# EOS Russia – MRSK Newsletter 04/11/21

## MRSK earnings growth accelerated further

MRSKs posted their 9-month 2021 RAS financial statements in the last days of October.

The numbers show generally further improvements in Y/Y earnings performance even though 3q20 was a tougher comparable period than 2q20, as 2q20 was the main period for the comprehensive Russian lockdowns.

| | EBIT margin | | Net margin | | Revenue, Y/Y |
|---|---|---|---|---|---|
| RAS | 9m21 | 9m20 | 9m21 | 9m20 | 9m21 |
| MRSK Center-Volga | 16,3% | 12,5% | 11,7% | 8,6% | 11,8% |
| MRSK Volga | -1,3% | -2,6% | -1,1% | -2,5% | 7,1% |
| MRSK Urals | 8,0% | 2,7% | 8,8% | 0,8% | 9,5% |
| MRSK North-West | 4,2% | 4,1% | 1,8% | 0,7% | 3,4% |

Source: Companies, EOS Russia

| | EBIT 9m21 growth Y/Y | Net profit 9m21 growth Y/Y |
|---|---|---|
| MRSK Center-Volga | 47% | 53% |
| MRSK Volga | NA | NA |
| MRSK Urals | 230% | 1177% |
| MRSK North-West | 7% | 170% |

Source: Companies, EOS Russia

MRSK Center-Volga's 9m Y/Y EBIT growth accelerated to 47% from 27% in 1H21. Based on these numbers, and assuming a 40% dividend payout, the company's  dividend yield for 2021 could reasonably be projected to in the range 14.1-16.7%.

MRSK Volga once again posted a RAS net loss for 9m. However, as its IFRS numbers have been consistently better, it could be now on a track for a IFRS net profit of around RUB500mln for 2021. Assuming a 40% dividend payout, this would translate into a dividend yield of 1.7% for 2021.

MRSK Urals accelerated further with a 9m RAS EBIT growth of 230% Y/Y after the 166% growth in 1H21. Assuming that the company matches the q3 net profit in the last quarter and pays a 40% payout, its dividend yield for 2021 would be around 15%. The actual dividend payout ratio at MRSK Urals is subject to some uncertainty. In some previous years, the company has paid out a lower proportion of its earnings than other MRSKS; and specifically as regards 2021 earnings, the bad debt write-up that has contributed to the positive result might – in the view of some market participants – be excluded from the dividend calculation.

MRSK North-West posted a 9m EBIT growth of 7% after 25% growth in 1H21. MRSK North-West historically makes a lot of its profit in the last quarter as the temperatures fall. Assuming a 40% payout, a 6-9% dividend yield is a reasonable estimate for 2021.

**MRSKs stand to benefit from sustained commodity price strength**

Global energy and metals prices have increased significantly this year. Due to the capital intensive and lengthy investment cycle for such commodities, upward price pressure has historically tended to last for the 10-15 years needed for adequate additional supply to come on stream.

The prospect of these positive price trends developing into a 'super cycle', as predicted for example by Goldman Sachs, stems from the response of government and companies to the climate crisis. The consequent energy transition will drive surging demand for metals and other commodity inputs for the construction of new solar, wind, hydrogen and electricity storage capacities all over the world on a completely unprecedented scale.

Russia's long-term climate strategy formally approved by the government on 1 November envisages exactly the kind of large-scale investments in decarbonisation that will drive this super cycle across the world. This investment would include major new capex – in the medium to long-term – to build up new electricity distribution sub-stations and other distribution assets. The only realistic funding sources are internally generated profits possibly boosted by significant tariff reforms and/or privatisations. The growing share of electric vehicles in the country's car fleet will also increase demand for electricity distribution assets in Russia.

As we have discussed previously (See EOS Investment Case, September 1, 2021), there are significant tariff reforms for MRSKs either already agreed by the Russian government or on the drawing board – including the long-term tariffs, tariff unification, reserve/idle capacity payments and connection fee reforms. All of these tariff reforms, as and when implemented, would benefit the MRSKs.

**Valuations and share prices**

The share prices of the EOS-owned MRSKs have mostly trended somewhat higher in the past few months. It is worth noting that the shares of MRSK Siberia have increased by 73% and the shares of Lenenergo by 68% in the past 45 days – although the trading volume underlying these price moves was quite thin. The positive performances can be attributed to global commodity price strength that is attracting more funds to Russia and increasing investors' interest in Russian assets.

The MRSKs continue to be attractively valued. They are currently trading at substantial discounts of 56-69% 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 | 4.8 | 3.4 | 4.1 | 2.7 | 2.5 | 2.1 |
| GEM Average | 12.9 | 11.6 | 9.4 | 7.0 | 7.4 | 6.7 |
| MRSK Discount | -63% | -71% | -56% | -61% | -66% | -69% |

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