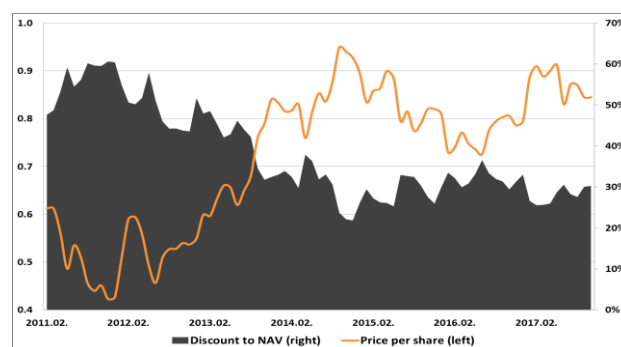


Fondul Proprietatea

Recommendation: Buy

Target price (12M): RON 1.00 (unch.)

	Q1 2017	Q2 2017	Q3 2017
NAV	10,690	10,570	10,606
NAV per share	1.19	1.22	1.21
Cash per share	0.03	0.03	0.09
% of Net cash	2.4%	2.5%	7.7%
% of Listed equity	29%	28%	30%
Discount to NAV	-25%	-29%	-30%
DIPS	0.00	0.06	0.08
EPS	0.04	0.09	0.11
PM fee per NAV	0.32%	0.51%	0.63%



Share price close as of 15/01/2018	RON 0.912	Bloomberg	FP RO
Market cap. [RON mn/EUR mn]	7,958/1,715	Reuters	FP.BX
Daily turnover 12M [EUR million]	1.6	52 week range	RON 0.68-0.92

In the same boat with the State

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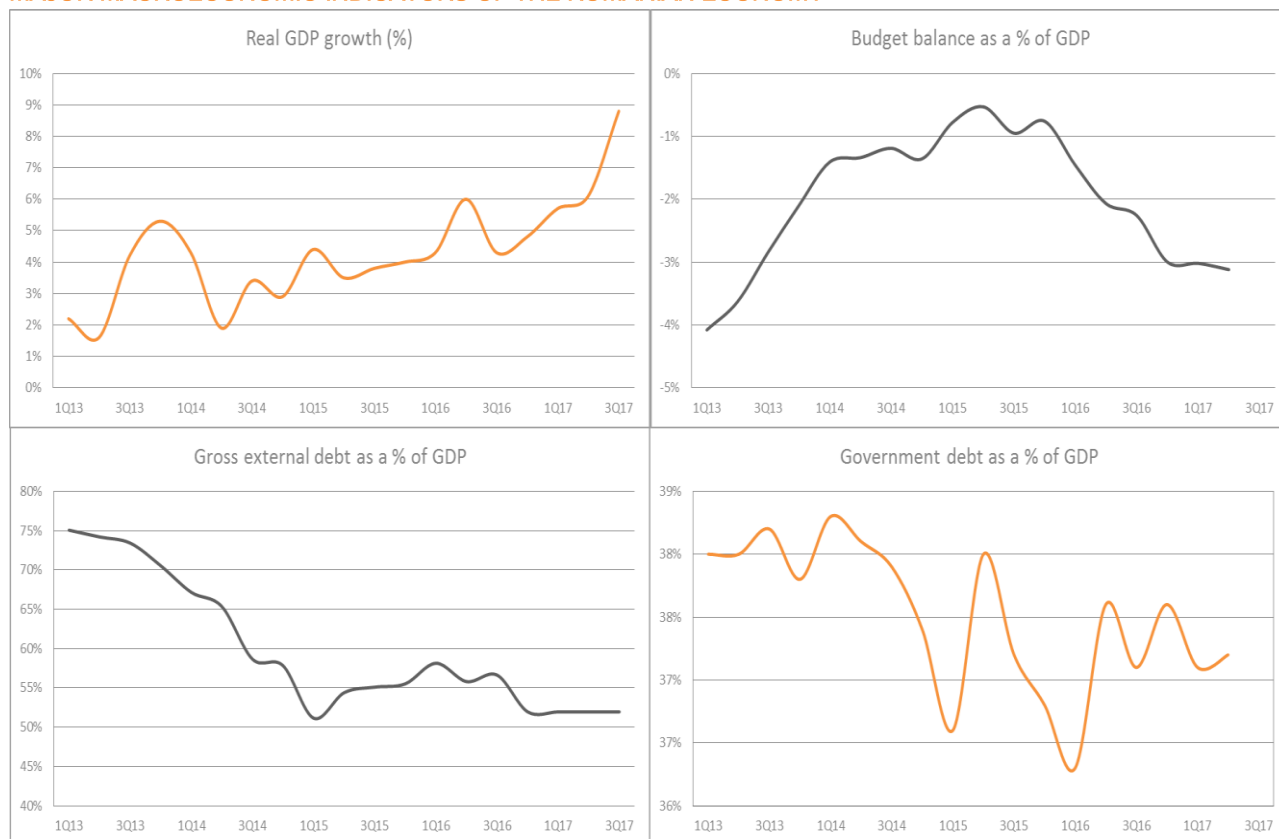
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- **Investment story:** In August 2017, a draft law was put forward regarding the creation of the Sovereign Development and Investment Fund (FSDI). Based on the proposal the portfolio would include controlling and minority stakes in 27 profitable and solvent SOEs. Since the overlap between the FSDI and Fondul's portfolio is significant we assume that this new structure might have an important impact on Fondul as well.
- **Political climate:** In recent years, the political climate in Romania has not managed to attain long-lasting stability. In December 2016, legislative elections were held throughout Romania, after which the Social Democratic Party (PSD) and the Alliance of Liberals and Democrats formed a governing coalition under Prime Minister Sorin Grindeanu. In June 2017, tensions arose between the Prime Minister and PSD leader Liviu Dragnea, which ultimately resulted in the loss of political support for the government on behalf of the PSD-ALDE coalition.
- Although Mr. Grindeanu did not resign, on June 21 a vote of no confidence against his cabinet was passed in the Parliament. On June 29, 2017 former Economy Minister Mihai Tudose took office as Prime Minister. Since then, the Tudose government has adopted a comprehensive tax reform, which, among other measures, lowered the income tax rate from 16 percent to 10 percent and adopted a turnover tax for small and medium size companies.
- **Budget deficit:** The aforementioned tax reform is part of Romania's considerably procyclical economic policymaking. In the recent period, the country has enjoyed robust economic growth, which has provided opportunity for significant fiscal expansion without breaching the budget deficit threshold of 3% of GDP, which is the upper limit laid down in EU rules. Economic growth at the present rate is clearly not sustainable. Understandably, the government aims to reduce spending to avoid an excessive deficit procedure.
- The Romanian government is aware that even though the budget deficit has been in the immediate vicinity of 3% of the GDP for a year now, there is little room for action should economic growth decelerate. To ensure budget balance, the government has been rumored to consider a bank tax and the restructuring of the second pillar of the pension

