

TARGET PRICE UPDATE

ROSSETI

A time to gather stones

Government and minority shareholders enjoy dividend flow. Subsidiaries of ROSSETI have become strong dividend stories following the government's decision that state-controlled companies should pay dividends totaling 50% of the higher of IFRS or RAS net income for 2015 (for details, see [our note](#) of April 25 entitled "ROSSETI: Subsidiaries may boost dividend payouts"). Parent company ROSSETI was unable to pay dividends for 2015 after having posted a net loss for the year. Interim dividends were paid for 1Q16 in the amount of RUB 1.8 bln, but the payout ratio was only 5% of 1Q16 RAS net profit. In this note, we update our financial models for ROSSETI and its subsidiaries based on their latest operating and financial results.

Target valuations based on dividend expectations. According to the draft Finance Ministry proposal that a 50% dividend payout ratio be used as a long-term target, we set new target prices and recommendations for distribution companies based on their expected dividend yields for 2016 of 9-12%. We have an OVERWEIGHT recommendation on the shares of MOESK, MRSK Center, MRSK Center & Volga and MRSK Volga; and NEUTRAL recommendations on ROSSETI (commons and prefs), MRSK Urals, MRSK South and MRSK North-West. We also place our recommendation on Lenenergo UNDER REVIEW.

Positive developments

- ▶ **ROSSETI has become less dependent on state financing.** The government revised its approach to the dividends of ROSSETI subsidiaries and decided to milk them in order to reduce ROSSETI's dependence on state financing.
- ▶ **Financials for 2015 underscore the companies' ability to cut operating expenses.** The companies managed to limit growth in operating expenses, which positively impacted financial results.
- ▶ **Tariff growth continues.** Growth in distribution companies' tariffs starting from July 1 averages 7.5%.
- ▶ **Flexible capex program.** ROSSETI has demonstrated its ability to adjust its capex, as confirmed by IFRS results for 2014 and 2015.

Risks

- ▶ **Federal regulator preparing for new tariff reform.** After obtaining the tariff regulation function, the Federal Antimonopoly Service (FAS) is preparing a new tariff reform.
- ▶ **Last-mile issue remains.** Industrial consumers in several regions in 2017 may switch to direct contracts with Federal Grid Company (FGC), which creates risks for the profits of regional distribution companies.

Valuations

- ▶ **Discounts to peers remain substantial.** Distribution companies remain heavily undervalued to international peers, trading at average discounts of 69% on EV/EBITDA and 81% on P/E. We see the current discounts as unjustified for certain ROSSETI subsidiaries.
- ▶ **Our approach to target price calculation.** We calculated our target prices based on expected dividends for 2016 and assuming that the fair yield lies in a range of 9-12% for individual companies.

Matvey Tayts

+7 (495) 980 43 89 (ext. 5 43 89)
Matvey.Tayts@gazprombank.ru

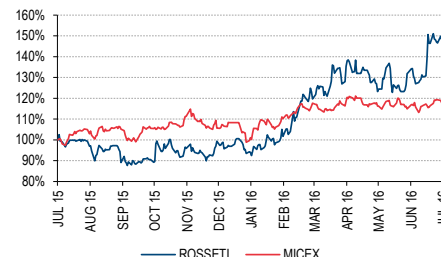
TICKER	RSTI RX
Closing price, RUB	0.69
Target price, RUB	0.61
Upside	-12%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	2,170
Net debt, \$ mln	7,631
EV, \$ mln	14,750
52-week high, RUB	0.71
52-week low, RUB	0.41

Source: Bloomberg

ROSSETI share price performance vs. MICEX Index



Source: Bloomberg

- **ROSSETI SOTP.** ROSSETI's current valuation implies a 43% discount to its SOTP value.
- **Comfortable debt burden.** ROSSETI's current net debt/EBITDA of 2.0x is comfortable and we see no short-term risk of a ratings revision.

Key financials, RUB mln

	2013	2014	2015	2016E	2017E	2018E
Revenues	755,806	759,608	766,812	821,857	869,851	913,928
EBITDA	228,224	235,593	242,840	256,510	271,750	286,356
EBITDA margin	30.2%	31.0%	31.7%	31.2%	31.2%	31.3%
Net income	-159,389	-25,257	81,602	95,107	104,593	112,775
EV/EBITDA, x	4.0	3.9	3.9	3.8	3.7	3.7
P/E, x	nm	nm	1.7	1.5	1.3	1.2

Source: company data, Gazprombank estimates

Valuation multiples

	2014	2015	2016E	2017E
P/E, x	nm	1.7	1.5	1.3
EV/EBITDA, x	3.9	3.9	3.8	3.7
EV/Revenues, x	1.2	1.2	1.2	1.2
Dividend yield	0.0%	0.0%	1.2%	7.9%
FCF yield	2.5%	32.8%	22.9%	38.4%

Income statement, RUB mln

	2014	2015	2016E	2017E
Revenues	759,608	766,812	821,857	869,851
Operating costs	-759,805	-652,538	-696,303	-734,508
incl. SG&A	0	0	0	0
DD&A	-125,910	-100,529	-107,083	-111,497
EBITDA	235,593	242,840	256,510	271,750
Operating profit	14,122	146,343	149,427	160,254
Financial income net	-13,750	-19,167	-30,543	-29,513
Pretax profit	-18,049	113,712	118,884	130,741
Income tax	-6,208	-32,110	-23,777	-26,148
Net income	-25,257	81,602	95,107	104,593
EPS	-0.15	0.50	0.49	0.53

Key margins

	2014	2015	2016E	2017E
EBIT	1.9%	19.1%	18.2%	18.4%
EBITDA	31.0%	31.7%	31.2%	31.2%
Net income	-3.3%	10.6%	11.6%	12.0%

Balance sheet statement, RUB mln

	2014	2015	2016E	2017E
Cash and equivalents	82,576	97,090	78,701	75,215
Accounts receivable	155,776	162,624	177,784	191,929
Inventories	26,630	33,921	36,356	38,479
Total current assets	287,526	334,613	333,819	346,602
PP&E	1,643,586	1,734,044	1,844,790	1,940,909
Total assets	1,984,079	2,145,757	2,255,709	2,364,610
Short-term debt	93,227	118,832	118,960	118,960
Accounts payable	268,469	267,972	281,464	291,943
Total current liabilities	382,114	399,720	413,340	423,818
Long-term debt	485,409	465,439	476,458	489,741
Total non-current liabilities	563,161	577,142	588,161	601,444
Total shareholders' equity	752,980	852,912	927,025	997,799
Minority interest	285,824	315,983	327,183	341,549
Total liabilities and equity	1,984,079	2,145,757	2,255,709	2,364,610

Cash flow statement, RUB mln

	2014	2015	2016E	2017E
Operating cash flow	214,948	225,652	252,407	265,960
incl. changes of w/c	-20,645	-17,188	-4,103	-5,790
Investing cash flow	-166,290	-174,519	-196,892	-186,678
incl. CAPEX	-204,193	-174,052	-196,892	-186,678
Financing cash flow	26,273	32,345	1,353	-6,171
Change in cash	74,931	14,514	-18,389	-3,486
Free cash flow	3,433	45,404	31,738	53,134

Key leverage data, RUB mln

	2014	2015	2016E	2017E
Total debt	578,636	584,271	595,418	608,700
Net debt	496,060	487,181	516,716	533,485
Total debt/Equity, x	0.8	0.7	0.6	0.6
Net debt/EBITDA, x	2.1	2.0	2.0	2.0

Source: company data, Gazprombank estimates



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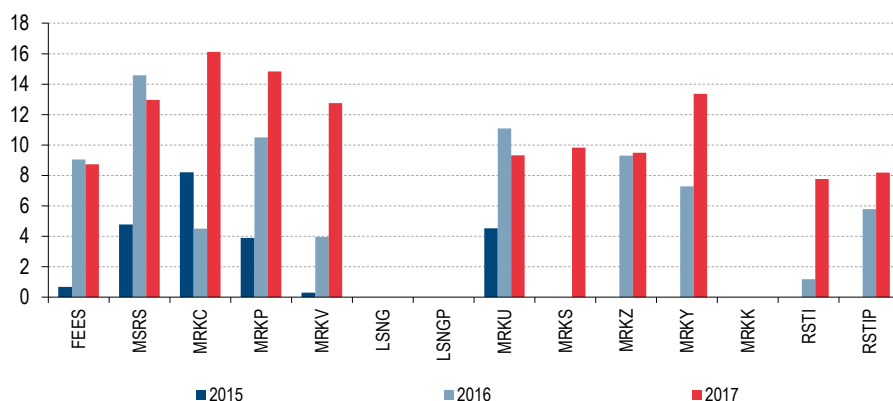
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POSITIVE DEVELOPMENTS IN SECTOR

Dividends to support budget proceeds

Next year might be better than expected. The Finance Ministry has prepared amendments to the document regulating the dividend payout ratios of state-controlled companies. The document targets a payout of 50% of net profit as a consistent long-term target. It also determined that the 50% payout will be calculated on the basis of IFRS results, and in case the total payout is higher than the total RAS net profit companies will use accumulated income from previous years.

