

REINITIATION OF COVERAGE

ROSSETI

Waiting for better economic conditions

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Unfavorable sector environment

We initiate coverage of ROSSETI and its subsidiaries with a neutral outlook on the sector. State-controlled electricity distributor ROSSETI is focused on the implementation of its investment program and all available financial resources are funneled into capex. The company's margins face pressure, as demand for electricity is weak, inflation is peaking and tariff growth is capped by the government. The company is undervalued vis-à-vis international peers on EV/EBITDA and P/E multiples. This undervaluation is justified, as the dividend flow from ROSSETI is unlikely to offer attractive yields in the medium term.

Tariff growth and flexible capex...

- ▶ **Tariffs unfrozen.** Electricity distribution tariffs have been hiked by an average of 7.5% since July 1, 2015 in the wake of the tariff freeze in 2014.
- ▶ **Selective support is possible.** The company is discussing additional tariff growth for its subsidiaries, which are in difficult financial shape.
- ▶ **Capex program reduced.** The investment program is flexible and the company may adjust its capex to the changing environment.
- ▶ **Cost-cutting measures.** The company has introduced savings practices that increase the efficiency of its operating performance.

... while economic trends are unfavorable for the sector

- ▶ **Lower GDP, high inflation and tariff risks.** A weak economy, high inflation and pressure on tariffs are weighing on sector margins.
- ▶ **Cash collection is becoming an issue.** Amid the deep recession in the Russian economy, payment discipline continues to deteriorate.
- ▶ **Privatization in the sector on hold.** Privatization of distribution companies is not currently on the agenda.
- ▶ **Dividend prospects are weak.** The dividend picture looks bleak this year, as the company does not plan to pay dividends from consolidated results.
- ▶ **Equity placement in the cards.** ROSSETI plans to issue additional shares to support its subsidiaries.

Valuation

- ▶ **Undervalued vs. peers, but justified.** ROSSETI trades at discounts on 2015E P/E and EV/EBITDA to international peers, but the weak dividend outlook justifies this undervaluation.

Company and model description

- ▶ **Position of grids in the Russian utilities sector.** ROSSETI is a holding company with controlling stakes in regional distribution companies and Federal Grid Company (FGC).
- ▶ **Model assumption.** Our model of ROSSETI is based on consolidated IFRS results published by the company and its subsidiaries. Core figures are driven by expectations of tariff growth, cost inflation and the companies' capex guidance.

TICKER	RSTI RX
Closing price, RUB	0.46
Target price, RUB	0.45
Upside	-2%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	1,099
Net debt, \$ mln	8,004
EV, \$ mln	13,436
52-week high, RUB	0.64
52-week low, RUB	0.32

Source: Bloomberg

ROSSETI share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2012	2013	2014	2015E	2016E	2017E
Revenues	652,183	755,806	759,608	757,685	826,980	896,634
EBITDA	198,894	228,224	235,593	224,796	245,811	278,273
EBITDA margin	30.5%	30.2%	31.0%	29.7%	29.7%	31.0%
Net income	43,855	-159,389	-25,257	45,314	55,344	75,657
EV/EBITDA, x	4.0	3.8	3.6	4.1	3.8	3.3
P/E, x	1.7	nm	nm	1.7	1.4	1.0

Source: company data, Gazprombank estimates

Valuation multiples

	2013	2014	2015E	2016E
P/E, x	nm	nm	1.7	1.4
EV/EBITDA, x	3.8	3.6	4.1	3.8
EV/Revenues, x	1.1	1.1	1.2	1.1
Dividend yield	0.0%	0.0%	0.0%	0.0%
FCF yield	-157.0%	-58.2%	-65.0%	1.9%

Income statement, RUB mln

	2013	2014	2015E	2016E
Revenues	755,806	759,608	757,685	826,980
Operating costs	-912,566	-759,805	-712,543	-774,515
incl. SG&A	0	0	0	0
DD&A	-115,942	-125,910	-129,688	-138,607
EBITDA	228,224	235,593	224,796	245,811
Operating profit	-148,821	14,122	95,107	107,204
Financial income net	-8,167	-13,750	-38,465	-38,025
Pretax profit	-190,401	-18,049	56,642	69,180
Income tax	31,012	-6,208	-11,328	-13,836
Net income	-159,389	-25,257	45,314	55,344
EPS	0.00	0.00	0.00	0.00

Key margins

	2013	2014	2015E	2016E
EBIT	-19.7%	1.9%	12.6%	13.0%
EBITDA	30.2%	31.0%	29.7%	29.7%
Net income	-21.1%	-3.3%	6.0%	6.7%

Balance sheet statement, RUB mln

	2013	2014	2015E	2016E
Cash and equivalents	61,917	82,576	52,951	70,409
Accounts receivable	143,944	155,776	155,382	169,592
Inventories	53,306	17,908	17,863	19,496
Total current assets	288,655	287,526	257,461	290,764
PP&E	1,595,862	1,643,586	1,737,300	1,799,850
Total assets	1,946,039	1,984,079	2,047,729	2,143,581
Short-term debt	57,808	93,227	85,125	85,602
Accounts payable	241,266	268,469	267,789	292,280
Total current liabilities	309,946	382,114	373,333	398,301
Long-term debt	492,229	485,409	512,526	528,067
Total non-current liabilities	574,402	563,161	590,278	605,819
Total shareholders' equity	765,759	752,980	789,231	833,506
Minority interest	295,932	285,824	294,887	305,955
Total liabilities and equity	1,946,039	1,984,079	2,047,729	2,143,581

Cash flow statement, RUB mln

	2013	2014	2015E	2016E
Operating cash flow	195,441	214,948	224,556	254,458
incl. changes of w/c	-32,783	-20,645	-240	8,647
Investing cash flow	-253,114	-166,290	-223,403	-201,156
incl. CAPEX	-266,415	-204,193	-223,403	-201,156
Financing cash flow	106,273	26,273	19,015	16,018
Change in cash	48,600	74,931	-29,625	17,458
Free cash flow	-117,472	-43,517	-48,640	1,441

Key leverage data, RUB mln

	2013	2014	2015E	2016E
Total debt	550,037	578,636	597,651	613,669
Net debt	488,120	496,060	544,700	543,260
Total debt/Equity, x	0.7	0.8	0.8	0.7
Net debt/EBITDA, x	2.1	2.1	2.4	2.2

Source: company data, Gazprombank estimates

CONTENTS

Tariff growth and flexible capex.....	4
Economic trends unfavorable for the sector.....	6
Company and model description	10
Federal Grid Company	14
MOESK.....	16
Lenenergo.....	18
MRSK Center	20
MRSK Center and Volga	22
MRSK Urals.....	24
MRSK Volga	26

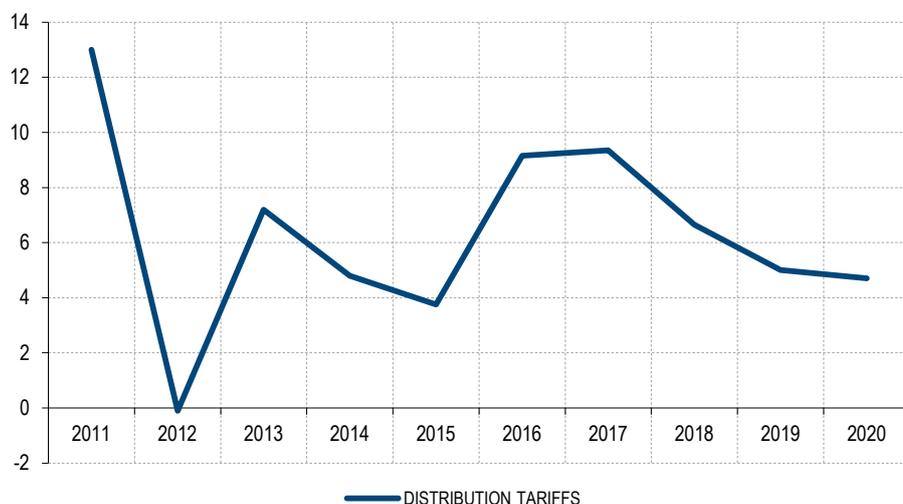
TARIFF GROWTH AND FLEXIBLE CAPEX

Tariffs unfrozen

Core business is totally regulated. ROSSETI's consolidated revenues increased by 0.5% YoY in 2014 to RUB 759.6 bln. Electricity distribution and transmission accounted for 82% of this amount, while 5% came from grid connection. Both electricity distribution and transmission tariffs are regulated by the state. Essentially, the initial political decision on tariff growth results in a subsequent regulatory decision.

Tariff freeze lasted for a year and a half. A tariff freeze for natural monopolies was announced in autumn 2013. The main goal of freezing tariffs was to support business activity in Russia and decrease inflationary pressure on the economy.

Tariff growth may intensify next year



Source: Gazprombank estimates

First growth after the freeze. Starting from July 1, electricity distribution and transmission tariffs increased by 7.5%, equivalent to 3.8% growth in the average annual level. Tariff growth will help ROSSETI to support its profitability until the next tariff hike, which is scheduled for July 2016. Positive results from the tariff growth will become noticeable in 2H15.

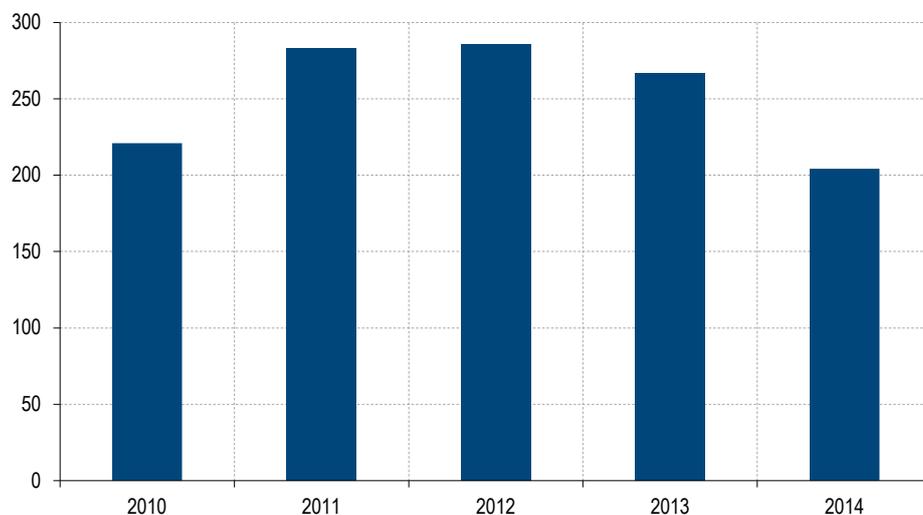
Selective support is possible

Some companies need additional tariff growth. Regional distribution companies that face substantial operating challenges may expect additional tariff growth during 2016. This means that additional tariff growth might be used as an extraordinary tool to support the financial performance of Russian grid subsidiaries, which decreases risks for company shareholders.

