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MRSKs reported disappointing 3q19 RAS results

In late October, MRSKs reported their third quarter 2019 RAS results (highlights summarized in the table below).

RAS	EBIT margin 3q19	EBIT margin 3q18	Net margin 3q19	Net margin 3q18	Revenue growth
MRSK Center-Volga	15,0%	16,9%	7,5%	12,1%	1,3%
MRSK Volga	5,8%	8,8%	3,2%	6,6%	-0,5%
MRSK Urals	7,9%	11,3%	2,9%	1,8%	19,0%
MRSK North-West	6,2%	4,9%	0,6%	1,0%	-27,0%
Lenenergo	28,7%	23,0%	17,0%	17,1%	9,0%

Source: Companies, EOS

	EBIT growth Y/Y	Net profit growth Y/Y
MRSK Center-Volga	-10%	-38%
MRSK Volga	-34%	-52%
MRSK Urals	-17%	97%
MRSK North-West	-7%	-57%
Lenenergo	36%	9%

Source: Companies, EOS

The two main drivers of these broadly disappointing results were pressures from higher wholesale electricity prices and increased provisions against bad debts. At the end of September, Rosseti CEO Pavel Livinskiy gave an interview in which he warned that the company aimed to increasing bad debt provisions, so the weak results were to be expected.

Positive regulation changes in the making

In October 20, Mr Livinskiy said that Rosseti is expecting to receive 10-year tariffs by the end of the year or, at the latest, in the first half of 2020.

We think it likely that Rosseti and the MRSKs have somewhat stalled their cost-cutting pending the launch of the new long-term tariff framework, since this new system will allow the companies to keep the benefits of whatever cost-cutting they can achieve during the regulatory (10-year) period.

In addition, the government continues to consider a system of payments for the grids' unused reserve capacities. While the details have not been agreed, the government generally recognizes the issue and is trying to find a solution, which would be a positive development for MRSKs.

Valuations and share prices

MRSK share price movements have reflected the market's disappointment with these 3q19 results. However, even with these numbers, the dividend yields for 2019 can mostly be projected at around 10%, so the market will probably find valuation support soon.

The companies continue to be attractively valued. They are currently trading at substantial discounts of 76-84% to emerging market peers on P/E and EV/EBITDA multiples based on last year's earnings and this year's consensus forecast earnings.

	P/E				EV/EBITDA			
	2016	2017	2018	2019e	2016	2017	2018	2019e
MRSK Average	8,0	2,8	3,1	3,2	2,8	3,1	1,6	2,2
GEM Average	17,6	19,8	17,8	18,0	11,7	10,1	10,2	9,1
MRSK Discount	-54%	-86%	-83%	-82%	-76%	-70%	-84%	-76%

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 November, 2019