

FLASHNOTE / UPGRADE

MRSK of Center

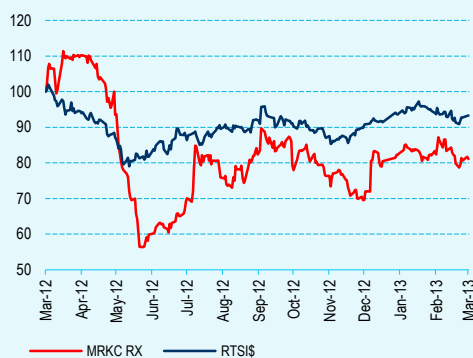
Upgrade to BUY based on recent court decision

BUY [from HOLD]

Ticker	MRKC RX
Target price, RUB	0.831
Last price of common shares, RUB	0.603
Upside	38%
Number of common shares, mn	42,218
Market cap, \$mn	830
Net debt, \$mn	1,053
EV, \$mn	1,883
Free float	30%
52-week min, RUB	0.419
52-week max, RUB	0.829

Sources: Bloomberg, Otkritie Capital Research

Share price performance



Sources: Bloomberg

We are upgrading MRSK of Center from HOLD to BUY based on the Supreme Commercial Court's overruling of a previous court decision that went in favour of Chelyabinsk Metallurgical plant in its case against MRSK of Ural relating to the last mile problem. We think this could create a precedent and result in a positive decision for MRSK Center in its appeal against NLMK for c. RUB5bn. A positive outcome could boost MRSK Center's share price, hence our upgrade to BUY.

The Supreme Commercial Court has ruled in favour of MRSK of Ural over the last mile issue, creating a precedent. MRSK of Ural has won its case against Chelyabinsk Metallurgical plant, overturning previous court decisions in favour of the latter. We believe that this ruling could create a precedent and influence the outcome of MRSK Center's current appeal of the Moscow Commercial Court's ruling on the last mile issue in favour of NLMK.

Shares of MRSK Center have underperformed peers due to court decision. Recently, the commercial courts awarded NLMK RUB5bn in its case against MRSK Center related to the last mile problem. The claim represented c. 19% of MRSK Center's market cap and is 50% above its FY12 RAS Net Income. As a result, the share price of MRSK Center has slipped 1% YtD, while its peers, particularly MRSK Center&Volga and MRSK Volga, have demonstrated positive dynamics (up 15% and 11% respectively). If MRSK Center's appeal is successful, we see 10%-15% upside potential for its share price.

We expect a positive market cross read and upgrade the stock to BUY. We anticipate a positive market cross read to the news, which could offset MRSK Center's sluggish performance relative to its peers. We acknowledge that the appeal could be unsuccessful, but the probability of this has decreased with this latest ruling, in our view. Moreover, we believe that finding a solution to the last mile problem is very complex and should be reached gradually. In our view, the government will hold a meeting devoted to this problem in March, so that further court decisions can take government policy on this matter into consideration.

Figure 1. Key metrics (RUBmn)

	2012E	2013E	2014E	2015E
Revenues	71,875	80,282	89,441	100,099
EBITDA	15,081	19,165	22,806	27,916
EBIT	8,266	11,763	14,746	19,138
Net income	4,691	7,092	8,975	12,461
Net debt	25,769	32,327	39,171	44,223
EPS, RUB	0.11	0.17	0.21	0.30
CEPS, RUB	0.27	0.34	0.40	0.50
BVPS, RUB	1.02	1.19	1.40	1.69
DPS, RUB	0.00	0.00	0.01	0.01

Sources: Bloomberg, Otkritie Capital estimates

Figure 2. Valuation

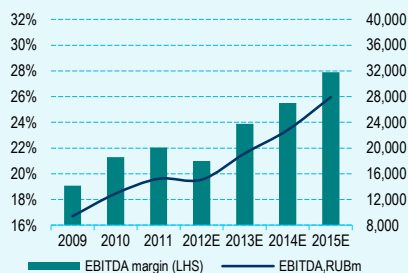
	2012E	2013E	2014E	2015E
P/E	5.4	3.6	2.8	2.0
EV/EBITDA	3.4	3.0	2.8	2.5
EV/Sales	0.7	0.7	0.7	0.7
P/BV	0.6	0.5	0.4	0.4
EBITDA margin	21.0%	23.9%	25.5%	27.9%
Net margin	6.5%	8.8%	10.0%	12.4%
Revenue growth	4%	12%	11%	12%
EPS growth	-15%	51%	27%	39%
Div yield	0%	1%	1%	2%