system, which have not been realized. A more sensible step in the direction of budget sustainability is the proposal to create a Sovereign Development and Investment Fund (FSDI) comprising profitable state companies, which we cover in detail below. The FSDI would take away state companies' dividends from the budget but in a few years, it could finance significant investment and infrastructure development projects, thus boosting the economy.

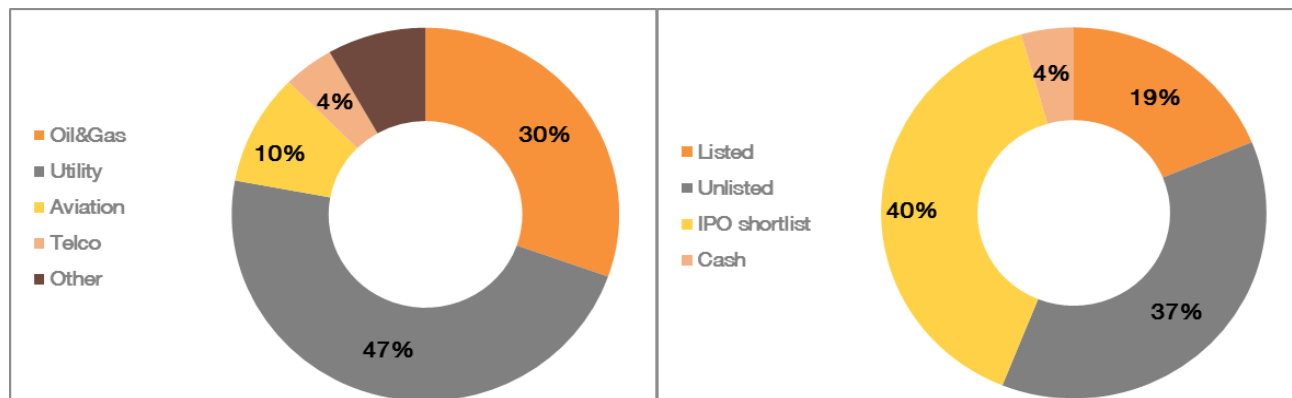
MAJOR MACROECONOMIC INDICATORS OF THE ROMANIAN ECONOMY



Source: Bloomberg

- First FSDI proposal:** In August 2017, a draft law was put forward regarding the creation of the Sovereign Development and Investment Fund (FSDI). Based on the proposal, the portfolio would include controlling and minority stakes in 27 profitable and solvent SOEs. The fund would start with a cash contribution of RON 1.85 billion by the state. The Fund would be managed in a dual system by a supervisory board and a directorate in an independent manner. The State, through the Ministry of Public Finance, would approve the investment strategy and investment plan.