ROSSETI and subsidiaries dividend yield history and expectations, % of current market price



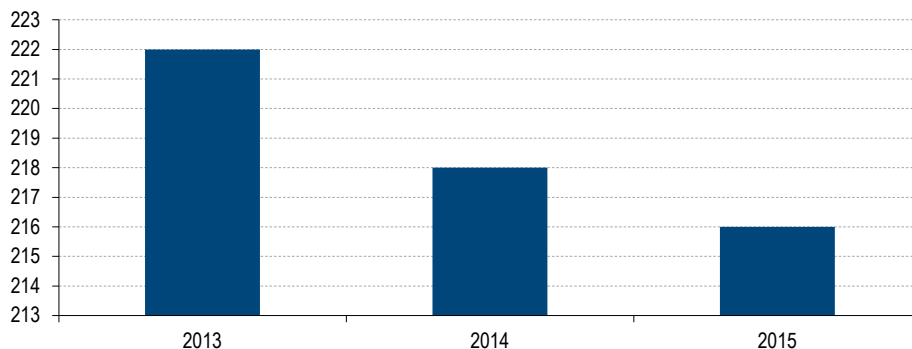
Source: Bloomberg, Company data, Gazprombank estimates

ROSSETI subsidiaries were among the best dividend plays. Despite being only indirectly controlled by the government, subsidiaries of ROSSETI fulfilled the state's directive to pay dividends totaling 50% of the higher of RAS or IFRS net profit. As a result, ROSSETI received a total of RUB 21 bln in dividends from its subsidiaries. As a parent company, ROSSETI will not pay dividends for 2015 due to the net loss and accumulated loss on its book. The parent company only paid interim dividends for 1Q16 totaling RUB 1.6 bln and RUB 155 mln on common and preferred shares, respectively.

Companies managed to keep operating expenses under control

Labor and maintenance costs under control. In 2015, ROSSETI's consolidated labor costs increased 5% YoY to RUB 162.9 bln, while the total number of employees according to the annual report was reduced by 1% YoY to 216,000. Maintenance costs decreased 16% YoY to RUB 11.9 bln, as the company strove to heighten the efficiency of its operating performance.

ROSSETI optimization of labor costs ('000 employees)



Source: company data, Gazprombank estimates

Specifics of cost structure. ROSSETI's cost structure consists of manageable and non-manageable costs. The latter include expenses for electricity losses (20% of total operating cash costs), and distribution and transmission fees paid to third parties (23%). However, costs related to labor (31%), maintenance (3%) and other cash costs (23%) might be reduced through management efforts.

Tariff growth continues

New tariff hike this year. Electricity distribution companies were granted an average tariff hike of 7.5% starting from July 1. Current tariff regulation is based on the RAB (Regulatory Asset Base) system, which should provide investors with a guaranteed regulated return on approved assets and new investments. However, tariff regulation is actually based on annual revision of tariff growth. This is limited by the price cap, which takes account of the social impact of tariff expansion and cost-based demand from distribution companies.

Tariff growth continues after the tariff freeze. The top lines of distribution companies are in relatively strong shape, as the tariff freeze in 2014 was not extended going forward. Average tariff growth in 2015 was close to 3.8% YoY following the 7.5% tariff hike starting from July 1, 2015. We assume that tariffs will increase by 6.3%, 4.5% and 4.0% in 2017-2019, or at levels below our CPI expectations. Our assumptions are based on FAS statements that tariff growth for monopolies would be targeted at below CPI.

Flexible capex program

Adequate reaction to weaker demand. In response to the economic downturn, ROSSETI scaled back its investment program for 2014 by 23% YoY to RUB 204.2 bln, and for 2015 by 15% to RUB 174.1 bln. This capex reduction followed less aggressive demand from consumers on the back of slowing economic activity and the substantial investments in previous years. Moreover, the company implemented some cost-cutting measures in order to minimize capex.

Capex forecast indicates conservative approach. Going forward, we expect capex to stabilize at a level below RUB 200 bln annually. Our expectations are based on long-term investment plans prepared by ROSSETI subsidiaries and our expectations with regard to potential capex revision due to the state's new dividend requirements. The largest parts of the investment program are allocated to FGC (38% of total), MOESK (18%) and Lenenergo (12%).

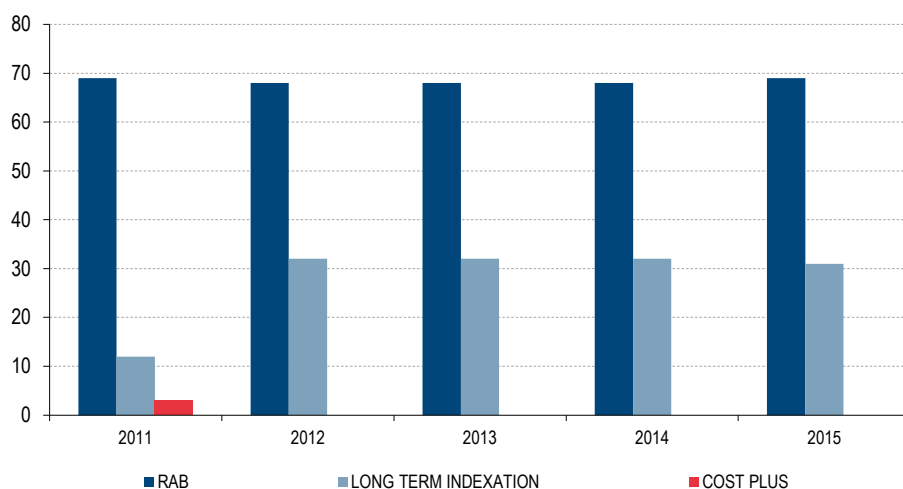
Substantial investments in the sector in 2008-15. Another reason to expect flexible capex programs is substantial investment in the sector during the 2008-15 period. Companies that currently form ROSSETI group have spent a cumulative RUB 1.8 trln on construction and renovation of distribution and transmission grids. These massive investments were made when the growth rate of electricity consumption was expected at 3-4% per annum, which seems overestimated when compared to current expectations of 1% annualized growth in electricity demand. Thus, it is reasonable to assume that excessive capacity may allow companies to be more flexible when implementing their capex programs.

RISKS

Federal regulator prepares for new tariff reform

Switch from RAB to long-term indexation. In July, the head of the FAS, which is also responsible for tariff regulation, met with President Putin and gained approval for reform of tariff regulation for distribution companies. According to information available on the Kremlin's website, the FAS has proposed replacing the existing RAB tariff regulation methodology with a long-term indexation methodology.

Tariff regulation system by ROSSETI operating branches, %



Source: Bloomberg, Reuters, Gazprombank estimates

Less pressure on investment program implementation. The RAB tariff system was implemented in order to attract investments to the distribution sector with a guaranteed return of 10-11% on invested capital. Given that ROSSETI spent a significant RUB 1.8 trln in recent years for investment purposes, we expect the switch from RAB tariff regulation to a long-term indexation system to lead to a scaling down of investment plans amid slow growth in business activity. Otherwise, huge capex without an appropriate return on investment would destroy value for shareholders of ROSSETI and its subsidiaries.