Capex program reduced

Flexible capex. Total capex of Russian Grids decreased by 23% in 2014 to RUB 204.2 bln, as the company is suffering from the weak macroeconomic environment. However, this flexibility in capex program implementation helps ROSSETI to support its financial performance. Even a reduced capex program requires substantial operating cash flow generation. In case of an emergency, ROSSETI may further decrease its capex to leave more cash for the company's needs.

Flexible capex program



Source: company data, Gazprombank estimates

Complicated process of capex approval. Approval of the capex of ROSSETI's subsidiaries on the regional level includes discussion with the participation of local businesses and local authorities so as to minimize the risk of construction of unnecessary assets (nonetheless, some assets were built amid a lack of customer demand). FGC's capex is approved at the federal level and is also flexible with regard to potential regulatory revision.

Cost control initiatives

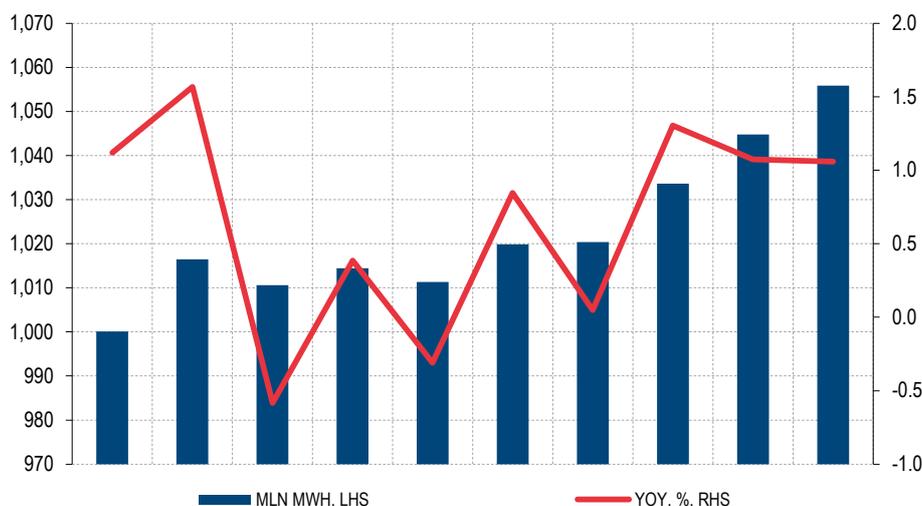
Higher operating efficiency. The implementation of systemic and focused actions to raise operating efficiency is one of the key areas of operation of ROSSETI Group of companies amid the current macroeconomic environment. In line with the Strategy for Development of the Electric Power Grid Complex of the Russian Federation, target guidelines were set for lowering opex by 15% as of end 2016, including inflation relative to 2012 restated per unit of power engineering equipment serviced. The cost-cutting efforts by ROSSETI management made it possible to save about RUB 23 bln in 2014, while the effect totaled about RUB 20 bln in 2013.

ECONOMIC TRENDS UNFAVORABLE FOR THE SECTOR

GDP decrease, high inflation and tariff risks

Weak economic conditions. As a result of weak economic conditions and an expected contraction of Russian GDP in 2015, we expect electricity consumption to decrease. For distribution companies, the volumes of electricity distribution are one of the key drivers for the top line. On the cost side, 57% of the companies' costs are fixed, and thus the increase in volumes of electricity transmission may help distributors to raise their profitability. However, we do not expect fast growth in electricity consumption, which we expect to rise by 0.7% on average until 2020.

Moderate growth in electricity consumption expected



Source: Gazprombank estimates

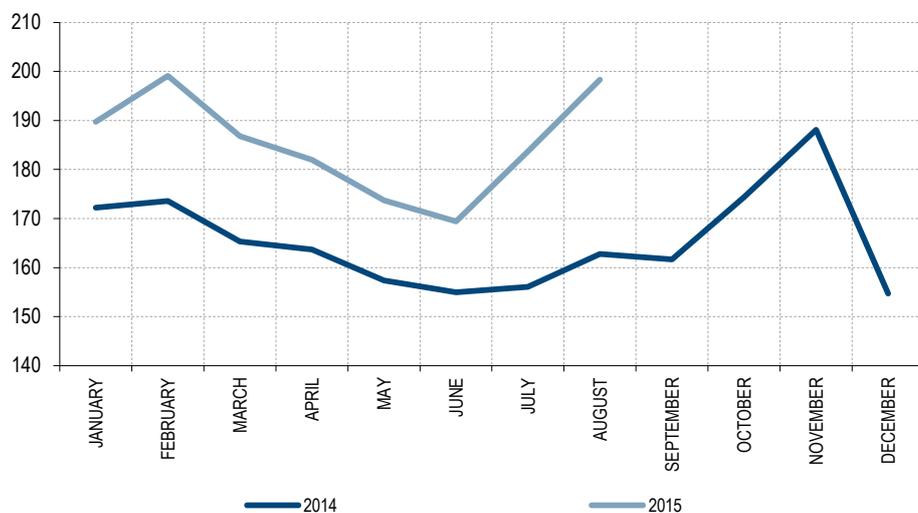
Inflationary risks. Inflation drives 67% of the companies' operating costs. This includes repair and maintenance, personnel other operating expenses. Distribution companies are trying to minimize this growth in operating costs, but inflationary processes are having a negative impact and exerting pressure on operating income.

Risks of unfavorable tariff regulation. Growth of electricity distribution tariffs should not exceed the inflation index for the previous year. High inflation in 2015 should result in similar a tariff hike in mid-2016, which will result in 9.1% average annual growth in distribution tariffs. However, these growth expectations might not be realized. Investors have already seen that the government may adjust its approach to tariff regulation. In terms of sensitivity, each 1% decrease in tariff growth may reduce revenues by 0.7% and EBITDA by 2.0%.

Cash collection is becoming an issue

Withdrawal of accounts receivable. In 2014, ROSSETI recognised a loss of RUB 18.9 bln from devaluation of accounts receivable, equal to 2.5% of the company's total operating costs and exceeding EBIT. The process may continue in 2015, which creates downside risk to our net income forecast.

Accounts payable on the electricity retail market, RUB bln



Source: Market Council

Electricity resellers use ROSSETI as a source for funding. According to ROSSETI management, the company plans to introduce new rules for electricity retail companies that will increase the retailer's responsibility for payments to ROSSETI. The company wants to introduce prepayments that will amount to 70% of planned electricity consumption. Electricity retail companies are fined for non-payments to ROSSETI calculated based on an interest rate of 8.25%, which is far below the price of bank loans. Regulatory amendments should eliminate such opportunities for electricity retailers and decrease ROSSETI's need for working capital.

Privatization in the sector on hold

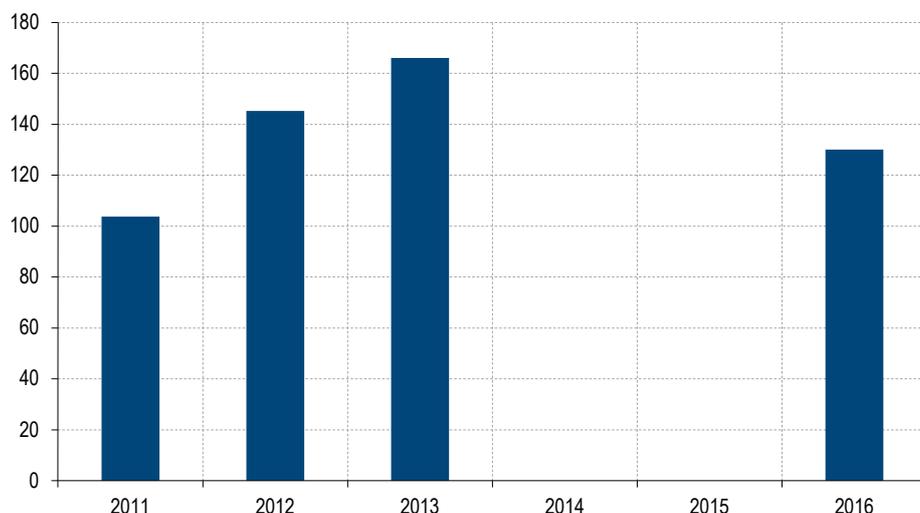
Sale of regional distribution companies not on the agenda. The privatization of ROSSETI's regional distribution subsidiaries was one of the key drivers for stocks in the utilities subsector. However, alongside escalation of geopolitical tension and an increase of the state's share in the economy, the privatization process has been put on hold. All of the latest deadlines for the privatization of distribution companies have already passed and new dates have not been announced.

Consolidation process is also not being discussed at this point. Aside from privatization, there was also an idea to consolidate the distribution subsidiaries of ROSSETI and build a single large operating company. This idea has not gained support on the government level. Moreover, given the increased cost of debt at the moment, the consolidation project has become less feasible, as this process allows creditors to require immediate debt repayment.

Dividend prospects are weak

Holding structure does not support the dividend story. ROSSETI paid dividends only on preferred shares in 2011-13, and did not pay dividends on common shares. The dividend payout amounted to RUB 138 mln on average per year based on RAS net income in a range of RUB 104-166 mln. In 2014, the company reported negative retained earnings, which prevented the payment of dividends. The holding structure does not allow the company to generate operating cash flow, which will likely prevent the company from paying any noticeable dividends on common shares. However, based on the recent guidance for 2015 RAS net income of RUB 1.4 bln and a 10% payout ratio on preferred shares, it is reasonable to expect a 14% dividend yield on ROSSETI prefs.