Sources: Bloomberg, Otkritie Capital estimates

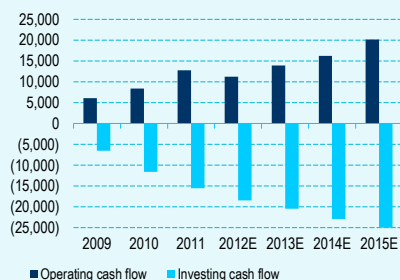
Appendix: Financial forecasts

RUBmn unless otherwise stated

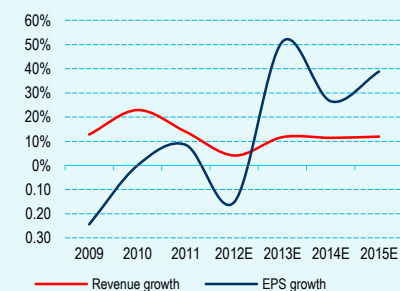
Profitability



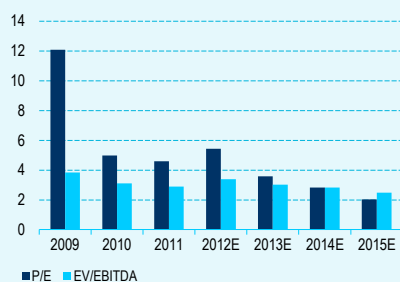
Cash flows, RUBmn



Momentum



Valuation



	2010	2011	2012E	2013E	2014E	2015E
Income statement						
Revenues	60,614	69,041	71,875	80,282	89,441	100,099
Depreciation	5,011	6,285	6,815	7,402	8,061	8,777
EBITDA	12,908	15,217	15,081	19,165	22,806	27,916
Operating profit (EBIT)	7,897	8,932	8,266	11,763	14,746	19,138
Net interest expense	(1,507)	(1,556)	(2,402)	(2,897)	(3,527)	(3,562)
Non-op. revenue (expenses)	0	0	0	0	0	1
Pretax profit	6,390	7,376	5,863	8,865	11,219	15,576
Taxes	1,289	1,841	1,173	1,773	2,244	3,115
Minority interest	4	4	4	6	7	10
Net income	5,101	5,534	4,691	7,092	8,975	12,461
Cash flow statement						
Net change in work. cap.	2,029	(533)	115	465	697	931
Provisions and write-offs	0	0	0	0	0	0
Other	(260)	(47)	(118)	(118)	(118)	(118)
Operating cashflow	8,418	12,818	11,274	13,911	16,221	20,189
Capex	(10,590)	(15,716)	(18,570)	(20,540)	(23,040)	(25,090)
Disposals (Acquisitions)	(1,075)	0	0	0	0	0
Investing cashflow	(11,586)	(15,542)	(18,452)	(20,422)	(22,922)	(24,972)
Equity	0	0	0	0	0	0
Debt	3,059	0	6,763	5,500	7,000	5,500
Financing cashflow	3,059	5,111	6,763	5,453	6,858	5,231
Net change in cash	(109)	2,387	(416)	(1,058)	157	448
Balance sheet						
Cash & equivalents	259	2,646	2,231	1,173	1,329	1,777
Current assets	9,333	12,968	13,159	13,265	14,709	16,633
PP&E	51,779	62,196	73,951	87,088	102,068	118,380
Goodwill and other assets	1,860	1,653	1,653	1,653	1,653	1,653
Total assets	62,972	76,817	88,762	102,006	118,429	136,666
Current liabilities	9,543	11,325	25,656	29,302	33,644	37,138
S-T Debt	1,166	1,167	15,007	17,954	21,706	24,654
L-T Debt	13,770	20,070	12,993	15,546	18,794	21,346
Other L-T liabilities	232	354	354	354	354	354
Shareholders funds	33,647	38,567	43,254	50,294	59,120	71,302
Total liabilities & equity	62,972	76,817	88,762	102,006	118,429	136,666
Net Debt	14,677	18,591	25,769	32,327	39,171	44,223
Margins and profitability						
EBIT margin	13.0%	12.9%	11.5%	14.7%	16.5%	19.1%
EBITDA margin	21.3%	22.0%	21.0%	23.9%	25.5%	27.9%
Net margin	8.4%	8.0%	6.5%	8.8%	10.0%	12.4%
ROE	15.2%	14.3%	10.8%	14.1%	15.2%	17.5%
ROA	8.1%	7.2%	5.3%	7.0%	7.6%	9.1%
ROIC	11.9%	11.4%	10.9%	13.2%	14.1%	15.7%
Momentum						
Revenue growth	23%	14%	4%	12%	11%	12%
EBITDA growth	37%	18%	-1%	27%	19%	22%
EPS growth	142%	8%	-15%	51%	27%	39%
Liquidity and solvency						
Cash ratio	0.0	0.2	0.1	0.0	0.0	0.0
Current ratio	1.0	1.1	0.5	0.5	0.4	0.4
Interest coverage	(5.2)	(5.7)	(3.4)	(4.1)	(4.2)	(5.4)
Debt/Equity	0.4	0.6	0.6	0.7	0.7	0.6
Debt/Total assets	0.2	0.3	0.3	0.3	0.3	0.3
Net debt / EBITDA	1.1	1.2	1.7	1.7	1.7	1.6
Valuation						
P/E	5.0	4.6	5.4	3.6	2.8	2.0
P/CE	2.5	2.2	2.2	1.8	1.5	1.2
P/BV	0.8	0.7	0.6	0.5	0.4	0.4
EV/Sales	0.7	0.6	0.7	0.7	0.7	0.7
EV/EBITDA	3.1	2.9	3.4	3.0	2.8	2.5
Dividend yield, (ords)	2.4%	0.0%	0.2%	0.6%	1.1%	2.0%
Dividend yield, (prefs)	-	-	-	-	-	-
Per Share Data						
EPS	0.12	0.13	0.11	0.17	0.21	0.30
DPS, ords	0.01	0.00	0.00	0.00	0.01	0.01
DPS, prefs	-	-	-	-	-	-
BVPS	0.80	0.91	1.02	1.19	1.40	1.69

Sources: Company data, Otkritie Capital estimates