Potential details of new regulation system. Given recent public statements at utilities conferences by FAS representatives, we conclude that the following steps will be taken during the course of implementation of the new tariff system. The first is the establishment of a benchmark system that will help distribution companies to calculate tariffs based on standardized expenses per unit of equipment and special adjustment coefficients. According to FAS representatives, tariffs will include a 5% net margin. In addition, tariffs will be set for 3-5 years and all of the savings derived from implementation of cost-cutting programs will remain untouched by the regulator during this period.

Impact on financials. ROSSETI's net margin in 2015 was 10.6%, with those of distribution companies ranging from 1-12% and that of FGC standing at 23%. Assuming that all of the companies in the group receive tariffs providing only a 5% net margin, we arrive at a valuation 43% below ROSSETI's current share price. However, we do not expect the regulators to choose such a strict rule as a core criterion, and anticipate more discussion regarding the issue in the near future.

Last-mile issue remains

Large industrial consumers subsidize other consumers. The last-mile issue refers to the obligation on the part of large industrial consumers to pay for electricity distribution at the price of low-voltage distribution services, even though they are physically connected to the high-voltage grid. As a result, revenues from large industrial consumers are a source for subsidization of other groups of electricity consumers, including the population. Direct access to high-voltage tariffs would lead to a drop in ROSSETI's revenues. The Energy Ministry has estimated a loss of more than RUB 50 bln should the last-mile regulation system be canceled.

Situation under control until mid-2017. According to current energy regulation laws, the last-mile issue will remain until July 1, 2017 in the Republic of Karelia, the Republic of Mari-El and the Republic of Khakasia; in Belgorod, Volgograd, Kursk, Lipetsk, Nizhny Novgorod, Rostov, Tambov, Tomsk, Tyumen and Chelyabinsk regions; and in Khanty-Mansiisk and Yamalo-Nenets Autonomous Districts. This means that risks related to the last-mile issue are concentrated at MRSK North-West, MRSK Center, MRSK Urals, MRSK South, MRSK Center & Volga, and MRSK Siberia.

VALUATIONS

Discounts to peers remain substantial. Distribution companies remain heavily undervalued to international peers, trading at average discounts to emerging market peers of 69% on 2016 EV/EBITDA and 81% on 2016 P/E. We see the current discounts as unjustified for certain ROSSETI subsidiaries (**MOESK, MRSK Center, MRSK Center & Volga, MRSK Volga**), as their expected dividend yields suggest the discounts will tighten.

Russian companies trade with huge discounts to peers

COMPARATIVE VALUATION OF ELECTRICITY DISTRIBUTION COMPANIES												
COMPANY	COUNTRY	PRICE, \$	MCAP, \$ MLN	EV, \$ MLN	P/E				EV/EBITDA			
					2014	2015	2016E	2017E	2014E	2015	2016E	2017E
ROSSETI	Russia	0.011	2,170	14,750	n/m	1.7	1.5	1.3	3.9	3.9	3.8	3.7
FGC	Russia	0.002	2,936	6,904	n/m	4.3	3.2	3.8	3.9	4.3	4.0	3.8
MOESK	Russia	0.014	676	1,829	5.3	3.4	4.2	3.5	2.8	2.6	2.6	2.4
MRSK North-West	Russia	0.001	67	236	n/m	5.3	5.2	3.0	3.4	3.0	2.7	2.6
MRSK Center & Volga	Russia	0.001	141	353	n/m	2.6	3.4	2.4	3.0	2.7	2.5	2.3
MRSK Center	Russia	0.004	160	658	n/m	11.2	3.1	2.4	2.8	3.3	3.0	2.9
MRSK South	Russia	0.001	31	367	n/m	2.9	3.8	1.5	4.7	4.3	4.4	4.1
MRSK Siberia	Russia	0.001	76	320	n/m	n/m	5.6	4.3	2.0	2.7	2.8	2.3
MRSK Volga	Russia	0.001	89	236	7.1	4.5	3.7	2.4	2.6	2.0	1.9	1.8
MRSK Urals	Russia	0.002	176	349	5.4	7.6	5.4	4.0	2.4	2.2	2.1	2.0
Average					5.9	4.8	3.9	2.8	3.1	3.1	3.0	2.8
Discount to DM, %					69	72	79	84	73	74	75	76
Discount to EM, %					57	80	81	67	72	74	69	51
DEVELOPED MARKET PEERS												
United Utilities	UK	13.979	9,532	19,269	19.5	17.7	20.2	20.9	11.7	12.1	13.6	13.2
Severn Trent	UK	32.989	7,907	14,892	23.4	22.3	22.7	22.8	10.9	11.3	12.5	12.2
Snam Rete Gas	Italy	5.753	20,141	35,555	17.7	15.2	17.1	16.2	11.8	11.3	12.0	11.7
Terna Spa	Italy	5.567	11,190	20,720	20.0	17.0	17.7	16.6	13.0	12.0	12.0	11.5
Elia	Belgium	51.073	3,103	5,911	16.5	16.3	16.2	14.3	11.0	16.4	14.4	13.5
REN	Portugal	2.954	1,578	4,422	13.1	12.4	14.3	13.8	8.1	8.1	8.4	8.4
Red Electrica	Spain	88.842	12,018	18,283	18.9	17.8	16.6	16.1	11.6	11.3	11.0	10.8
ITC Holdings	US	44.520	6,807	11,354	23.1	21.1	21.3	20.6	14.7	13.9	13.1	12.1
Average					19.0	17.5	18.3	17.7	11.6	12.1	12.1	11.7
EMERGING MARKET PEERS												
CIA de Transmissao	Brazil	16.948	2,709	2,928	19.3	39.1	23.1	9.0	19.0	27.7	19.4	7.6
Transelectrica SA	Romania	7.454	546	487	6.6	6.6	7.9	7.5	2.6	2.6	2.9	2.9
Transener	Argentina	0.463	206	281	-	37.2	35.8	7.6	-	7.0	6.1	4.4
Power Grid	India	2.211	11,568	26,710	15.3	14.1	12.7	10.5	12.4	11.0	9.8	8.1
Average					13.7	24.3	19.9	8.6	11.3	12.1	9.6	5.8

Source: Bloomberg, company data, Gazprombank estimates

Our approach to target price calculation. We set our target prices based on expected dividends for 2016, assuming that the fair yield lies in a range of 9-12% for individual companies. Our core assumption is that the government will continue to require that ROSSETI and its subsidiaries pay generous dividends in order to mitigate pressure on federal budget spending. In other words, the government will not inject cash into the capital of ROSSETI, while the latter will redistribute cash received in dividends among its subsidiaries in need of capital injections and shareholders of the parent company, including the government, which currently owns an 85% stake in ROSSETI.

ROSSETI SOTP. ROSSETI's current valuation implies a 43% discount to its SOTP value. We consider this valuation discount as justified, as ROSSETI is likely to pay dividends totaling just a fraction of total dividends collected from its subsidiaries. In particular, our valuation of ROSSETI assumes that the company will distribute 50% of total dividends collected from its subsidiaries as dividends from the parent company.

COMFORTABLE DEBT BURDEN

Increase of dividend payout will not weigh on credit quality. ROSSETI's net debt/EBITDA stood at 2.0x as of end 2015, with the company's net debt amounting to RUB 487.2 bln. Based on our expectations, the increase of the dividend payout will raise the debt burden to RUB 533.5 bln by end 2017. In our view, the current level of ratings at BB+/Ba2/- is not at risk, as the company's net debt/EBITDA will remain below 3.0x. The state remains the core shareholder of ROSSETI and the company's current ratings are limited not by financial performance, but rather by the sovereign rating.

TARGET PRICE UPDATE

Federal Grid Company

Backbone of the Russian grid

Federal Grid Company

Federal Grid Company (FGC), one of Russia's key infrastructure companies, is controlled by ROSSETI, which holds an 80% stake. FGC provides high-voltage transmission services for Russia's unified energy system. Based on our assumptions and expectations of a future dividend payout totaling 50% of adjusted IFRS net income, the dividend yield may reach 8.7% in 2017.

