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**MRKH:BUY**

**Stock data**

Shares Ords '000	42,217,941	Free float, %	33.3%
Shares Prefs '000	2,075,149	Free Float, \$ mn	2,462
Bid Ords, \$	0.1525	12-m TP ords, \$	<b>0.208</b>
Offer Ords, \$	0.154	Upside, %	35.4%
Bid Prefs, \$	0.065	TP prefs, \$	<b>0.145</b>
Offer Prefs, \$	0.13	Upside, %	49%
M.Cap, \$ mn	6,492	Rating	<b>BUY</b>

**Financials**

	2010E	2011E
Revenue, \$ mn	17,636	22,556
EBITDA, \$ mn	2,864	4,804
CAPEX, \$ mn	87,346	71,485

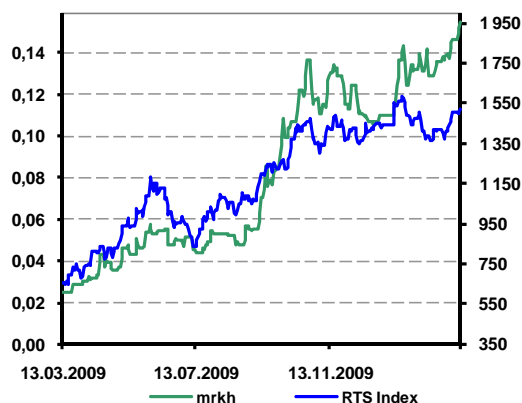
**Operative characteristics**

Length of grids, km	2,000,000
Output, mn kwh	650,000
IRAB, mn rub	1,005,713

**Market performance**

		1 month	6 months
Absolute	Ords	12.23 %	118.18%
Relative to RTSI	Ords	2.37%	71.68%
Price range, \$			
High	Ords	0.156	0.156
Low	Ords	0.13	0.06

MRKH – Relative performance



**IDGCs: by wholesale and retail**

**Initiation of MRSK Holding coverage**

• We are initiating analytical coverage of MRSK Holding (MRSK - Interregional Distribution Grid Company), which has managed, since it was first listed at stock exchanges in December of 2008, to become one of the most liquid energy companies in the Russian stock market. The holding essentially replaced RAO UES following the reorganization.

• The Holding owns a controlling stake in each MRSK; shares in Tomskenergo DGC and Kubanenergo, which did not join it, also constitute a portion of the assets it controls. Additionally, the holding owns a number of core and non-core assets transferred to it under the separation of RAO's balance sheet, the largest of which is Tyumenenergo.

• The Holding is traded at a premium to the current value of its shares in traded companies, but it should be observed that there is no market appraisal of Tyumenenergo; the length of Tyumenenergo's lines is comparable with those of Lenenergo, and the supposed level of its capital base is similar to that of a comparable MRSK combining several regions. The premium is also conditioned by the larger liquidity of the holding's shares: many investors prefer to invest in baskets of shares instead of separate MRSKs.

• We appraised the Holding as the sum of its parts, proceeding from the fair value of its MRSKs (including Tyumenenergo), which we have calculated and presented as of the beginning of 2011; we obtained a 12-month target price of \$0.208 for ordinary shares and \$0.145 for preferred shares. This presupposes 35.4% and 49% upsides with respect to these shares' current quotations; therefore we assign to its shares the recommendation to **BUY**.

• The following pieces of news, which may positively affect the company's quotations in the nearest future, are noteworthy:

- The inclusion of shares in MRSK Holding in the MSCI index upon the next review: it meets the index's free float cost criteria and is the final energy company among the four most liquid energy companies formed following the reorganization of RAO UES to be included in the MSCI index, after RusHydro, FSK and Inter RAO;

- The listing of the Holding's depositary receipts in London;

- News about the Holding's switch to a single share with MRSKs: the idea of consolidation arose in 2009, but no resolution has been adopted.



## Company Description

MRSK Holding, as well as a number of other companies in the energy sector, was created within the framework of electric power industry reform. Its function is to provide control by the state, which obtained 52% of MRSK Holding's shares, over the distribution grid segment. The Holding was separated from RAO UES on the date of the latter's reorganization, having included in its books upon its creation equity stakes in 10 MRSKs previously owned by RAO. The number of shares and their type coincide with the stakes which were owned by RAO UES - 41,041,753,984 ordinary shares and 2,075,149,384 preferred shares with a par value of 0.5 rubles each.

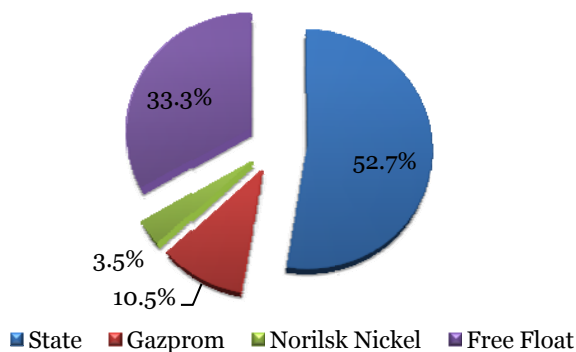
The Head of MRSK Holding is Nikolay Shwets; he possesses ample work experience, particularly in the power-holding structures of the Amur region and with Rosoboronexport before his appointment to this position.