Total dividend payout on preferred shares, RUB mln



Source: Gazprombank estimates

Dividends from subsidiaries. ROSSETI's operating subsidiaries pay 25% of RAS net income as dividends. In 2012 and 2013, ROSSETI collected a total of RUB 3.6 bln and RUB 3.1 bln, or 59% and 49% of the company's total RAS non-consolidated revenues, respectively. Based on RAS net income guidance for the company's subsidiaries, dividend yields are expected in a range of 2-8%.

Equity placement to support subsidiary

EGM for new equity placement already announced. ROSSETI plans to issue new shares in order to raise capital for its further injection into the equity of Lenenergo. The latter is in difficult financial condition, as it faces a 20-year freeze on RUB 10.6 bln held on deposit at banks that lost their repayment ability. According to media reports, the share issue may be scaled back to RUB 32 bln. Assuming that the company issues common shares at the minimum possible price of RUB 1 per share, ROSSETI may increase its share capital by 26.5%, with the new issue amounting to 21% of expanded capital.

Valuation

Undervalued to peers but justified. ROSSETI trades at an 89% discount to international peers on 2015E P/E and a 66% discount on EV/EBITDA. However, we do not expect these discounts to narrow, as the company's dividend prospects are weak. We expect the discount to remain close to current levels, supporting our NEUTRAL recommendation on the company's common shares. However, we expect some rerating of preferred shares, as the company will likely pay attractive dividends for 2015. We therefore have an OVERWEIGHT recommendation on ROSSETTI prefs, which show 20% upside potential.

Comparative valuation

COMPANY	COUNTRY	PRICE, \$	MCAP, \$ MLN	EV, \$ MLN	P/E				EV/EBITDA			
					2013	2014	2015П	2016П	2013	2014	2015E	2016П
ROSSETI	Russia	0.007	1,099	13,354	nm	nm	1.8	1.5	3.8	3.6	4	3.9
FGC	Russia	0.001	1,227	4,963	nm	nm	2	1.8	3.9	2.9	3.3	3.5
Lenenergo	Russia	0.043	63	497	1.3	Nm	1.3	1.3	2.2	3.3	2.1	2.7
MRSK Center	Russia	0.003	134	745	nm	nm	nm	nm	1.9	2.7	4.2	4.4
MRSK Urals	Russia	0.001	88	276	nm	2.9	nm	nm	2.5	1.8	3.1	3
MRSK Center	Russia	0.001	112	497	4.6	nm	nm	11.8	2.5	3.2	3.8	3.6
MRSK Volga	Russia	0.0004	56	209	3	4.7	nm	6.5	2.6	2.3	2.2	1.6
MOESK	Russia	0.013	608	1,899	2.2	5.1	6.1	5.4	2.2	2.7	3.3	3.2
MRSK North West	Russia	0.0005	44	318	3	nm	nm	nm	2.5	4.5	5.1	5.1
MRSK South	Russia	0.001	24	376	11.1	nm	nm	nm	4.3	4.7	4.9	4.7
MRSK Siberia	Russia	0.001	74	341	4.2	nm	nm	nm	2.4	3.2	3.3	2.7
MRSK North Caucasus	Russia	0.224	35	133	nm	nm	nm	nm	1.8	9.4	10.8	-
Average					4.2	4.2	2.8	4.7	2.7	3.7	4.2	3.5
Discount to DM peers, %					74	75	83	73	72	65	63	70
Discount to EM market peers, %					65	63	76	48	88	58	62	61
DEVELOPED MARKETS												
United Utilities	UK	13.7	9,322	18,824	22.7	19.1	17.3	20.2	13.2	11.4	11.8	12.5
Severn Trent	UK	33.9	8,043	15,114	25.4	23.8	22.7	24.8	12.4	11	11.4	12
Snam Rete Gas	Italy	5	17,423	33,214	14	15.3	13.4	16.1	8.8	11	10.5	11.7
Terna Spa	Italy	4.7	9,433	17,708	13.7	16.9	14.8	17.5	8.8	11.1	10.5	11.5
Elia	Belgium	41.9	2,548	5,621	12	13.6	16.9	14.6	8.1	10.4	14.4	15.3
REN	Portugal	3.1	1,633	4,481	10.1	13.5	14.8	13.2	6.3	8.2	8.5	8.7
Red Electrica	Spain	80.5	10,887	17,626	15.3	17.1	16.3	14.9	9.9	11.2	10.9	10.6
Average					16.2	17.1	16.6	17.3	9.6	10.6	11.2	11.8
EMERGING MARKETS												
CIA de Transmissao	Brazil	11.6	1,876	2,126	nm	13.3	14.1	8	40.2	13.8	19.5	15.1
Transelectrica SA	Romania	6.9	509	538	9.3	6.2	7.7	7.7	3.3	2.8	3.2	3.2
Transener	Argentina	0.6	259	359	nm	nm	nm	nm	31.2	6.3	nm	nm
Power Grid	India	2.1	10,987	25,192	14.5	14.6	13.3	11.4	12.7	11.7	10.3	8.9
Average					11.9	11.4	11.7	9	21.8	8.7	11	9

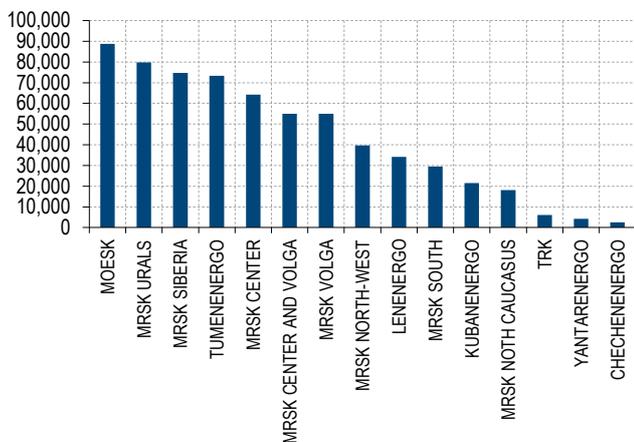
Source: company data, Bloomberg, Gazprombank estimates

COMPANY AND MODEL DESCRIPTION

Position of ROSSETI in the Russian utilities sector

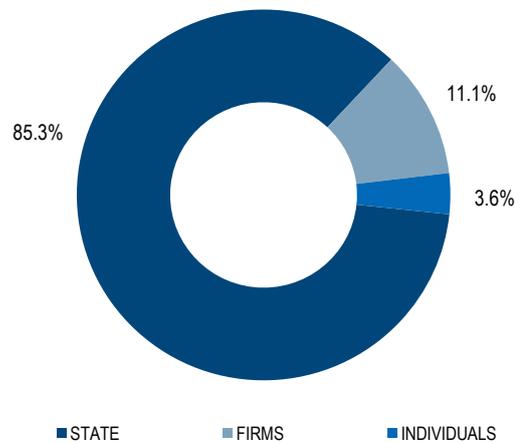
As a result of sector reform, generation and distribution assets were separated and the Energy Law now prohibits the combination of electricity generation and distribution assets in regions where competition among generation companies is possible. In addition, electricity retail companies were separated and electricity retailers can now be owned by generators; however, electricity retailers cannot be owners of the electricity distribution network. Such areas include a majority of regions in the European part of Russia, the Urals and Siberia. Vertically integrated utilities continue to operate in isolated territories in the Far East.

Gross electricity output, mln kWh, FY14



Source: Company data

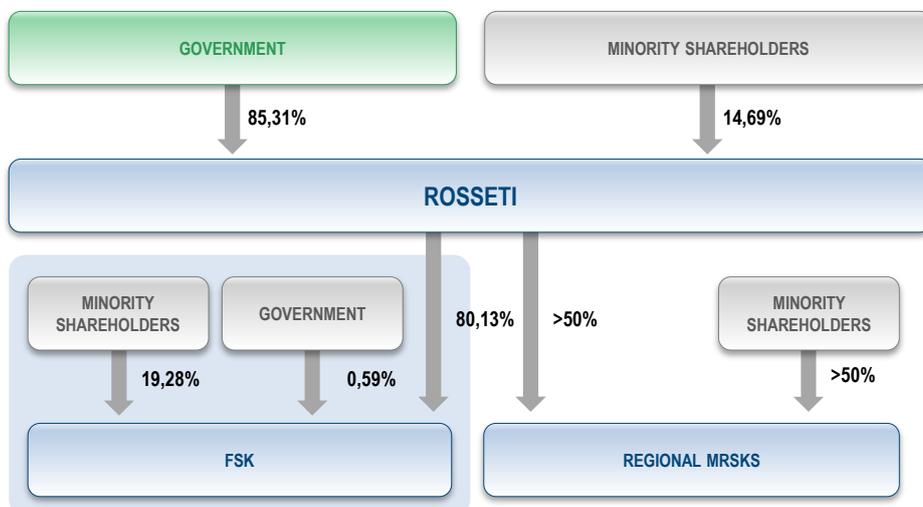
Shareholders structure



Source: Bloomberg, Reuters, Gazprombank estimates

Distribution and transmission assets were separated from vertically integrated utilities and then consolidated in several regional distribution companies (so-called MRSKs) and FGC. Currently all of the companies are under the control of ROSSETI, which is state-run. This means that the state maintains control over all interregional distribution companies with some exceptions, such as Altaienergo, which is now privately controlled.