Pros

- ▶ FGC is a key infrastructure company providing reliable services that will always be in demand. The company operates throughout Russia and has a highly reliable source of revenues.
- ▶ The company holds a 19% stake in Inter RAO, which might serve as an additional source of cash.
- ▶ FGC paid the most generous dividends in the sector for 2015.

Cons

- ▶ Attempts to meet the company's capex plan may force FGC to borrow in order to meet its dividend payout targets.
- ▶ Regulatory risks have reduced investor interest in the sector in general and FGC in particular, but the company's sound dividend story eases the focus on such risks.

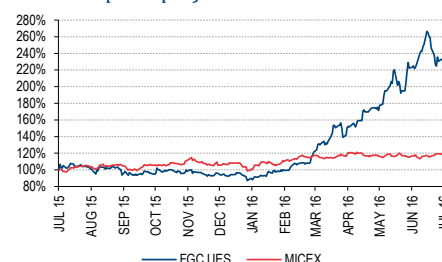
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Upside	-3%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

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Net debt, \$ mln	3,968
EV, \$ mln	6,904
52-week high, RUB	0.17
52-week low, RUB	0.05

Source: Bloomberg

FGC share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2013	2014	2015	2016E	2017E	2018E
Revenues	164,125	181,586	191,042	201,908	211,730	219,209
EBITDA	89,940	105,655	103,225	109,046	114,891	118,794
EBITDA margin	54.8%	58.2%	54.0%	54.0%	54.3%	54.2%
Net income	-234,771	-20,601	44,098	48,601	48,977	49,018
EV/EBITDA, x	5.0	3.9	4.3	4.0	3.8	3.7
P/E, x	nm	nm	4.3	3.9	3.8	3.8

Source: company data, Gazprombank estimates

Valuation multiples

	2014	2015	2016E	2017E
P/E, x	nm	4.3	3.9	3.8
EV/EBITDA, x	3.9	4.3	4.0	3.8
EV/Revenues, x	2.2	2.3	2.2	2.1
Dividend yield	0.0%	0.7%	9.1%	8.7%
FCF yield	8.6%	12.0%	9.2%	12.9%

Income statement, RUB mln

	2014	2015	2016E	2017E
Revenues	181,586	191,042	201,908	211,730
Operating costs	-126,137	-130,963	-135,942	-142,378
incl. SG&A	0	0	0	0
DD&A	-47,138	-39,447	-41,231	-43,690
EBITDA	105,655	103,225	109,046	114,891
Operating profit	-15,326	57,229	64,541	67,927
Financial income net	-1,179	-934	-3,791	-6,705
Pretax profit	-22,513	56,287	60,751	61,221
Income tax	1,912	-12,189	-12,150	-12,244
Net income	-20,601	44,098	48,601	48,977
EPS	-0.02	0.03	0.04	0.04

Key margins

	2014	2015	2016E	2017E
EBIT	-8.4%	30.0%	32.0%	32.1%
EBITDA	58.2%	54.0%	54.0%	54.3%
Net income	-11.3%	23.1%	24.1%	23.1%

Balance sheet statement, RUB mln

	2014	2015	2016E	2017E
Cash and equivalents	42,068	28,176	6,085	904
Accounts receivable	55,912	50,043	52,889	55,462
Inventories	10,446	16,063	16,063	16,063
Total current assets	110,821	125,261	106,016	103,408
PP&E	795,029	821,114	872,653	918,799
Total assets	935,175	995,328	1,027,622	1,071,160
Short-term debt	29,686	31,466	31,466	31,466
Accounts payable	89,316	71,036	71,706	72,625
Total current liabilities	119,113	102,563	103,233	104,152
Long-term debt	233,291	250,076	250,076	260,076
Total non-current liabilities	242,831	273,127	273,127	283,127
Total shareholders' equity	573,231	619,638	651,262	683,881
Minority interest	0	0	0	0
Total liabilities and equity	935,175	995,328	1,027,622	1,071,160

Cash flow statement, RUB mln

	2014	2015	2016E	2017E
Operating cash flow	89,726	98,023	91,446	97,719
incl. changes of w/c	-11,960	-13,672	-9,239	-8,717
Investing cash flow	-73,612	-75,604	-74,250	-73,575
incl. CAPEX	-73,612	-75,604	-74,250	-73,575
Financing cash flow	-44,513	-14,673	-39,287	-29,325
Change in cash	20,441	-13,892	-22,091	-5,181
Free cash flow	16,114	22,419	17,196	24,144

Key leverage data, RUB mln

	2014	2015	2016E	2017E
Total debt	262,977	281,542	281,542	291,542
Net debt	220,909	253,366	275,457	290,638
Total debt/Equity, x	0.5	0.5	0.4	0.4
Net debt/EBITDA, x	2.1	2.5	2.5	2.5

Source: company data, Gazprombank estimates

TARGET PRICE UPDATE

MOESK

Power provider for Russia's 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 for 2016 to reach 11.9%, one of the highest levels among distribution peers. We have an OVERWEIGHT recommendation on MOESK with a target price of RUB 1.20 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 well above the average level of domestic income.
- ▶ MOESK is the largest company within ROSSETI holding. The company's electricity output in 2015 totaled 87.6 mln MWh, equal to 14% of ROSSETI's aggregate electricity output.
- ▶ The company has a reliable client base. Moscow and Moscow region comprise 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 seeking direct contracts with FGC.
- ▶ The company has a long dividend history. MOESK regularly pays dividends based on RAS net income, with the payout ratio set at 25%. However, dividends for last year were calculated based on 50% of IFRS net income. We forecast the dividend yield for 2016 at an attractive 11.9%.

Cons

- ▶ MOESK faces one of the heaviest investment programs in the sector. In 2016, the company's capex is expected to rise 22% to RUB 34.5 bln.

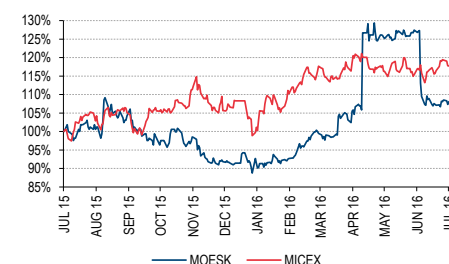
TICKER	MSRS RX
Closing price, RUB	0.89
Target price, RUB	1.20
Upside	35%
Recommendation	OVERWEIGHT

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	676
Net debt, \$ mln	1,153
EV, \$ mln	1,829
52-week high, RUB	1.06
52-week low, RUB	0.73

Source: Bloomberg

MOESK share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2013	2014	2015	2016E	2017E	2018E
Revenues	129,125	128,018	132,356	139,877	147,960	155,850
EBITDA	44,446	40,589	44,686	42,878	45,397	48,683
EBITDA margin	34.4%	31.7%	33.8%	30.7%	30.7%	31.2%
Net income	18,927	8,078	12,631	10,314	12,321	14,157
EV/EBITDA, x	2.2	2.8	2.6	2.7	2.6	2.4
P/E, x	2.3	5.3	3.4	4.2	3.5	3.0

Source: company data, Gazprombank estimates

Valuation multiples

	2014	2015	2016E	2017E
P/E, x	5.3	3.4	4.2	3.5
EV/EBITDA, x	2.8	2.6	2.7	2.6
EV/Revenues, x	0.9	0.9	0.8	0.8
Dividend yield	4.5%	4.8%	14.6%	11.9%
FCF yield	-11.2%	13.5%	14.1%	16.8%

Income statement, RUB mln

	2014	2015	2016E	2017E
Revenues	128,018	132,356	139,877	147,960
Operating costs	-119,827	-111,486	-121,842	-128,362
incl. SG&A	0	0	0	0
DD&A	-20,593	-20,770	-21,815	-22,771
EBITDA	40,589	44,686	42,878	45,397
Operating profit	14,399	23,898	21,063	22,626
Financial income net	-2,994	-4,258	-7,312	-6,198
Pretax profit	11,406	19,640	13,752	16,428
Income tax	-3,327	-7,010	-3,438	-4,107
Net income	8,078	12,631	10,314	12,321
EPS	0.17	0.26	0.21	0.25