The Holding has not yet started to carry out any operating activity; it is presumed that the source of its income will be limited to MRSK dividends and revenues from management. Notably, in the autumn of 2008, managers of the Holding said that they had worked over the dividend policy with respect to MRSK. According to their idea, dividend payments could depend on profit fluctuations, especially additional profits from operating improvements. According to managers, the regulator will welcome the use of a greater part of additional profits for the payment of dividends. There were no further communications about any work in this direction.

In 2009, Russian federal authorities decided to entrust the holding with the implementation of part of its investment project for the construction and reconstruction of facilities related to the 2014 Olympic Games in Sochi. At least 18 billion rubles will be allocated to it in the federal budget within three years for this purpose, including 4.4 billion rubles in 2010. For these reasons, shareholders of the Holding have already entered into its Articles of Association an item regarding 33.56 billion in new declared shares. If these shares are allocated, the number of ordinary shares in the holding will grow over a three-year period by a factor of 1.8.

Additionally, the idea of the Holding's switch to a single share with MRSK arose in the summer of 2009, which would permit a more strict system of state management of distribution grids to be built up. Another purpose of such a switch is the provision of the Holding with funds for the implementation of important projects, including R&D, the start-up of the pilot-scale production of various types of equipment, other pilot projects, and the support of distribution grids in problem regions. The introduction of subscription fees to be collected by the Holding, which would function similarly to subscription fees that had been collected by RAO UES, was mentioned as an alternative to the switch. N. Shwets has said that the idea was supported in the Ministry of Energy and by Deputy Prime Minister Igor Sechin, who supervises power generation, but that no final resolution has been adopted. The idea has been complicated by the legal requirement that the Holding not reduce the government's share in distribution grid complex companies until the end of 2011: if consolidation takes place with the current shareholding in MRSK, the Russian federal government's stake in the holding will no longer be a controlling interest.

The Holding's shareholders breakdown:



Source: company' data



## Valuation

The method for appraisal of the value of shares in MRSK Holding was elaborated earlier for other holdings, the most impressive example of which in the last two years was RAO UES of Russia. The appraisal of the holding company is created by totaling the sum of the parts it consists of. The main parts of MRSK Holding are equity stakes in traded MRSKs, Kubanenergo and Tomskenergo DGC, as well as Tyumenenergo, which did not join an MRSK.

<b>Holding's structure</b>	Holding's share, %	Current Mcap, mn \$	Current share value, mn \$	12-m fair Mcap, mn \$	12-m share fair Mcap, mn \$
Center MRSK	50.23%	1,414	710	2,101	1,055
Center and Volga MRSK	50.40%	896	452	1,460	736
North West MRSK	55.38%	872	483	1,063	589
Volga MRSK	67.63%	705	477	875	592
Ural MRSK	51.52%	861	444	1,070	551
South MRSK	51.66%	269	139	351	181
Siberia MRSK	52.88%	1,019	539	1,421	751
North Caucasus MRSK	58.25%	190	111	203	118
MOESK	50.90%	2,591	1,319	3,480	1,771
Lenenergo ords	50.31%	522	263	1,128	567
Tomskenergo-RSK	52.03%	76	40	109	56
Kubanenergo	49%	88	37	90	44
Tyumenenergo	100%	NA	NA	1,808	1,808
<b>In total</b>			<b>5,013</b>		<b>8,820</b>

\* Valuation of Tyumenenergo is presented in Appendix 1

However, some components of the holding are not traded. These include 25% equity stakes in engineering centers transferred to the holding upon the reorganization of RAO UES, the options for which are preserved by the management of those centers; special OJSCs, to which the real estate of engineering centers was allotted before the selling thereof (so that a new investor would be interested to a greater degree in their scientific potential, and not their buildings for subsequent resale), and scientific research institutes. Additionally, they include Caucasian trade companies, which preserved their brands upon the reorganization of their respective energy companies. We did not appraise all these assets, although the complete list thereof is presented in the Appendix 2.

### Discount vs premium

Currently the Holding is traded at a 29% premium to the sum of its traded parts. To what extent is this justified? We suppose that the existence of premium is reasonable, when we take into account that Tyumenenergo is not traded. The premium is conditioned also by the greater liquidity of shares in the Holding: many investors prefer to invest in baskets instead of separate MRSKs. We are under the impression that the greater interest in the holding in comparison with its “daughters” is also warmed up by the expectation of inclusion of shares in the Holding in the MSCI index, which will result in new investments in this equity.

The current discount of the value of preferred shares in the Holding in comparison with ordinary shares is about 30%. We used this figure when calculating the fair value of ‘prefs’.