Shareholders structure



Source: Company data

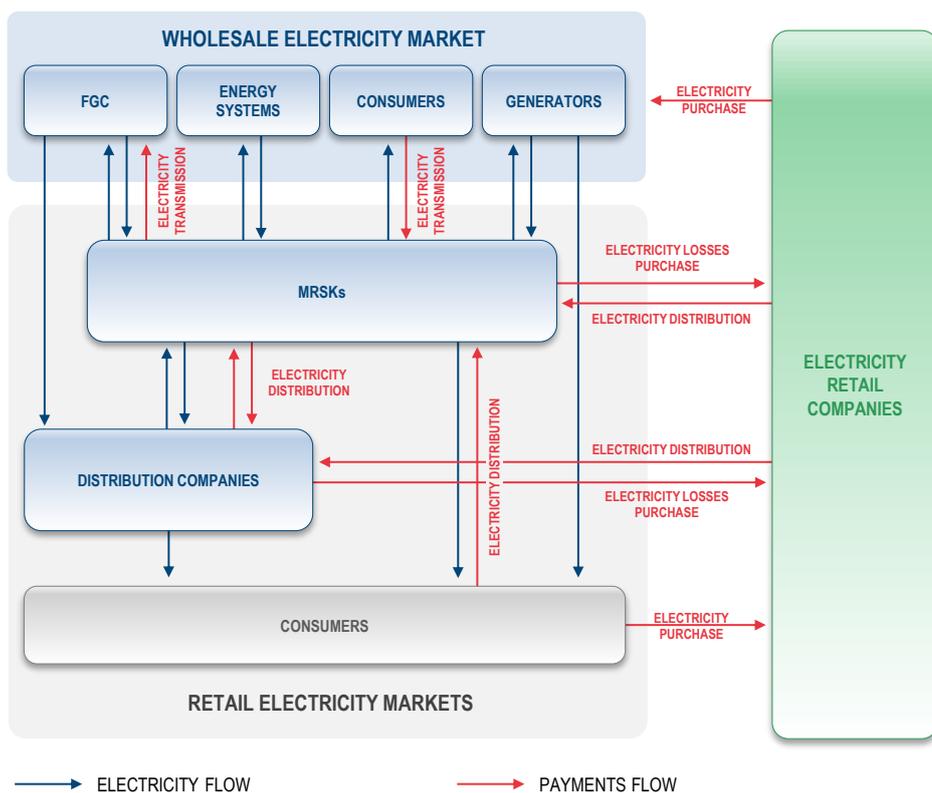
The Russian utilities sector contains an electricity generation subsector with total capacity of 232.5 GW. Generation capacity is divided among private and state-controlled (directly and indirectly) generation companies. The largest state-controlled companies are Rosatom (25.2 GW), Inter RAO (29 GW), Gazprom Energoholding (38 GW) and RusHydro (37.5 GW). The effective market share of state-controlled companies is close to 56%, while privately controlled generators (such as E.ON Russia (10 GW), Enel Russia (9.5 GW), IES Holding (15 GW) and Eurosibenergo (19.5 GW)) control 44% of Russian generation capacities.

Electricity retail companies are now controlled by state-run generation companies such as Inter RAO (16% market share) and Rosatom (2%). Private electricity retail companies are controlled by IES Holding (3%) and TNS (5%).

Cash flows in the sector

Generation companies sell electricity on the wholesale electricity market or directly to consumers. The core electricity buyers on the wholesale electricity market are retail companies. Distribution companies receive revenues from electricity retailers and large wholesale consumers for volumes of distributed electricity. FGC's revenues come from high voltage transmission by electricity distribution companies.

Core flows in the sector



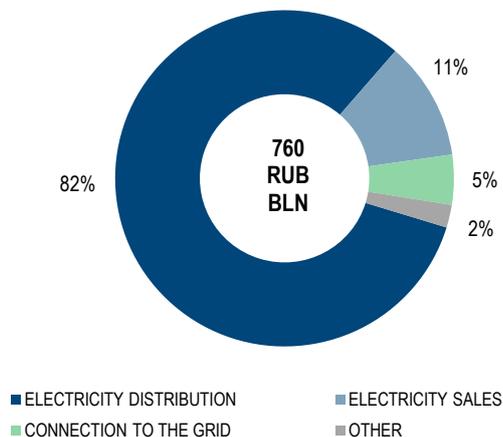
Source: Company data.

Our assumptions

Top line

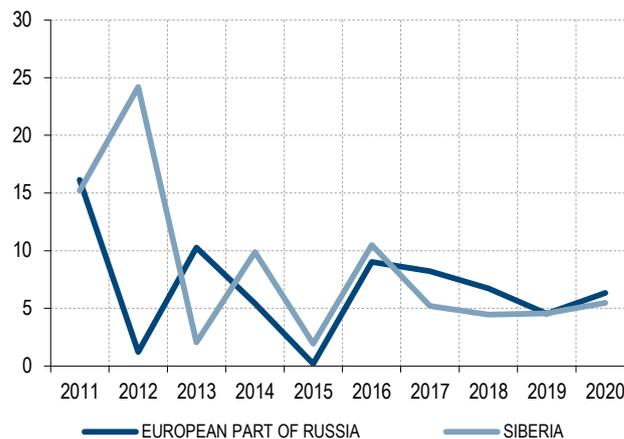
On the top line we expect average electricity distribution tariffs to rise by 3.8% YoY in 2015, and then to increase with CAGR of 7.5% in 2016-19.

ROSSETI revenue breakdown, FY14



Source: Company data

Wholesale electricity price growth assumptions



Source: Gazprombank estimates

Electricity distribution is expected to decrease by 0.3% in 2015 YoY, and we expect moderate growth with CAGR of 0.8% in 2016-20.

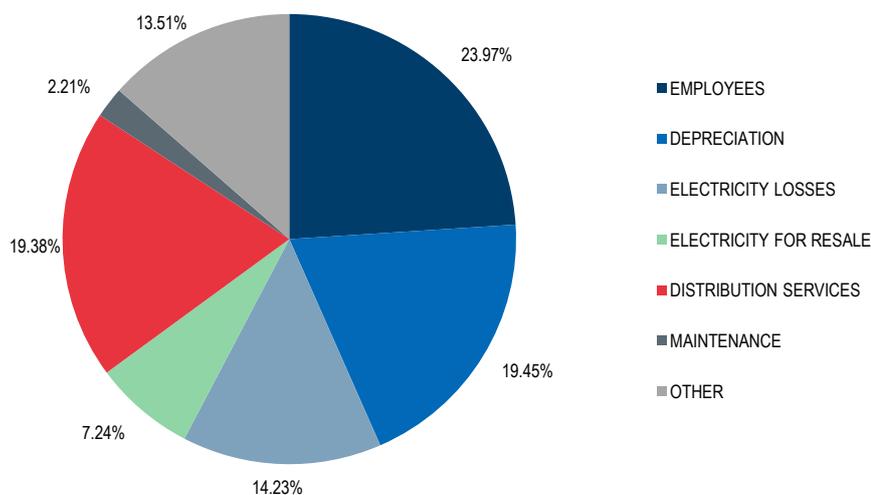
Opex

Personnel costs are driven by our expectations of personal income growth.

The cost of electricity purchased for compensation of electricity losses is driven by the wholesale electricity price forecast for the European part of Russia and Siberia.

Other costs are driven by CPI, adjusted by 1.5% due to the company's efforts to heighten cost efficiency.

COGS breakdown



Source: Company data

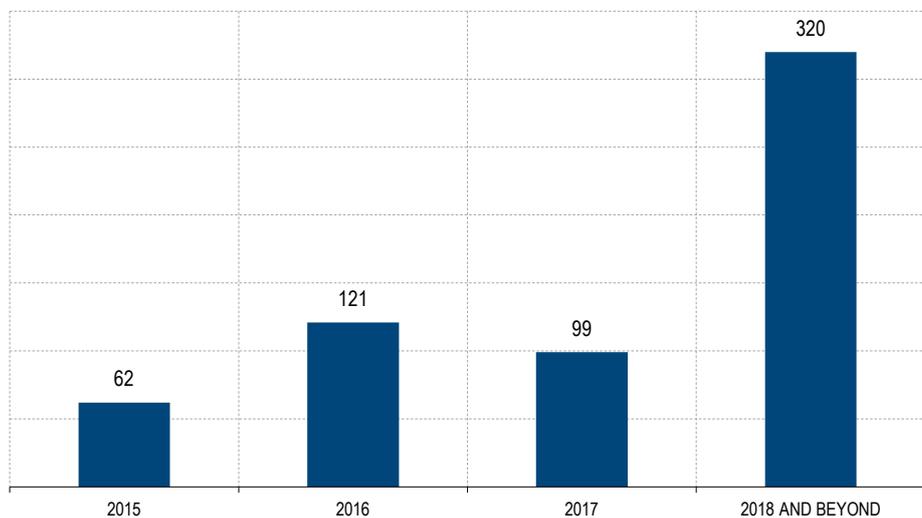
Capex

Capex expectations are based on the company's long-term investment plans disclosed in the 2014 annual reports of subsidiaries.

Debt

We assume that the company will raise debt in order to finance its capex program.

Debt repayment schedule, RUB bln



Source: Company data

REINITIATION OF COVERAGE

Federal Grid Company

Backbone of the Russian grid

Federal Grid Company

Federal Grid Company (FGC) is one of Russia's key infrastructure companies. It is controlled by ROSSETI, which holds an 80% stake. FGC has been tasked with implementation of a massive investment program, which leaves the company with no FCF in the near future. We have a neutral view on the stock, as poor dividend prospects do not suggest any upside potential for minority shareholders. Based on recent 1H15 RAS results and management guidance, the dividend yield may reach only 2% in 2016.

Pros

- ▶ FGC is a key infrastructure company providing reliable services that will always be in demand. The company operates across Russia and has a highly reliable source of revenues.
- ▶ The government may decide at some point to use the company as a source of dividends for ROSSETI.
- ▶ The company holds a 20% stake in Inter RAO, which might serve as a source of additional cash.
- ▶ The company plans to reduce its capex program for 2015-2019 by 30%.

Cons

- ▶ FGC has a poor dividend history and dividend expectations are weak based on recent RAS net income guidance.
- ▶ Regulatory risks have reduced investor interest in the sector in general and the company in particular.

