 %

Source: Companies, EOS

To highlight two of the most notable positive changes in the IFRS results, MRSK Center-Volga improved its net profit under 9m RAS by 6%, and under the 1H IFRS by 12%, while MRSK Volga's IFRS net profit increased by 30% in the 1H18 compared with the 18% growth recorded under the 9m RAS. Assuming similar performance by both those companies in the last quarter and that this year's dividend payout ratio is repeated, their dividend yields for 2018 based on current share prices could be around 16%.

As noted in our previous newsletter in August (see https://www.eos-russia.com/wp-content/uploads/MRSKnewsletter_07aug18.pdf) MRSK Urals incurred a major cost-item of about R6bn in 2q18 due a write-down of supply company receivables. Despite the big write-down, MRSK Urals posted a positive 9m18 RAS result. MRSK Urals will probably have a dividend yield of 1-4% for 2018, although without the write-down, the yield could have exceeded 15%.

MRSK North-West is having a turnaround year after the big write-down made at the end of the last year. Sales are growing rapidly partially due to the Arkhangelsk Supply Company consolidation. Based on management's earlier profit guidance, the dividend yield for 2018 could be 7% assuming a 20%

payout ratio. Assuming a 50% payout ratio on this year's earnings, the dividend yield could be as high as 18%.

Lenenergo posted strong 9m RAS results. Net profit grew by 49% Y/Y. Assuming 40% growth for the full year, the dividend yield on the preferred shares would be around 19%.

Regulatory environment improving

The Russian government is working on introducing a new regulatory framework for MRSKs, which would involve a fixed tariff framework for 10 years ahead with annual tariff increases of 'inflation minus 0.1%' – that is, increasing by 0.1 of a percentage point less than the percentage change in the previous year's consumer price index.

We believe that this would create a very good environment for the MRSKs to manage their costs more efficiently and improve profits.

In addition, the Russian government is working on other possible regulatory changes that would be beneficial for MRSKs including the payments for unused capacity, reform of the residential connection fee system (currently largely loss-making) and the effective return of the last-mile payments, in which industrial users subsidize residential users.

Valuations and share prices

While global equity markets experienced a large correction in October, MRSK share prices were quite stable in the same month supported by their isolation from the global financial markets and their solid dividend yields.

MRSKs continue to be very attractively valued. They are currently trading at substantial discounts of 78-79% 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	9.1	3.6	3.0		3.1	3.3	1.9
GEM Average	18.5	20.3	14.5		10.6	9.1	8.7
MRSK Discount	-50%	-82%	-79%		-71%	-64%	-78%

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: 1 November, 2018