Thus, the calculation of the fair value of shares in the holding appears as follows:

The holding's fair value as the sum of its parts, million \$	8,820
Number of ordinary shares, pcs	41,041,753,984
Number of preference shares, pcs	2,075,149,384
The fair value of 1 ordinary share, \$	<b>0.208</b>
The fair value of 1 preference share, \$	<b>0.145</b>



**Appendix 1**

**Tumenenergo**

*Forecast financials*

mn \$	2010	2011	2012	2013	2014	2015	2016	2017
Revenues	1,407	1,819	2,171	2,519	2,720	2,836	2,886	2,955
Operating expenses	1,189	1,378	1,574	1,772	1,940	2,058	2,109	2,178
EBITDA	218	441	597	747	780	778	776	777
Depreciation	90	94	100	103	106	109	113	117
EBIT	128	346	497	645	674	668	663	660
Working capital	98	128	153	178	191	198	203	207

*DCF*

mn \$	2011	2012	2013	2014	2015	2016	2017
EBIT*(1-t)	264	383	500	525	523	522	528
Depreciation	90	96	100	103	107	111	117
Change in WC	-34.8	-30.1	-29.3	-18.1	-11.7	-20.7	-17.2
Capex	-367	-227	-220	-214	-209	-206	-206
Cash Flow	-49	223	351	397	409	406	422
WACC	15.6%	15.9%	15.9%	15.9%	15.9%	15.9%	15.9%
Discount factor	0.9	0.7	0.6	0.6	0.5	0.4	0.4
Discounted Cash Flow, млн \$	-42	166	225	220	196	168	150

*Target price by the end of 2010:*

Present value of cash flow, mln \$	1,083
Terminal Value, mln \$	948
Fair EV, mln \$	2,031
Net debt, mln \$	222
Mcap, mln \$	1,808
Shares outstanding	273,738,951
Price \$	<b>6.6</b>

*Sensitivity analysis:*

		WACC				
		13.4%	14.4%	15.4%	16.4%	17.4%
IRAB, bn rub	-30%	4.8	4.3	3.8	3.5	3.1
	-15%	6.4	5.8	5.2	4.8	4.4
	119.2	7.9	7.2	<b>6.6</b>	6.1	5.6
	15%	9.5	8.7	8.0	7.4	6.8
	30%	11.1	10.2	9.4	8.7	8.0



**Appendix 2. Subsidiary and related companies of the holding other than MRSKs**

Company	Holding's stake
OJSC "Yantarenergo"	100%
OJSC "Chechenenergo"	0.51
OJSC "Nurenergo"	0.23
OJSC "Karachaevo-Cherkesskenenergo"	100%
OJSC "Kalmenergosbyt"	100%
OJSC "Tyvaenergosbyt"	100%
OJSC "Kabbalkenergo"	65.27%
OJSC "Dagestan retail supplier"	51%
OJSC "Sevkavkazenergo"	49%
OJSC "Ingushenergo"	49%
OJSC "Energy Economics Scientific Research Institute "	100%
OJSC "VNIPIenergoprom Association"	100%
OJSC "VTI Special Heat Energy Equipment Design Bureau"	100%
OJSC "Sibenergosetproject" Siberian Grids and Electric Power Lines Designing, Surveying and Scientific Research Institute"	100%
OJSC "Energy Institute named after G.M. Krzhizhanovsky"	31.34%
OJSC "Ural power generation engineering center – URALVNIPIENERGOPROM, Uralselenergoproject, UralTEP, UralORGRES, UralVTI, Uralenergosexproject, Chelyabenergosexproject"	25.00%
OJSC " North-Western power generation engineering center"	25%
OJSC "Volga region power generation engineering center"	25%
OJSC "Southern power generation engineering center"	25%
OJSC "Siberian Energy Research and Development Center"	25%
OJSC "Center for settlement of UES accounts receivable and accounts payable"	100%
OJSC "Real Estate of VNIPIenergoprom"	100%
OJSC "Real Estate of UES EC"	100%
OJSC "Real Estate of North-Western power generation EC"	100%
OJSC "Real Estate of Volga region power generation EC"	100%
OJSC "Real Estate of Southern power generation EC"	100%
OJSC "Real Estate of Ural power generation EC"	100%
OJSC "Real Estate Siberian Energy EC"	100%
"Grozenergo" Open Joint-Stock Company for power generation in and electrification of the Chechen Republic	49%
OJSC "North-Western Energy Management Company"	49%
OJSC "Bureyagesstroy"	25.01%
OJSC "ChirkeyGESstroy"	25%
OJSC "Zarubezhenergostroy"	9.51%
LLC "IT Energy Service"	20.00%

Source: Holding's data



## STOCK RATING POLICY

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<b>STRONG BUY:</b>	Upside over 25%; confidence level – high / upside over 100%; confidence level - low
<b>BUY:</b>	Upside between 15 and 25%; confidence level – high / upside between 25% and 100%; confidence level – low
<b>HOLD:</b>	Upside of less than 15%; confidence level – high / upside of less than 25%; confidence level – low
<b>SELL:</b>	Target price at or below current price levels

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