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Target price, RUB	0.06
Upside	-9%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

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Source: Bloomberg

FGC share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2012	2013	2014	2015E	2016E	2017E
Revenues	143,909	164,125	181,586	185,700	201,732	217,238
EBITDA	76,992	89,940	105,655	103,511	113,985	126,251
EBITDA margin	53.5%	54.8%	58.2%	55.7%	56.5%	58.1%
Net income	7,043	-234,771	-20,601	41,947	46,808	52,797
EV/EBITDA, x	3.6	3.9	2.9	3.2	3.0	2.9
P/E, x	11.9	nm	nm	2.0	1.8	1.6

Source: company data, Gazprombank estimates

Valuation multiples

	2013	2014	2015E	2016E
P/E, x	nm	nm	2.0	1.8
EV/EBITDA, x	3.9	2.9	3.2	3.0
EV/Revenues, x	2.1	1.7	1.8	1.7
Dividend yield	0.0%	0.0%	0.0%	2.2%
FCF yield	-36.7%	30.4%	3.2%	18.7%

Income statement, RUB mln

	2013	2014	2015E	2016E
Revenues	164,125	181,586	185,700	201,732
Operating costs	-133,811	-126,137	-131,956	-141,410
incl. SG&A	0	0	0	0
DD&A	-56,758	-47,138	-49,768	-53,662
EBITDA	89,940	105,655	103,511	113,985
Operating profit	-262,546	-15,326	53,744	60,322
Financial income net	1,918	-1,179	-1,309	-1,812
Pretax profit	-289,914	-22,513	52,434	58,510
Income tax	55,143	1,912	-10,487	-11,702
Net income	-234,771	-20,601	41,947	46,808
EPS	0.00	0.00	0.00	0.00

Key margins

	2013	2014	2015E	2016E
EBIT	-160.0%	-8.4%	28.9%	29.9%
EBITDA	54.8%	58.2%	55.7%	56.5%
Net income	-143.0%	-11.3%	22.6%	23.2%

Balance sheet statement, RUB mln

	2013	2014	2015E	2016E
Cash and equivalents	21,627	42,068	41,865	32,508
Accounts receivable	48,694	55,912	57,179	62,115
Inventories	7,990	10,446	10,867	11,993
Total current assets	122,352	110,821	112,306	109,012
PP&E	749,710	795,029	866,365	915,536
Total assets	918,502	935,175	1,007,995	1,053,872
Short-term debt	29,624	29,686	29,686	29,686
Accounts payable	70,376	89,316	90,189	91,644
Total current liabilities	103,817	119,113	119,986	121,441
Long-term debt	257,964	233,291	263,291	263,291
Total non-current liabilities	266,388	242,831	271,715	271,715
Total shareholders' equity	548,297	573,231	616,294	660,716
Minority interest	0	0	0	0
Total liabilities and equity	918,502	935,175	1,007,995	1,053,872

Cash flow statement, RUB mln

	2013	2014	2015E	2016E
Operating cash flow	78,792	89,726	92,210	97,675
incl. changes of w/c	12,691	9,266	-815	-4,608
Investing cash flow	-122,143	-73,612	-88,699	-77,410
incl. CAPEX	-122,143	-73,612	-88,699	-77,410
Financing cash flow	56,237	-44,513	-3,713	-29,622
Change in cash	-2,429	20,441	-203	-9,357
Free cash flow	-30,660	25,380	2,696	15,657

Key leverage data, RUB mln

	2013	2014	2015E	2016E
Total debt	287,588	262,977	292,977	292,977
Net debt	265,961	220,909	251,112	260,469
Total debt/Equity, x	0.5	0.5	0.5	0.4
Net debt/EBITDA, x	3.0	2.1	2.4	2.3

Source: company data, Gazprombank estimates

REINITIATION OF COVERAGE

MOESK

Power provider for the Russian capital

MOESK is an electricity distribution company operating in Moscow and Moscow region, and is the largest distribution company within ROSSETI holding. The company regularly pays dividends and we expect the dividend yield to reach 5% for 2015 based on the management's recent guidance regarding a potential increase of RAS net income. MOESK's dividend yield is one of the best among distribution peers, although it remains moderate. We have a NEUTRAL recommendation on MOESK with a target price of RUB 0.9 per share.

Pros

- ▶ MOESK operates top-notch assets that provide the company with access to the best consumer base in Russia, as per capita income in Moscow is far above the average domestic income level.
- ▶ It is the largest company within ROSSETI holding. The company's electricity output in 2014 totaled 88.8 mln MWh, equal to 14% of ROSSETI's aggregate electricity output.
- ▶ MOESK has a reliable client base. Moscow and Moscow region cover a densely populated area with a relatively low share of industrial consumption. This makes MOESK one of the best electricity companies with a low risk of losing large industrial consumers, which are looking for direct contracts with FGC.
- ▶ Net income guidance for 2015 may be increased. In mid-July, the management announced new RAS net income guidance at RUB 9.2 bln, which exceeds the previous level by 12%.
- ▶ The company has a long dividend history. MOESK regularly pays dividends based on RAS net income, with the payout ratio set at 25%. Based on the company's RAS net income guidance, the dividend yield for 2015 may reach 5%.

Cons

- ▶ MOESK faces one of the heaviest investment programs in the sector. In 2015, capex is expected to total RUB 47 bln, potentially leaving the company with negative FCF of RUB 6 bln.

Key financials, RUB mln

	2012	2013	2014	2015E	2016E	2017E
Revenues	125,324	129,125	128,018	131,542	144,717	157,001
EBITDA	43,580	44,446	40,589	39,507	43,494	48,647
EBITDA margin	34.8%	34.4%	31.7%	30.0%	30.1%	31.0%
Net income	18,950	18,927	8,078	9,466	11,499	15,000
EV/EBITDA, x	2.0	2.2	2.7	3.2	3.0	2.8
P/E, x	2.2	2.2	5.1	4.4	3.6	2.8

Source: company data, Gazprombank estimates

TICKER	MSRS RX
Closing price, RUB	0.85
Target price, RUB	0.90
Upside	6%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	608
Net debt, \$ mln	1,252
EV, \$ mln	1,860
52-week high, RUB	1.33
52-week low, RUB	0.80

Source: Bloomberg

MOESK share price performance vs. MICEX Index



Source: Bloomberg

Valuation multiples

	2013	2014	2015E	2016E
P/E, x	2.2	5.1	4.4	3.6
EV/EBITDA, x	2.2	2.7	3.2	3.0
EV/Revenues, x	0.8	0.9	1.0	0.9
Dividend yield	7.0%	4.7%	5.0%	5.9%
FCF yield	-25.1%	-26.4%	-14.5%	2.0%

Income statement, RUB mln

	2013	2014	2015E	2016E
Revenues	129,125	128,018	131,542	144,717
Operating costs	-106,760	-119,827	-118,836	-130,041
incl. SG&A	0	0	0	0
DD&A	-17,918	-20,593	-20,593	-22,610
EBITDA	44,446	40,589	39,507	43,494
Operating profit	26,528	14,399	18,914	20,884
Financial income net	-2,156	-2,994	-7,081	-6,511
Pretax profit	24,371	11,406	11,833	14,374
Income tax	-4,898	-3,327	-2,367	-2,875
Net income	18,927	8,078	9,466	11,499
EPS	0.00	0.00	0.00	0.00

Key margins

	2013	2014	2015E	2016E
EBIT	20.5%	11.2%	14.4%	14.4%
EBITDA	34.4%	31.7%	30.0%	30.1%
Net income	14.7%	6.3%	7.2%	7.9%

Balance sheet statement, RUB mln

	2013	2014	2015E	2016E
Cash and equivalents	1,596	4,304	4,098	7,920
Accounts receivable	21,737	23,408	22,473	24,724
Inventories	2,289	2,295	2,638	2,835
Total current assets	26,399	30,558	29,760	36,031
PP&E	253,234	273,668	300,475	314,665
Total assets	286,301	310,583	336,593	357,053
Short-term debt	5,996	21,554	21,554	21,554
Accounts payable	52,081	52,800	54,343	55,305
Total current liabilities	58,822	76,393	77,936	78,898
Long-term debt	52,289	52,730	67,730	75,730
Total non-current liabilities	73,902	75,165	90,165	98,165
Total shareholders' equity	153,578	159,026	168,492	179,991
Minority interest	0	0	0	0
Total liabilities and equity	286,301	310,583	336,593	357,053

Cash flow statement, RUB mln

	2013	2014	2015E	2016E
Operating cash flow	36,168	35,808	39,275	39,133
incl. changes of w/c	-8,021	-958	2,135	-1,487
Investing cash flow	-38,535	-45,792	-47,400	-36,800
incl. CAPEX	-38,535	-45,792	-47,400	-36,800
Financing cash flow	-4,368	12,693	7,919	1,489
Change in cash	-6,736	2,709	-206	3,822
Free cash flow	-10,388	-10,942	-5,990	846

Key leverage data, RUB mln

	2013	2014	2015E	2016E
Total debt	58,286	74,284	89,284	97,284
Net debt	56,689	69,979	85,185	89,363
Total debt/Equity, x	0.4	0.5	0.5	0.5
Net debt/EBITDA, x	1.3	1.7	2.2	2.1

Source: company data, Gazprombank estimates

REINITIATION OF COVERAGE

Lenenergo

Looking for capital injection

Lenenergo provides electricity distribution and grid connection services in St. Petersburg and Leningrad region. The company has mid-sized electricity distribution volumes within ROSSETI holding. In 2014, Lenenergo reported an RAS loss of RUB 8.0 bln, as the company was forced to set aside provisions for cash held on account at Bank Tavrichesky, which faced financial difficulties. Lenenergo may receive a cash injection from ROSSETI in order to raise the funds required to meet its grid connection obligations. We do not expect Lenenergo to pay dividends anytime in the near future, i.e. until the company's financial situation stabilizes. Lenenergo shares trade with a substantial discount to domestic and international peers and offer poor dividend expectations. Thus, we assign the company a NEUTRAL recommendation.

Pros

- ▶ Lenenergo is a key distribution company operating in St. Petersburg and Leningrad region. The company's share on the electricity distribution market was 71.1% in 2014, with total electricity distribution volumes amounting to 34.2 mln MWh.
- ▶ The company is undervalued versus domestic and international peers. Based on 2015E P/E and EV/EBITDA, Lenenergo trades with significant discounts to international peers.
- ▶ Lenenergo has a high-quality consumer base. The company's main client is an electricity retail company controlled by Inter RAO, which is one of the best FCF generators in the utilities sector. This means that Lenenergo should benefit from relatively strong payment discipline.

Cons

- ▶ An additional share issue might be dilutive for current shareholders. In order to resolve its liquidity issue, Lenenergo may place additional shares to raise capital needed to finance its investment obligations.
- ▶ Consolidation with municipal assets lies ahead, although the conditions are unclear. Lenenergo is likely to merge with a municipal distribution company in St. Petersburg. The details of the transaction remain unknown.
- ▶ Electricity losses account for 11.08% of Lenenergo's total electricity distribution. This amount of losses is above the weighted-average electricity distribution loss of 8.35% within ROSSETI holding.
- ▶ The company faces a large investment program with no source of financing. Lenenergo has the second-largest investment program among distribution companies within ROSSETI holding. This large capex exerts pressure on the company's cash flow and results in negative FCF in the medium term.