Key margins

	2014	2015	2016E	2017E
EBIT	11.2%	18.1%	15.1%	15.3%
EBITDA	31.7%	33.8%	30.7%	30.7%
Net income	6.3%	9.5%	7.4%	8.3%

Balance sheet statement, RUB mln

	2014	2015	2016E	2017E
Cash and equivalents	4,304	400	2,876	1,781
Accounts receivable	23,408	25,897	25,876	27,457
Inventories	2,295	2,650	2,844	3,000
Total current assets	30,558	29,149	31,798	32,441
PP&E	273,668	289,912	302,615	314,972
Total assets	310,583	325,618	340,970	353,970
Short-term debt	21,554	8,148	8,148	8,148
Accounts payable	52,800	51,646	53,001	55,837
Total current liabilities	76,393	61,792	63,148	65,984
Long-term debt	52,730	65,874	75,874	78,874
Total non-current liabilities	75,165	94,593	104,593	107,593
Total shareholders' equity	159,026	169,233	173,229	180,393
Minority interest	0	0	0	0
Total liabilities and equity	310,583	325,618	340,970	353,970

Cash flow statement, RUB mln

	2014	2015	2016E	2017E
Operating cash flow	35,889	33,990	40,624	42,388
incl. changes of w/c	-1,778	-3,277	-310	-394
Investing cash flow	-40,738	-28,174	-34,518	-35,128
incl. CAPEX	-40,738	-28,174	-34,518	-35,128
Financing cash flow	7,558	-9,720	-3,629	-8,355
Change in cash	2,709	-3,905	2,476	-1,095
Free cash flow	-4,849	5,816	6,105	7,260

Key leverage data, RUB mln

	2014	2015	2016E	2017E
Total debt	74,284	74,021	84,021	87,021
Net debt	69,979	73,621	81,145	85,240
Total debt/Equity, x	0.5	0.4	0.5	0.5
Net debt/EBITDA, x	1.7	1.6	1.9	1.9

Source: company data, Gazprombank estimates

TARGET PRICE UPDATE

MRSK Center

Access to central Russian infrastructure

MRSK Center owns the 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%. MRSK Center offers shareholders an attractive expected dividend yield of 16.0% for 2016. For this reason, we have an OVERWEIGHT recommendation on the stock.

Pros

- **Net electricity output** in 2015 totaled 62.6 mln MWh, making MRSK Center the fifth-largest distribution company in Russia by volume of electricity distribution.
- **Strong dividend outlook for 2016.** Given our IFRS forecast and potential payout of 50% of IFRS net income for 2016, we expect the dividend yield for 2015 to be 15.9%.
- **Capex.** We estimate capex for 2016 at RUB 13.3 bln, while EBITDA should total RUB 17.2 bln.

Cons

- **Last-mile issue.** The company has exposure to the last-mile issue, by which large industrial consumers may switch to direct contracts with FGC. This poses a threat to the company's financials after mid-2017.

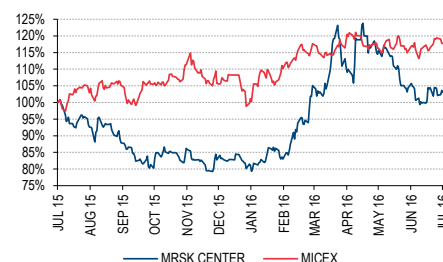
TICKER	MRKC RX
Closing price, RUB	0.24
Target price, RUB	0.39
Upside	60%
Recommendation	OVERWEIGHT

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	160
Net debt, \$ mln	658
EV, \$ mln	818
52-week high, RUB	0.29
52-week low, RUB	0.19

Source: Bloomberg

MRSK Center share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2013	2014	2015	2016E	2017E	2018E
Revenues	93,297	86,992	80,830	87,443	92,857	98,175
EBITDA	21,214	16,880	15,616	17,154	18,304	19,412
EBITDA margin	22.7%	19.4%	19.3%	19.6%	19.7%	19.8%
Net income	-57	-3,285	881	3,267	4,320	4,908
EV/EBITDA, x	2.0	2.8	3.3	3.0	2.9	2.7
P/E, x	nm	nm	11.6	3.1	2.4	2.1

Source: company data, Gazprombank estimates

Valuation multiples

	2014	2015	2016E	2017E
P/E, x	nm	11.6	3.1	2.4
EV/EBITDA, x	2.8	3.3	3.0	2.9
EV/Revenues, x	0.5	0.6	0.6	0.6
Dividend yield	0.7%	8.1%	4.5%	16.0%
FCF yield	3.9%	1.2%	3.6%	4.6%

Income statement, RUB mln

	2014	2015	2016E	2017E
Revenues	86,992	80,830	87,443	92,857
Operating costs	-88,940	-75,204	-80,844	-85,597
incl. SG&A	0	0	0	0
DD&A	-8,572	-7,813	-9,106	-9,596
EBITDA	16,880	15,616	17,154	18,304
Operating profit	-749	7,074	8,047	8,709
Financial income net	-2,649	-4,274	-3,963	-3,308
Pretax profit	-3,398	2,801	4,084	5,400
Income tax	114	-1,920	-817	-1,080
Net income	-3,285	881	3,267	4,320
EPS	-0.08	0.02	0.01	0.10

Key margins

	2014	2015	2016E	2017E
EBIT	-0.9%	8.8%	9.2%	9.4%
EBITDA	19.4%	19.3%	19.6%	19.7%
Net income	-3.8%	1.1%	3.7%	4.7%

Balance sheet statement, RUB mln

	2014	2015	2016E	2017E
Cash and equivalents	396	123	372	475
Accounts receivable	16,272	16,762	16,629	17,751
Inventories	1,809	2,012	2,159	2,278
Total current assets	19,479	20,274	20,536	21,880
PP&E	73,086	77,639	81,812	85,679
Total assets	93,794	100,449	104,884	110,095
Short-term debt	9,610	1,677	1,677	1,677
Accounts payable	9,202	8,312	8,935	9,460
Total current liabilities	20,539	13,224	13,847	14,372
Long-term debt	27,670	40,435	41,435	43,435
Total non-current liabilities	34,323	48,339	49,339	51,339
Total shareholders' equity	38,932	38,886	41,698	44,384
Minority interest	0	0	0	0
Total liabilities and equity	93,794	100,449	104,884	110,095

Cash flow statement, RUB mln

	2014	2015	2016E	2017E
Operating cash flow	10,779	13,517	16,947	16,508
incl. changes of w/c	-4,909	-2,160	-895	-2,221
Investing cash flow	-12,345	-13,243	-13,279	-13,463
incl. CAPEX	-12,477	-13,579	-13,279	-13,463
Financing cash flow	847	-547	-3,419	-2,942
Change in cash	-719	-273	249	103
Free cash flow	396	123	372	475

Key leverage data, RUB mln

	2014	2015	2016E	2017E
Total debt	37,280	42,112	43,112	45,112
Net debt	36,884	41,989	42,740	44,637
Total debt/Equity, x	1.0	1.1	1.0	1.0
Net debt/EBITDA, x	2.2	2.7	2.5	2.4

Source: company data, Gazprombank estimates

TARGET PRICE UPDATE

MRSK Center & Volga

Flexible approach to changing environment

MRSK Center & 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, metals producers, chemical manufacturers, woodworkers, transportation and agriculture companies, and households. Its share of electricity distribution in regions of operation stood at 72%. We have an OVERWEIGHT recommendation on MRSK Center & Volga shares due to their attractive expected dividend yield for 2016 of 14.9%.

Pros

- ▶ MRSK Center & Volga's electricity transmission volumes amounted to 53.0 mln MWh, ranking the company sixth among regional distribution companies controlled by ROSSETI.
- ▶ The coverage area of MRSK Center & 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 & Volga has a long history of regular dividend payments.
- ▶ The company's flexible investment program for 2016 allows it to generate positive FCF.

Cons

- ▶ Electricity losses account for 9.07% of total output, above the weighted-average loss of 8.47%.