TICKER	LSNG RX
Closing price, RUB	2.6
Target price, RUB	2.3
Upside	-11%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	63
Net debt, \$ mln	435
EV, \$ mln	497
52-week high, RUB	3.6
52-week low, RUB	1.7

Source: Bloomberg

Lenenergo share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2012	2013	2014	2015E	2016E	2017E
Revenues	37,323	42,900	47,600	49,256	53,271	57,323
EBITDA	10,292	12,698	15,968	15,803	16,670	18,096
EBITDA margin	27.6%	29.6%	33.5%	32.1%	31.3%	31.6%
Net income	233	3,281	-4,215	3,249	3,340	3,980
EV/EBITDA, x	2.6	2.2	3.3	2.1	2.7	2.8
P/E, x	18.3	1.3	nm	1.3	1.3	1.1

Source: company data, Gazprombank estimates

Valuation multiples

	2013	2014	2015E	2016E
P/E, x	1.3	nm	1.3	1.3
EV/EBITDA, x	2.2	3.3	2.1	2.7
EV/Revenues, x	0.6	1.1	0.7	0.8
Dividend yield	6.2%	1.6%	0.0%	0.0%
FCF yield	-187.6%	-436.1%	-225.6%	-79.2%

Income statement, RUB mln

	2013	2014	2015E	2016E
Revenues	42,900	47,600	49,256	53,271
Operating costs	-36,585	-41,515	-38,507	-42,409
incl. SG&A	0	0	0	0
DD&A	-3,920	-4,827	-5,054	-5,807
EBITDA	12,698	15,968	15,803	16,670
Operating profit	6,316	6,085	10,749	10,863
Financial income net	-2,014	-10,819	-6,687	-6,687
Pretax profit	4,301	-4,734	4,062	4,175
Income tax	-1,020	519	-812	-835
Net income	3,281	-4,215	3,249	3,340
EPS	1.98	-2.54	1.96	2.01

Key margins

	2013	2014	2015E	2016E
EBIT	14.7%	12.8%	21.8%	20.4%
EBITDA	29.6%	33.5%	32.1%	31.3%
Net income	7.6%	-8.9%	6.6%	6.3%

Balance sheet statement, RUB mln

	2013	2014	2015E	2016E
Cash and equivalents	10,084	1,512	20,186	9,302
Accounts receivable	5,190	4,095	4,350	4,704
Inventories	419	637	732	787
Total current assets	18,744	17,199	36,223	25,749
PP&E	100,549	113,508	130,442	144,510
Total assets	120,845	135,169	171,127	174,721
Short-term debt	3,982	1,589	1,589	1,589
Accounts payable	15,322	20,919	18,627	19,694
Total current liabilities	36,679	38,271	35,979	37,046
Long-term debt	29,402	48,180	48,180	48,180
Total non-current liabilities	34,700	53,461	53,461	53,461
Total shareholders' equity	49,465	43,437	81,687	84,215
Minority interest	0	0	0	0
Total liabilities and equity	120,845	135,169	171,127	174,721

Cash flow statement, RUB mln

	2013	2014	2015E	2016E
Operating cash flow	11,602	8,846	12,348	16,492
incl. changes of w/c	3,423	6,474	-2,642	657
Investing cash flow	-19,615	-27,475	-21,987	-19,876
incl. CAPEX	-19,615	-27,475	-21,987	-19,876
Financing cash flow	8,219	16,420	28,313	-7,500
Change in cash	206	-2,208	18,674	-10,883
Free cash flow	-8,013	-18,628	-9,639	-3,384

Key leverage data, RUB mln

	2013	2014	2015E	2016E
Total debt	33,384	49,770	49,770	49,770
Net debt	23,300	48,258	29,584	40,467
Total debt/Equity, x	0.7	1.1	0.6	0.6
Net debt/EBITDA, x	1.8	3.0	1.9	2.4

Source: company data, Gazprombank estimates

REINITIATION OF COVERAGE

MRSK Center

Access to central Russian infrastructure

MRSK Center owns a distribution network in Belgorod, Bryansk, Voronezh, Kursk, Kostroma, Lipetsk, Orel, Smolensk, Tambov, Tver and Yaroslavl regions. The company's clients are large industrial consumers, as well as transport, agricultural and electricity retail companies. ROSSETI holds a 50.2% stake in MRSK Center. The company's market share in electricity distribution within regions of its business activity is 83%, while its share in the connection of new consumers stands at 87.4%. Shares of MRSK Center do not offer shareholders an attractive dividend yield or upside potential. For this reason, we have a neutral view on the stock.

Pros

- ▶ **Net electricity output** in 2014 totaled 64.2 mln MWh, making MRSK Center the fifth-largest distribution company in Russia by volume of electricity distribution.
- ▶ **Large industrial consumers.** Oskol Metallurgical Plant accounts for 6.0% of the company's electricity output and NLMK for 5.3%. Another large industrial consumer, Mikhailovsky GOK, is the third-largest consumer with a 4.2% share in the company's total output.
- ▶ **New customer connectivity.** In 2014, the company provided grid connection to the three largest industrial customers with connected capacity in excess of 10 MW, and total connected capacity of 55 MW. As a result, overall connected capacity increased by 9.7% YoY to 1,116.6 MW.
- ▶ **Ongoing construction of new assets.** The company's investment program continues, resulting in the construction of 5,110 km of distribution lines and 1,107 MVA of new transformer capacity.

Cons

- ▶ **Electricity losses.** Electricity losses by MRSK Center amount to 9.27%, which is above the weighted-average electricity loss of 8.35%.
- ▶ **Capex.** The company plans to maintain its capex plans. According to the management, these plans remain nearly unchanged despite an expected decrease in EBITDA. Capex for 2015 is expected at RUB 11.9 bln, while EBITDA is estimated at RUB 12.2 bln.
- ▶ **Weak dividend outlook for 2015.** MRSK Center's dividend payout is based on 25% of RAS net income. Given the company's RAS net loss expectation for 2015 of RUB 0.5 bln, the company is unlikely to pay dividends for 2015.

TICKER	MRKC RX
Closing price, RUB	0.22
Target price, RUB	0.22
Upside	2%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA

MCap, \$ mln	134
Net debt, \$ mln	611
EV, \$ mln	745
52-week high, RUB	0.35
52-week low, RUB	0.21

Source: Bloomberg

MRSK Center share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2012	2013	2014	2015E	2016E	2017E
Revenues	69,984	93,297	86,992	74,309	81,508	88,942
EBITDA	15,004	21,214	16,880	12,184	12,862	15,231
EBITDA margin	21.4%	22.7%	19.4%	16.4%	15.8%	17.1%
Net income	4,428	-57	-3,285	-537	-1,459	-217
EV/EBITDA, x	2.3	1.9	2.7	4.2	4.4	4.0
P/E, x	2.1	nm	nm	nm	nm	nm

Source: company data, Gazprombank estimates

Valuation multiples

	2013	2014	2015E	2016E
P/E, x	nm	nm	nm	nm
EV/EBITDA, x	1.9	2.7	4.2	4.4
EV/Revenues, x	0.4	0.5	0.7	0.7
Dividend yield	9.5%	0.8%	9.1%	0.0%
FCF yield	12.2%	4.3%	7.7%	0.1%

Income statement, RUB mln

	2013	2014	2015E	2016E
Revenues	93,297	86,992	74,309	81,508
Operating costs	-89,901	-88,940	-70,834	-79,024
incl. SG&A	0	0	0	0
DD&A	-7,930	-8,572	-7,510	-9,178
EBITDA	21,214	16,880	12,184	12,862
Operating profit	4,703	-749	4,674	3,684
Financial income net	-2,347	-2,649	-5,345	-5,508
Pretax profit	2,356	-3,398	-671	-1,824
Income tax	-782	114	134	365
Net income	-57	-3,285	-537	-1,459
EPS	0.00	-0.08	-0.01	-0.03

Key margins

	2013	2014	2015E	2016E
EBIT	5.0%	-0.9%	6.3%	4.5%
EBITDA	22.7%	19.4%	16.4%	15.8%
Net income	-0.1%	-3.8%	-0.7%	-1.8%

Balance sheet statement, RUB mln

	2013	2014	2015E	2016E
Cash and equivalents	1,115	396	698	12
Accounts receivable	12,630	16,272	13,899	15,246
Inventories	2,051	1,809	2,079	2,235
Total current assets	16,708	19,479	17,680	18,496
PP&E	78,074	73,086	77,475	81,047
Total assets	96,047	93,794	96,384	100,772
Short-term debt	1,912	9,610	9,610	9,610
Accounts payable	10,539	9,202	7,329	8,176
Total current liabilities	14,863	20,539	18,666	19,513
Long-term debt	31,208	27,670	32,670	37,670
Total non-current liabilities	39,430	34,323	39,323	44,323
Total shareholders' equity	41,754	38,932	38,395	36,936
Minority interest	0	0	0	0
Total liabilities and equity	96,047	93,794	96,384	100,772

Cash flow statement, RUB mln

	2013	2014	2015E	2016E
Operating cash flow	10,266	7,978	12,547	12,572
incl. changes of w/c	-294	-4,735	228	-655
Investing cash flow	-15,433	-12,345	-11,899	-12,750
incl. CAPEX	-15,547	-12,477	-11,899	-12,750
Financing cash flow	5,311	3,647	-345	-508
Change in cash	143	-719	303	-686
Free cash flow	1,115	396	698	12

Key leverage data, RUB mln

	2013	2014	2015E	2016E
Total debt	33,120	37,280	42,280	47,280
Net debt	32,005	36,884	41,582	47,268
Total debt/Equity, x	0.8	1.0	1.1	1.3
Net debt/EBITDA, x	1.5	2.2	3.4	3.7

Source: company data, Gazprombank estimates

REINITIATION OF COVERAGE

MRSK Center and Volga

Flexible approach to changing environment

MRSK Center and Volga provides electricity grid distribution and connection services in Vladimir, Ivanovo, Kaluga, Kirov, Nizhniy Novgorod, Ryazan and Tula regions, as well as the republics of Mari-El and Udmurtia. The company provides services to the oil industry, machine-engineering concerns and metal producers, chemical manufacturers, woodworkers, transport, agriculture and households. Its share of electricity distribution in regions of operation stood at 72% in 2014. MRSK Center and Volga announced plans to scale back its investment program for 2015, a move that should help the company generate positive FCF. However, our overall neutral view of the sector also applies to MRSK Center and Volga shares.