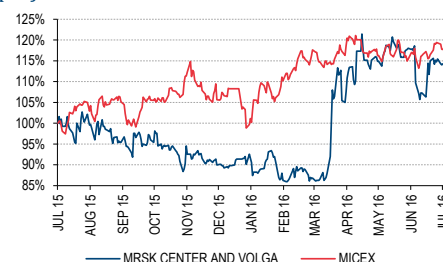
TICKER	MRKP RX
Closing price, RUB	0.080
Target price, RUB	0.118
Upside	48%
Recommendation	OVERWEIGHT

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	141
Net debt, \$ mln	353
EV, \$ mln	494
52-week high, RUB	0.085
52-week low, RUB	0.060

Source: Bloomberg

MRSK Center & Volga share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2013	2014	2015	2016E	2017E	2018E
Revenues	77,856	70,160	69,624	75,114	79,651	84,100
EBITDA	12,466	11,182	11,795	12,848	13,537	14,575
EBITDA margin	16.0%	15.9%	16.9%	17.1%	17.0%	17.3%
Net income	1,651	-1,630	3,414	2,684	3,752	4,510
EV/EBITDA, x	2.3	3.0	2.6	2.4	2.3	2.1
P/E, x	5.5	nm	2.6	3.4	2.4	2.0

Source: company data, Gazprombank estimates

Valuation multiples

	2014	2015	2016E	2017E
P/E, x	nm	2.6	3.4	2.4
EV/EBITDA, x	3.0	2.6	2.4	2.3
EV/Revenues, x	0.5	0.4	0.4	0.4
Dividend yield	7.0%	3.9%	10.5%	14.9%
FCF yield	-3.9%	25.1%	59.8%	36.0%

Income statement, RUB mln

	2014	2015	2016E	2017E
Revenues	70,160	69,624	75,114	79,651
Operating costs	-69,237	-62,861	-69,631	-73,376
incl. SG&A	2	3	4	5
DD&A	-5,986	-5,689	-5,918	-5,815
EBITDA	11,182	11,795	12,848	13,537
Operating profit	923	6,763	5,483	6,275
Financial income net	-1,867	-2,202	-2,128	-1,585
Pretax profit	-943	4,562	3,355	4,689
Income tax	-686	-1,147	-671	-938
Net income	-1,630	3,414	2,684	3,752
EPS	-0.01	0.03	0.02	0.03

Key margins

	2014	2015	2016E	2017E
EBIT	1.3%	9.7%	7.3%	7.9%
EBITDA	15.9%	16.9%	17.1%	17.0%
Net income	-2.3%	4.9%	3.6%	4.7%

Balance sheet statement, RUB mln

	2014	2015	2016E	2017E
Cash and equivalents	2,300	2,555	4,873	5,189
Accounts receivable	12,174	13,100	12,631	13,439
Inventories	1,464	1,649	1,769	1,867
Total current assets	18,607	17,610	19,580	20,800
PP&E	58,438	60,006	60,124	61,718
Total assets	78,175	78,772	80,859	83,674
Short-term debt	7,018	10,862	10,862	10,862
Accounts payable	10,045	9,110	9,456	9,861
Total current liabilities	18,574	21,749	22,096	22,501
Long-term debt	19,828	13,933	13,933	13,933
Total non-current liabilities	27,351	22,274	22,274	22,274
Total shareholders' equity	32,250	34,748	36,490	38,899
Minority interest	0	0	0	0
Total liabilities and equity	78,175	78,772	80,859	83,674

Cash flow statement, RUB mln

	2014	2015	2016E	2017E
Operating cash flow	7,912	7,506	11,424	10,651
incl. changes of w/c	-2,390	-3,598	-752	-1,948
Investing cash flow	-9,802	-2,832	-6,035	-7,409
incl. CAPEX	-8,259	-5,248	-6,035	-7,409
Financing cash flow	900	-4,419	-3,070	-2,928
Change in cash	-990	254	2,319	315
Free cash flow	-347	2,259	5,389	3,243

Key leverage data, RUB mln

	2014	2015	2016E	2017E
Total debt	26,846	24,795	24,795	24,795
Net debt	24,546	22,240	19,921	19,606
Total debt/Equity, x	0.8	0.7	0.7	0.6
Net debt/EBITDA, x	2.2	1.9	1.6	1.4

Source: company data, Gazprombank estimates

TARGET PRICE UPDATE

MRSK Urals

Infrastructure in industrialized regions

MRSK Urals is an electricity distribution company operating 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 stock in view of its fair dividend yield of 9.3% for 2016.

Pros

- ▶ MRSK Urals' electricity distribution in 2015 totaled 76.2 mln MWh, ranking the company second in terms of electricity distribution volumes among ROSSETI subsidiaries.
- ▶ 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.
- ▶ We forecast MRSK Urals' dividend yield for 2016 at a fair level of 9.3%, supporting our NEUTRAL recommendation on the stock.

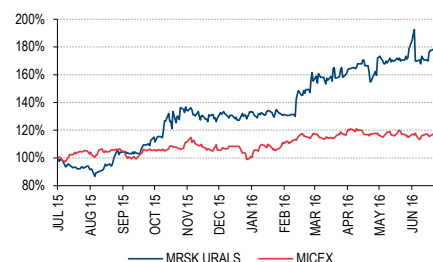
TICKER	MRKU RX
Closing price, RUB	0.128
Target price, RUB	0.108
Upside	-15%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	176
Net debt, \$ mln	173
EV, \$ mln	349
52-week high, RUB	0.140
52-week low, RUB	0.063

Source: Bloomberg

MRSK Urals share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2013	2014	2015	2016E	2017E	2018E
Revenues	65,523	68,975	69,672	74,888	79,763	83,685
EBITDA	7,328	8,917	10,128	10,715	11,296	11,561
EBITDA margin	11.2%	12.9%	14.5%	14.3%	14.2%	13.8%
Net income	-1,100	2,055	1,478	2,084	2,811	3,050
EV/EBITDA, x	3.2	2.4	2.2	2.1	2.0	1.9
P/E, x	nm	5.4	7.6	5.4	4.0	3.7

Source: company data, Gazprombank estimates

Valuation multiples

	2014	2015	2016E	2017E
P/E, x	5.4	7.6	5.4	4.0
EV/EBITDA, x	2.4	2.2	2.1	2.0
EV/Revenues, x	0.3	0.3	0.3	0.3
Dividend yield	0.8%	4.5%	11.1%	9.3%
FCF yield	25.9%	11.0%	45.4%	31.5%

Income statement, RUB mln

	2014	2015	2016E	2017E
Revenues	68,975	69,672	74,888	79,763
Operating costs	-67,798	-68,215	-72,080	-76,322
incl. SG&A	0	0	0	0
DD&A	-5,711	-5,924	-5,924	-5,872
EBITDA	8,917	10,128	10,715	11,296
Operating profit	3,070	2,676	4,027	4,660
Financial income net	-689	-750	-1,422	-1,146
Pretax profit	2,381	1,925	2,605	3,513
Income tax	-326	-447	-521	-703
Net income	2,055	1,478	2,084	2,811
EPS	0.02	0.02	0.02	0.03

Key margins

	2014	2015	2016E	2017E
EBIT	4.5%	3.8%	5.4%	5.8%
EBITDA	12.9%	14.5%	14.3%	14.2%
Net income	3.0%	2.1%	2.8%	3.5%

Balance sheet statement, RUB mln

	2014	2015	2016E	2017E
Cash and equivalents	3,665	4,291	6,708	8,040
Accounts receivable	9,355	9,850	9,393	10,054
Inventories	637	710	762	803
Total current assets	13,951	15,205	17,217	19,252
PP&E	62,075	60,913	60,380	60,812
Total assets	76,723	77,359	78,838	81,305
Short-term debt	2,634	7,761	7,761	7,761
Accounts payable	9,948	11,235	11,872	12,570
Total current liabilities	16,453	21,972	22,609	23,307
Long-term debt	11,526	7,525	7,525	7,525
Total non-current liabilities	18,429	14,027	14,027	14,027
Total shareholders' equity	41,841	41,360	42,202	43,971
Minority interest	0	0	0	0
Total liabilities and equity	76,723	77,359	78,838	81,305

Cash flow statement, RUB mln

	2014	2015	2016E	2017E
Operating cash flow	11,761	8,563	10,471	9,825
incl. changes of w/c	646	-2,143	277	-768
Investing cash flow	-8,860	-7,336	-5,392	-6,304
incl. CAPEX	-8,860	-7,336	-5,392	-6,304
Financing cash flow	-1,228	-600	-2,663	-2,189
Change in cash	1,673	626	2,416	1,332
Free cash flow	2,901	1,227	5,080	3,521

Key leverage data, RUB mln

	2014	2015	2016E	2017E
Total debt	14,160	15,286	15,286	15,286
Net debt	10,494	10,994	8,578	7,246
Total debt/Equity, x	0.3	0.4	0.4	0.3
Net debt/EBITDA, x	1.2	1.1	0.8	0.6

Source: company data, Gazprombank estimates

TARGET PRICE UPDATE

MRSK Volga

Mid-sized and highly efficient

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. We expect the company to pay attractive dividends for 2016 currently yielding 13.1%. We have an OVERWEIGHT recommendation on MRSK Volga shares.

Pros

- ▶ MRSK Volga has an electricity loss rate of 6.7% of total electricity output. This is one of the lowest figures among distribution companies within ROSSETI Holding, which has a weighted-average electricity loss rate of 8.47%.
- ▶ The company's total electricity output amounted to 52.9 mln MWh in 2015, ranking MRSK Volga seventh among distribution companies within ROSSETI Holding.
- ▶ MRSK Volga reduced its capex in 2015 by 49%, which helped the company to generate substantial FCF. We expect MRSK Volga to remain FCF-positive going forward.
- ▶ We expect MRSK Volga to pay dividends totaling 50% of 2016 IFRS net income, making the company an attractive dividend story with a target yield of 12.6%.

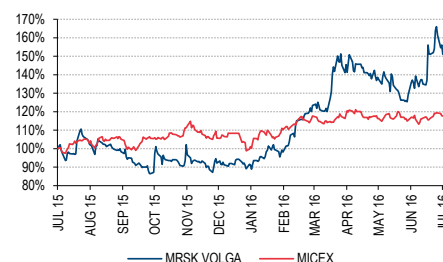
TICKER	MRKV RX
Closing price, RUB	0.032
Target price, RUB	0.042
Upside	31%
Recommendation	OVERWEIGHT

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	89
Net debt, \$ mln	147
EV, \$ mln	236
52-week high, RUB	0.035
52-week low, RUB	0.018

Source: Bloomberg

MRSK Volga share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2013	2014	2015	2016E	2017E	2018E
Revenues	49,202	46,156	47,991	51,993	55,270	58,486
EBITDA	6,537	7,103	7,713	7,793	8,434	9,324
EBITDA margin	13.3%	15.4%	16.1%	15.0%	15.3%	15.9%
Net income	1,261	808	1,268	1,532	2,406	3,306
EV/EBITDA, x	2.8	2.6	2.0	1.9	1.8	1.6
P/E, x	4.5	7.1	4.5	3.7	2.4	1.7

Source: company data, Gazprombank estimates

Valuation multiples

	2014	2015	2016E	2017E
P/E, x	7.1	4.5	3.7	2.4
EV/EBITDA, x	2.6	2.0	1.9	1.8
EV/Revenues, x	0.4	0.3	0.3	0.3
Dividend yield	0.3%	0.3%	4.0%	13.1%
FCF yield	24.2%	80.7%	93.6%	77.4%

Income statement, RUB mln

	2014	2015	2016E	2017E
Revenues	46,156	47,991	51,993	55,270
Operating costs	-44,186	-45,251	-49,026	-51,413
incl. SG&A	0	0	0	0
DD&A	-5,008	-4,795	-4,825	-4,577
EBITDA	7,103	7,713	7,793	8,434
Operating profit	2,095	2,917	2,968	3,857
Financial income net	-956	-1,215	-1,053	-849
Pretax profit	1,139	1,702	1,915	3,008
Income tax	-332	-434	-383	-602
Net income	808	1,268	1,532	2,406
EPS	0.00	0.01	0.01	0.01

Key margins

	2014	2015	2016E	2017E
EBIT	4.5%	6.1%	5.7%	7.0%
EBITDA	15.4%	16.1%	15.0%	15.3%
Net income	1.7%	2.6%	2.9%	4.4%

Balance sheet statement, RUB mln

	2014	2015	2016E	2017E
Cash and equivalents	1,258	1,958	6,013	8,812
Accounts receivable	6,377	6,855	6,427	6,895
Inventories	1,227	1,257	1,348	1,422
Total current assets	9,163	10,221	13,939	17,281
PP&E	42,326	39,983	37,925	36,451
Total assets	52,279	51,036	52,696	54,563
Short-term debt	1,919	3,623	3,623	3,623
Accounts payable	5,249	4,301	4,659	4,886
Total current liabilities	8,205	9,530	9,889	10,116
Long-term debt	12,000	7,700	7,700	7,700
Total non-current liabilities	17,053	13,321	13,321	13,321
Total shareholders' equity	27,021	28,185	29,486	31,127
Minority interest	0	0	0	0
Total liabilities and equity	52,279	51,036	52,696	54,563

Cash flow statement, RUB mln

	2014	2015	2016E	2017E
Operating cash flow	6,568	7,240	8,105	7,517
incl. changes of w/c	-1,305	-676	-305	-1,315
Investing cash flow	-5,185	-2,634	-2,767	-3,103
incl. CAPEX	-5,185	-2,634	-2,767	-3,103
Financing cash flow	-1,181	-3,906	-1,284	-1,615
Change in cash	202	700	4,055	2,799
Free cash flow	1,383	4,606	5,338	4,414

Key leverage data, RUB mln

	2014	2015	2016E	2017E
Total debt	13,919	11,323	11,323	11,323
Net debt	12,661	9,365	5,310	2,511
Total debt/Equity, x	0.5	0.4	0.4	0.4
Net debt/EBITDA, x	1.8	1.2	0.7	0.3

Source: company data, Gazprombank estimates

REINITIATION OF COVERAGE

MRSK North-West

Access to north European part of Russia

MRSK North-West provides distribution service in the Republics of Karelia and Komi, and the regions of Murmansk, Arkhangelsk, Vologda, Novgorod and Pskov. The company controls 76% of the country's electricity distribution market. ROSSETI is the controlling shareholder with a 55.3% stake. We expect the company to continue dividend payments next year and have a NEUTRAL recommendation on the stock due to its fair expected dividend yield of 9.7% for 2016.

Pros

- ▶ **Mid-sized company.** MRSK North-West's distribution in 2015 amounted to 39.5 mln MWh, ranking the company eighth among distribution subsidiaries of ROSSETI.
- ▶ **FCF positive.** MRSK North-West reported positive free cash flow for 2015 and we expect this positive dynamic to continue in the near term, as capex is unlikely to increase substantially this year.
- ▶ **Emerging dividend story.** MRSK North-West began paying dividends this year and we expect the company to continue this practice. We forecast the dividend yield for 2016 at a fair level of 9.5%.

Cons

- ▶ **Dependence on large consumer.** Severstal is one of the largest consumers of MRSK North-West, and the potential switch of the steel giant to direct contracts with FGC poses a risk for the company's financials in 2017.