Pros

- ▶ MRSK Center and Volga's electricity transmission volumes reached 55.0 mln MWh, ranking the company sixth among regional distribution companies controlled by ROSSETI.
- ▶ The coverage area of MRSK Center and Volga amounts to 408k km² with a total population approaching 13 mln.
- ▶ Three of the company's top 10 consumers – Russian Railways, Gazprom and Transneft – account for 10% of its total electricity output.
- ▶ MRSK Center and Volga has a long dividend history, regularly paying dividends with a 3.6% average yield in 2010-14.
- ▶ The company's flexible investment program allows it to maintain positive FCF.
- ▶ The launch of new capacity continues, as in 2014 the company completed the construction of 2,800 km of power transmission lines and 360 MVA of transformer capacity.

Cons

- ▶ Electricity losses account for 9.23% of total output, a figure that is above the weighted-average loss of 8.35%.

Key financials, RUB mln

	2012	2013	2014	2015E	2016E	2017E
Revenues	60,082	77,856	70,160	69,195	76,099	82,970
EBITDA	10,989	11,244	10,178	8,982	9,954	11,985
EBITDA margin	18.3%	14.4%	14.5%	13.0%	13.1%	14.4%
Net income	1,380	1,651	-1,630	-152	645	2,090
EV/EBITDA, x	2.7	2.5	3.2	3.8	3.6	3.1
P/E, x	5.5	4.6	nm	nm	11.8	3.6

Source: company data, Gazprombank estimates

TICKER	MRKP RX
Closing price, RUB	0.067
Target price, RUB	0.070
Upside	4%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	112
Net debt, \$ mln	385
EV, \$ mln	497
52-week high, RUB	0.105
52-week low, RUB	0.067

Source: Bloomberg

MRSK Center and Volga share price performance vs. MICEX Index



Source: Bloomberg

Valuation multiples

	2013	2014	2015E	2016E
P/E, x	4.6	nm	nm	11.8
EV/EBITDA, x	2.5	3.2	3.8	3.6
EV/Revenues, x	0.4	0.5	0.5	0.5
Dividend yield	6.3%	8.4%	4.6%	1.4%
FCF yield	12.7%	-31.4%	22.4%	14.5%

Income statement, RUB mln

	2013	2014	2015E	2016E
Revenues	77,856	70,160	69,195	76,099
Operating costs	-73,618	-69,237	-66,010	-72,048
incl. SG&A	1	2	3	4
DD&A	-5,460	-5,986	-5,797	-5,903
EBITDA	11,244	10,178	8,982	9,954
Operating profit	4,238	923	3,185	4,051
Financial income net	-1,915	-1,867	-3,375	-3,245
Pretax profit	2,323	-943	-191	806
Income tax	-571	-686	38	-161
Net income	1,651	-1,630	-152	645
EPS	0.01	-0.01	0.00	0.01

Key margins

	2013	2014	2015E	2016E
EBIT	5.4%	1.3%	4.6%	5.3%
EBITDA	14.4%	14.5%	13.0%	13.1%
Net income	2.1%	-2.3%	-0.2%	0.8%

Balance sheet statement, RUB mln

	2013	2014	2015E	2016E
Cash and equivalents	3,290	2,300	625	-1,519
Accounts receivable	10,429	12,174	12,017	13,137
Inventories	1,380	1,464	1,683	1,809
Total current assets	15,939	18,607	16,994	16,096
PP&E	59,794	58,438	59,653	61,654
Total assets	76,890	78,175	77,778	78,881
Short-term debt	951	7,018	7,018	7,018
Accounts payable	10,069	10,045	9,800	10,258
Total current liabilities	12,611	18,574	18,329	18,787
Long-term debt	22,331	19,828	19,828	19,828
Total non-current liabilities	29,823	27,351	27,351	27,351
Total shareholders' equity	34,456	32,250	32,098	32,743
Minority interest	0	0	0	0
Total liabilities and equity	76,890	78,175	77,778	78,881

Cash flow statement, RUB mln

	2013	2014	2015E	2016E
Operating cash flow	9,562	5,872	8,713	9,005
incl. changes of w/c	962	4,135	-307	-787
Investing cash flow	-7,367	-9,802	-7,013	-7,905
incl. CAPEX	-8,600	-8,259	-7,013	-7,905
Financing cash flow	-1,510	2,940	-3,375	-3,245
Change in cash	684	-990	-1,675	-2,144
Free cash flow	962	-2,387	1,700	1,100

Key leverage data, RUB mln

	2013	2014	2015E	2016E
Total debt	23,282	26,846	26,846	26,846
Net debt	19,992	24,546	26,221	28,365
Total debt/Equity, x	0.7	0.8	0.8	0.8
Net debt/EBITDA, x	1.8	2.4	2.9	2.8

Source: company data, Gazprombank estimates

REINITIATION OF COVERAGE

MRSK Urals

Infrastructure in industrialized regions

MRSK Urals is an electricity distribution company that operates in Sverdlovsk, Perm and Chelyabinsk regions. The company is controlled by ROSSETI, which holds a 51.5% equity stake in the company. MRSK Urals' share in electricity distribution stands at 73% in regions where the company has a footprint. We assign a NEUTRAL recommendation to MRSK Urals shares based on their 6% dividend yield for 2015.

Pros

- ▶ MRSK Urals' electricity distribution in 2014 totaled 79.7 mln MWh, ranking the company second in terms of electricity distribution volumes among ROSSETI subsidiaries.
- ▶ The company reported a 7.8% electricity loss rate in 2014, which is better than ROSSETI's weighted-average loss of 8.35%.
- ▶ The attractive dividend yield for 2014 of 7.6% is unlikely to be repeated in 2015. However, the company plans to report RAS net income of RUB 1.3 bln this year, resulting in a dividend yield of 5% – a relatively strong figure for the utilities sector.
- ▶ MRSK Urals consolidates a 90% stake in Yekaterinburg Electricity Distribution Company, providing it with access to one of the best electricity retail consumer bases in Russia.

Cons

- ▶ A large number of large industrial consumers intend to switch to direct payments to FGC, thus exerting pressure on the company's revenues.

TICKER	MRKU RX
Closing price, RUB	0.069
Target price, RUB	0.073
Upside	6%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	88
Net debt, \$ mln	187
EV, \$ mln	276
52-week high, RUB	0.085
52-week low, RUB	0.055

Source: Bloomberg

MRSK Urals share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2012	2013	2014	2015E	2016E	2017E
Revenues	59,431	65,523	68,975	71,146	78,113	84,740
EBITDA	6,384	7,328	8,917	5,988	6,479	7,750
EBITDA margin	10.7%	11.2%	12.9%	8.4%	8.3%	9.1%
Net income	243	-1,100	2,055	-1,392	-955	170
EV/EBITDA, x	2.2	2.5	1.8	3.1	3.0	2.4
P/E, x	24.7	nm	2.9	nm	nm	35.3

Source: company data, Gazprombank estimates

Valuation multiples

	2013	2014	2015E	2016E
P/E, x	nm	2.9	nm	nm
EV/EBITDA, x	2.5	1.8	3.1	3.0
EV/Revenues, x	0.3	0.2	0.3	0.2
Dividend yield	2.6%	1.5%	8.5%	5.6%
FCF yield	-48.4%	48.4%	2.6%	21.8%

Income statement, RUB mln

	2013	2014	2015E	2016E
Revenues	65,523	68,975	71,146	78,113
Operating costs	-67,171	-67,798	-70,983	-77,566
incl. SG&A	0	0	0	0
DD&A	-5,451	-5,711	-5,825	-5,931
EBITDA	7,328	8,917	5,988	6,479
Operating profit	226	3,070	163	547
Financial income net	-1,207	-689	-1,903	-1,742
Pretax profit	-993	2,381	-1,740	-1,194
Income tax	-107	-326	348	239
Net income	-1,100	2,055	-1,392	-955
EPS	-0.01	0.02	-0.02	-0.01

Key margins

	2013	2014	2015E	2016E
EBIT	0.3%	4.5%	0.2%	0.7%
EBITDA	11.2%	12.9%	8.4%	8.3%
Net income	-1.7%	3.0%	-2.0%	-1.2%

Balance sheet statement, RUB mln

	2013	2014	2015E	2016E
Cash and equivalents	1,992	3,665	1,403	971
Accounts receivable	7,702	9,355	7,781	8,543
Inventories	887	637	733	788
Total current assets	11,399	13,951	10,209	10,595
PP&E	58,336	62,075	63,209	62,725
Total assets	70,567	76,723	74,115	74,017
Short-term debt	476	2,634	2,634	2,634
Accounts payable	8,483	9,948	9,246	10,103
Total current liabilities	10,405	16,453	15,751	16,609
Long-term debt	13,718	11,526	11,526	11,526
Total non-current liabilities	20,198	18,429	18,429	18,429
Total shareholders' equity	39,964	41,841	39,936	38,980
Minority interest	0	0	0	0
Total liabilities and equity	70,567	76,723	74,115	74,017

Cash flow statement, RUB mln

	2013	2014	2015E	2016E
Operating cash flow	7,211	11,761	7,113	6,758
incl. changes of w/c	-435	61	777	41
Investing cash flow	-10,114	-8,860	-6,959	-5,448
incl. CAPEX	-10,114	-8,860	-6,959	-5,448
Financing cash flow	2,301	-1,228	-2,416	-1,742
Change in cash	-602	1,673	-2,262	-431
Free cash flow	-2,903	2,901	154	1,310

Key leverage data, RUB mln

	2013	2014	2015E	2016E
Total debt	14,194	14,160	14,160	14,160
Net debt	12,201	10,494	12,757	13,188
Total debt/Equity, x	0.4	0.3	0.4	0.4
Net debt/EBITDA, x	1.7	1.2	2.1	2.0

Source: company data, Gazprombank estimates

REINITIATION OF COVERAGE

MRSK Volga

Mid-sized company with high efficiency

MRSK Volga provides electricity distribution and grid connection services in the regions of Saratov, Samara, Orenburg, Penza and Ulyanovsk, as well as the republics of Mordovia and Chuvashia. ROSSETI holds a controlling stake in MRSK Volga, a mid-sized company within ROSSETI holding. In the regions of its activity, the company holds a 77% share of the electricity distribution market. The company's dividend story is not sustainable, although its shares are undervalued relative to domestic and international peers. We initiate coverage of MRSK Volga with a NEUTRAL recommendation.

Pros

- ▶ MRSK Volga has the lowest rate of electricity losses of 6.62% vs. total electricity output. This is one of the best loss rates among distribution companies within ROSSETI holding, where the weighted-average electricity loss stands at 8.35%.
- ▶ Total electricity output amounted to 54.9 mln MWh in 2014, ranking MRSK Volga seventh among distribution companies within ROSSETI holding.
- ▶ MRSK Volga plans to reduce its capex by 66% in 2015, which will result in generation of substantial FCF starting from 2015.

Cons

- ▶ MRSK Volga's dividend story is not sound, as the company distributed only tiny dividends for 2014. In light of relatively weak 1H15 RAS results and our FY15 expectations, the company is unlikely to pay better dividends for 2015.

TICKER	MRKV RX
Closing price, RUB	0.021
Target price, RUB	0.025
Upside	17%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	56
Net debt, \$ mln	153
EV, \$ mln	209
52-week high, RUB	0.030
52-week low, RUB	0.020

Source: Bloomberg

MRSK Volga share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2012	2013	2014	2015E	2016E	2017E
Revenues	45,908	49,202	46,156	47,771	52,521	57,390
EBITDA	7,166	6,537	7,103	6,483	7,214	8,808
EBITDA margin	15.6%	13.3%	15.4%	13.6%	13.7%	15.3%
Net income	2,328	1,261	808	-396	588	2,184
EV/EBITDA, x	1.7	2.6	2.3	2.2	1.6	0.9
P/E, x	1.6	3.0	4.7	nm	6.5	1.7

Source: company data, Gazprombank estimates

Valuation multiples

	2013	2014	2015E	2016E
P/E, x	3.0	4.7	nm	6.5
EV/EBITDA, x	2.6	2.3	2.2	1.6
EV/Revenues, x	0.3	0.4	0.3	0.2
Dividend yield	6.4%	0.5%	0.5%	0.5%
FCF yield	-101.8%	6.2%	108.8%	119.9%

Income statement, RUB mln

	2013	2014	2015E	2016E
Revenues	49,202	46,156	47,771	52,521
Operating costs	-46,757	-44,186	-46,396	-50,074
incl. SG&A	0	0	0	0
DD&A	-4,092	-5,008	-5,108	-4,767
EBITDA	6,537	7,103	6,483	7,214
Operating profit	2,445	2,095	1,375	2,447
Financial income net	-744	-956	-1,870	-1,712
Pretax profit	1,700	1,139	-495	735
Income tax	-249	-332	99	-147
Net income	1,261	808	-396	588
EPS	0.01	0.00	0.00	0.00

Key margins

	2013	2014	2015E	2016E
EBIT	5.0%	4.5%	2.9%	4.7%
EBITDA	13.3%	15.4%	13.6%	13.7%
Net income	2.6%	1.7%	-0.8%	1.1%

Balance sheet statement, RUB mln

	2013	2014	2015E	2016E
Cash and equivalents	1,056	1,258	3,538	6,397
Accounts receivable	4,405	6,377	6,601	7,257
Inventories	1,184	1,227	1,411	1,517
Total current assets	7,825	9,163	11,849	15,470
PP&E	41,846	42,326	39,506	36,910
Total assets	50,385	52,279	52,145	53,170
Short-term debt	37	1,919	1,919	1,919
Accounts payable	5,002	5,249	5,511	5,948
Total current liabilities	5,624	8,205	8,467	8,904
Long-term debt	13,900	12,000	12,000	12,000
Total non-current liabilities	18,551	17,053	17,053	17,053
Total shareholders' equity	26,210	27,021	26,625	27,213
Minority interest	0	0	0	0
Total liabilities and equity	50,385	52,279	52,145	53,170

Cash flow statement, RUB mln

	2013	2014	2015E	2016E
Operating cash flow	4,792	5,423	6,437	6,742
incl. changes of w/c	-809	-1,769	-144	-325
Investing cash flow	-8,672	-5,185	-2,288	-2,171
incl. CAPEX	-8,672	-5,185	-2,288	-2,171
Financing cash flow	2,847	-36	-1,870	-1,712
Change in cash	-1,032	202	2,279	2,859
Free cash flow	-3,880	238	4,150	4,571

Key leverage data, RUB mln

	2013	2014	2015E	2016E
Total debt	13,937	13,919	13,919	13,919
Net debt	12,880	12,661	10,382	7,523
Total debt/Equity, x	0.5	0.5	0.5	0.5
Net debt/EBITDA, x	2.0	1.8	1.6	1.0

Source: company data, Gazprombank estimates

REINITIATION OF COVERAGE

MRSK South

Small and challenging story for investors

MRSK South provides electricity distribution and grid connection services in the regions of Rostov, Volgograd, Astrakhan and the Republic of Kalmykia. The company is relatively small relative to ROSSETI's family of distribution companies. MRSK South is one of the most highly leveraged companies among domestic peers, trading at a premium to domestic peers on EV/EBITDA owing to its high leverage. However, the company plans to keep its capex at a relatively low level, which will allow deleveraging over the next few years. We assign a NEUTRAL recommendation to MRSK South with a target price of RUB 0.03 per share.

Pros

- ▶ Improved 1H15 RAS results may help the company to report RAS net profit for FY15. The company managed to increase revenues by 1.4% YoY and reported net profit of RUB 286.7 mln vs. a net loss in 1H14.
- ▶ Relatively low capex of RUB 1.9 bln in 2015 will likely allow MRSK South to generate FCF this year and going forward, thus allowing the company to deleverage in the medium term.

Cons

- ▶ MRSK South is one of the smallest distribution companies in ROSSETI holding, with total electricity output of 29.5 mln MWh in 2014. The company ranks tenth among distribution companies under ROSSETI's umbrella.
- ▶ Electricity losses stood at 9.3% in 2014. This level is below the weighted-average for ROSSETI of 8.35%.
- ▶ The company has one of the heaviest leverages in ROSSETI holding. Net debt/EBITDA stands at more than 4.0x, whereas this metric does not exceed 3.0x for most distribution companies.
- ▶ According to our expectations, the company is overvalued vs. domestic peers on 2015E EV/EBITDA. We expect this undervaluation to decrease in the near term, as we expect the company's profitability to expand over the next few years.

TICKER	MRKY RX
Closing price, RUB	0.033
Target price, RUB	0.030
Upside	-9%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA

MCap, \$ mln	24
Net debt, \$ mln	352
EV, \$ mln	376
52-week high, RUB	0.043
52-week low, RUB	0.027

Source: Bloomberg

MRSK South share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2012	2013	2014	2015E	2016E	2017E
Revenues	24,286	27,311	29,078	30,147	33,210	36,295
EBITDA	5,866	5,633	5,523	5,198	5,652	6,843
EBITDA margin	24.2%	20.6%	19.0%	17.2%	17.0%	18.9%
Net income	1,083	148	-6,784	-786	-20	1,394
EV/EBITDA, x	3.8	4.3	4.7	4.9	4.3	3.2
P/E, x	1.5	11.1	nm	nm	nm	1.2

Source: company data, Gazprombank estimates

Valuation multiples

	2013	2014	2015E	2016E
P/E, x	11.1	nm	nm	nm
EV/EBITDA, x	4.3	4.7	4.9	4.3
EV/Revenues, x	0.9	0.9	0.8	0.7
Dividend yield	0.0%	0.0%	0.0%	0.0%
FCF yield	9.1%	-127.6%	217.1%	278.6%

Income statement, RUB mln

	2013	2014	2015E	2016E
Revenues	27,311	29,078	30,147	33,210
Operating costs	-24,963	-35,558	-28,497	-31,035
incl. SG&A	0	0	0	0
DD&A	-2,721	-2,751	-2,772	-2,680
EBITDA	5,633	5,523	5,198	5,652
Operating profit	2,348	-5,727	2,425	2,972
Financial income net	-1,746	-2,228	-3,408	-2,997
Pretax profit	602	-7,956	-983	-25
Income tax	-408	1,172	197	5
Net income	148	-6,784	-786	-20
EPS	0.00	-0.14	-0.02	0.00

Key margins

	2013	2014	2015E	2016E
EBIT	8.6%	-19.7%	8.0%	9.0%
EBITDA	20.6%	19.0%	17.2%	17.0%
Net income	0.5%	-23.3%	-2.6%	-0.1%

Balance sheet statement, RUB mln

	2013	2014	2015E	2016E
Cash and equivalents	1,190	735	1,895	477
Accounts receivable	10,490	8,985	10,780	11,281
Inventories	1,279	676	777	835
Total current assets	13,121	10,633	13,689	12,831
PP&E	25,171	21,687	20,800	19,651
Total assets	39,138	34,064	36,233	34,226
Short-term debt	10,338	5,123	5,123	5,123
Accounts payable	9,962	9,417	11,372	12,385
Total current liabilities	21,005	16,256	18,211	19,224
Long-term debt	13,241	19,744	20,744	17,744
Total non-current liabilities	13,519	19,897	20,897	17,897
Total shareholders' equity	4,615	-2,089	-2,875	-2,895
Minority interest	0	0	0	0
Total liabilities and equity	39,138	34,064	36,233	34,226

Cash flow statement, RUB mln

	2013	2014	2015E	2016E
Operating cash flow	3,047	-766	5,453	6,111
incl. changes of w/c	-1,805	1,563	59	454
Investing cash flow	-2,896	-1,331	-1,885	-1,531
incl. CAPEX	-2,896	-1,331	-1,885	-1,531
Financing cash flow	-710	1,643	-2,408	-5,997
Change in cash	-560	-454	1,159	-1,418
Free cash flow	150	-2,098	3,568	4,580

Key leverage data, RUB mln

	2013	2014	2015E	2016E
Total debt	23,580	24,867	25,867	22,867
Net debt	22,390	24,132	23,972	22,390
Total debt/Equity, x	5.1	-11.9	-9.0	-7.9
Net debt/EBITDA, x	4.0	4.4	4.6	4.0

Source: company data, Gazprombank estimates



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