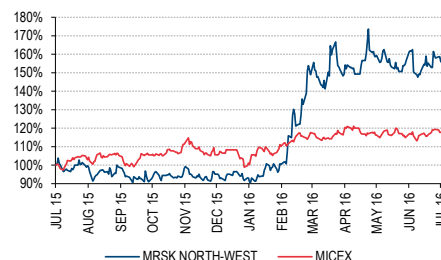
TICKER	MRKZ RX
Closing price, RUB	0.045
Target price, RUB	0.039
Upside	-12%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA	
MCap, \$ mln	67
Net debt, \$ mln	236
EV, \$ mln	303
52-week high, RUB	0.050
52-week low, RUB	0.026

Source: Bloomberg

MRSK North-West share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2013	2014	2015	2016E	2017E	2018E
Revenues	44,683	46,935	42,370	45,842	48,737	51,495
EBITDA	5,700	6,472	6,514	7,064	7,489	7,808
EBITDA margin	12.8%	13.8%	15.4%	15.4%	15.4%	15.2%
Net income	387	-2,217	814	831	1,415	1,647
EV/EBITDA, x	3.5	3.4	3.0	2.7	2.6	2.5
P/E, x	11.1	nm	5.3	5.2	3.0	2.6

Source: company data, Gazprombank estimates

Valuation multiples

	2014	2015	2016E	2017E
P/E, x	nm	5.3	5.2	3.0
EV/EBITDA, x	3.4	3.0	2.7	2.6
EV/Revenues, x	0.5	0.5	0.4	0.4
Dividend yield	0.0%	0.0%	9.5%	9.7%
FCF yield	64.6%	98.1%	60.1%	26.0%

Income statement, RUB mln

	2014	2015	2016E	2017E
Revenues	46,935	42,370	45,842	48,737
Operating costs	-47,593	-40,479	-43,395	-45,832
incl. SG&A	0	0	0	0
DD&A	-4,092	-4,001	-4,001	-3,968
EBITDA	6,472	6,514	7,064	7,489
Operating profit	-517	1,897	2,447	2,905
Financial income net	-2,897	-1,765	-1,408	-1,136
Pretax profit	-2,501	1,079	1,038	1,769
Income tax	284	-265	-208	-354
Net income	-2,217	814	831	1,415
EPS	-0.02	0.01	0.01	0.01

Key margins

	2014	2015	2016E	2017E
EBIT	-1.1%	4.5%	5.3%	6.0%
EBITDA	13.8%	15.4%	15.4%	15.4%
Net income	-4.7%	1.9%	1.8%	2.9%

Balance sheet statement, RUB mln

	2014	2015	2016E	2017E
Cash and equivalents	1,038	71	841	407
Accounts receivable	14,655	15,500	16,154	17,213
Inventories	790	925	926	926
Total current assets	18,212	17,057	18,482	19,107
PP&E	35,276	35,474	35,177	36,108
Total assets	54,898	53,901	55,029	56,585
Short-term debt	3,539	5,204	5,204	5,204
Accounts payable	11,079	11,498	12,204	12,760
Total current liabilities	16,147	18,592	19,297	19,853
Long-term debt	14,913	9,941	9,941	9,941
Total non-current liabilities	18,892	14,747	14,747	14,747
Total shareholders' equity	19,859	20,562	20,986	21,985
Minority interest	0	0	0	0
Total liabilities and equity	54,898	53,901	55,029	56,585

Cash flow statement, RUB mln

	2014	2015	2016E	2017E
Operating cash flow	7,158	7,429	6,291	6,016
incl. changes of w/c	-337	176	-565	-1,119
Investing cash flow	-4,378	-3,209	-3,705	-4,899
incl. CAPEX	-4,378	-3,209	-3,705	-4,899
Financing cash flow	307	-5,188	-1,816	-1,551
Change in cash	199	-967	771	-434
Free cash flow	2,780	4,220	2,586	1,117

Key leverage data, RUB mln

	2014	2015	2016E	2017E
Total debt	18,452	15,145	15,145	15,145
Net debt	17,415	15,074	14,304	14,738
Total debt/Equity, x	0.9	0.7	0.7	0.7
Net debt/EBITDA, x	2.7	2.3	2.0	2.0

Source: company data, Gazprombank estimates

TARGET PRICE UPDATE

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 0.044 per share.

Pros

- ▶ Relatively low capex of RUB 1.7 bln in 2015 allowed MRSK South to generate positive FCF last 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 28.8 mln MWh in 2014. The company ranks tenth among distribution companies under the umbrella of ROSSETI.
- ▶ The company has one of the heaviest debt burdens in ROSSETI Holding. Net debt/EBITDA stands at more than 3.5x, whereas this metric does not exceed 3.0x for most distribution companies.

TICKER	MRKY RX
Closing price, RUB	0.040
Target price, RUB	0.044
Upside	9%
Recommendation	NEUTRAL

Source: Bloomberg, Gazprombank estimates

SELECTED STOCK DATA

MCap, \$ mln	31
Net debt, \$ mln	367
EV, \$ mln	398
52-week high, RUB	0.048
52-week low, RUB	0.030

Source: Bloomberg

MRSK South share price performance vs. MICEX Index



Source: Bloomberg

Key financials, RUB mln

	2013	2014	2015	2016E	2017E	2018E
Revenues	27,311	29,078	30,657	32,514	34,580	36,600
EBITDA	5,633	5,523	5,925	5,771	6,167	6,528
EBITDA margin	20.6%	19.0%	19.3%	17.7%	17.8%	17.8%
Net income	148	-6,784	687	521	1,286	1,849
EV/EBITDA, x	4.3	4.7	4.3	4.4	4.1	3.9
P/E, x	13.4	nm	2.9	3.8	1.5	1.1

Source: company data, Gazprombank estimates

Valuation multiples

	2014	2015	2016E	2017E
P/E, x	nm	2.9	3.8	1.5
EV/EBITDA, x	4.7	4.3	4.4	4.1
EV/Revenues, x	0.9	0.8	0.8	0.7
Dividend yield	0.0%	0.0%	7.2%	13.1%
FCF yield	26.7%	168.8%	196.9%	179.7%

Income statement, RUB mln

	2014	2015	2016E	2017E
Revenues	29,078	30,657	32,514	34,580
Operating costs	-35,558	-27,539	-29,909	-31,583
incl. SG&A	0	0	0	0
DD&A	-2,751	-2,347	-2,697	-2,691
EBITDA	5,523	5,925	5,771	6,167
Operating profit	-5,727	3,436	2,933	3,335
Financial income net	-2,228	-2,534	-2,282	-1,728
Pretax profit	-7,956	902	652	1,607
Income tax	1,172	-215	-130	-321
Net income	-6,784	687	521	1,286
EPS	-0.14	0.01	0.01	0.03

Key margins

	2014	2015	2016E	2017E
EBIT	-19.7%	11.2%	9.0%	9.6%
EBITDA	19.0%	19.3%	17.7%	17.8%
Net income	-23.3%	2.2%	1.6%	3.7%

Balance sheet statement, RUB mln

	2014	2015	2016E	2017E
Cash and equivalents	735	1,588	2,078	1,660
Accounts receivable	8,985	11,006	10,948	11,417
Inventories	676	748	803	847
Total current assets	10,633	13,668	14,155	14,250
PP&E	21,687	20,930	20,728	20,297
Total assets	34,064	36,324	36,609	36,273
Short-term debt	5,123	11,630	11,630	11,630
Accounts payable	9,417	10,522	11,428	12,067
Total current liabilities	16,256	24,123	25,029	25,668
Long-term debt	19,744	13,403	12,403	10,403
Total non-current liabilities	19,897	13,620	12,620	10,620
Total shareholders' equity	-2,089	-1,419	-1,040	-15
Minority interest	0	0	0	0
Total liabilities and equity	34,064	36,324	36,609	36,273

Cash flow statement, RUB mln

	2014	2015	2016E	2017E
Operating cash flow	1,862	5,077	6,408	5,831
incl. changes of w/c	-2,199	-15	768	-14
Investing cash flow	-1,331	-1,723	-2,494	-2,261
incl. CAPEX	-1,331	-1,723	-2,494	-2,261
Financing cash flow	-985	-2,502	-3,424	-3,988
Change in cash	-454	852	490	-417
Free cash flow	531	3,355	3,914	3,571

Key leverage data, RUB mln

	2014	2015	2016E	2017E
Total debt	24,867	25,033	24,033	22,033
Net debt	24,132	23,446	21,955	20,373
Total debt/Equity, x	-11.9	-17.6	-23.1	-1,478.8
Net debt/EBITDA, x	4.4	4.0	3.8	3.3

Source: company data, Gazprombank estimates

Research Department

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