SECTOR BREAKDOWN OF THE FIRST PROPOSAL



Source: Local news

- Funding for FSDI would be made primarily from earnings from dividends received from the portfolio, from the proceeds from the sale of portfolio shares, and through the issuance of bonds. The investment policy would target cost-effective and sustainable projects in competitive areas, including equity investments, co-financing of public-private partnership projects and co-financing of European funded projects. The fund would also handle the privatization strategies for state-owned enterprises such as Hidroelectrica. The FSDI would start with a grace period of 3 years, during which the impact on the state budget would be considerable as dividends from state companies would not arrive in the budget but to the FSDI.

PORTFOLIO BREAKDOWN OF THE FIRST PROPOSAL

	Name	Stake	NAV	% of Gov.	% of NAV	NI 2016	Gov. NI
1	Antibiotice	53%	369	196	0.5%	30	16
2	Biofarm	1%	296	3	0.0%	29	0
3	Bucharest Airport	80%	3,805	3,044	7.2%	137	110
4	Chimcomplex	13%	201	26	0.1%	8	1
5	CIT	100%	146	146	0.3%	1	1
6	Maritime Danube Ports	92%	15	14	0.0%	2	1
7	Maritime Ports (APM)	80%	1,081	864	2.1%	49	39
8	CNCIR	100%	67	67	0.2%	20	20
9	Conpet	59%	864	507	1.2%	72	42
10	Cupru Min	100%	52	52	0.1%	3	3
11	Delgaz Grid	14%	3,746	506	1.2%	226	30
12	E.ON Romania	32%	2,783	886	2.1%	320	102
13	Electrica	49%	3,875	1,890	4.5%	469	229
14	Engie Romania	34%	3,810	1,296	3.1%	382	130
15	Hidroelectrica	80%	16,971	13,586	32.3%	1,267	1,014
16	IAR	72%	176	127	0.3%	12	9
17	Imprimeria Nationala	100%	517	517	1.2%	81	81
18	Romanian Lottery	100%	456	456	1.1%	75	75
19	Nuclearelectrica	82%	2,201	1,816	4.3%	112	93
20	Oil Terminal	60%	90	54	0.1%	15	9
21	OMV Petrom	21%	15,860	3,273	7.8%	1,162	240
22	Romgaz	70%	12,064	8,445	20.1%	1,025	718
23	Salrom	51%	369	188	0.4%	70	35
24	SAPE Energie	100%	431	431	1.0%	40	40
25	SNAM	100%	20	20	0.0%	5	5
26	Telekom Romania	46%	3,860	1,775	4.2%	82	38
27	Unifarm	100%	11	11	0.0%	1	1
FSDI Portfolio [RON million]			74,135	40,196		5,694	3,081
FSDI Portfolio [EUR million]			16,474	8,933		1,265	685

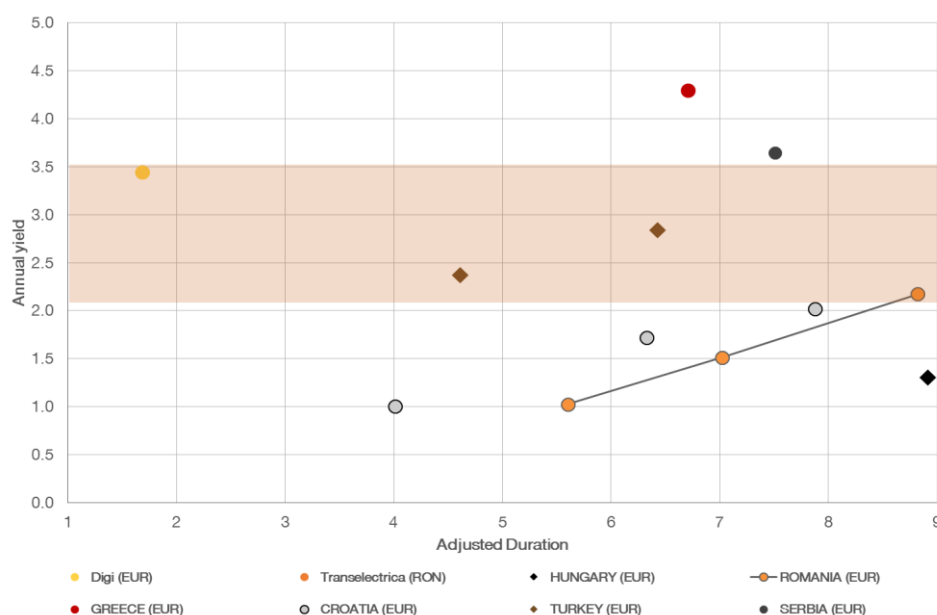
Source: Bloomberg, companies' websites, Bucharest Stock Exchange

- **Modified FSDI proposal:** On November 16, 2017 a modified draft law was presented in front of the Senate. This contains significant changes compared to the proposal from August. The most important modifications are the following: 89 companies would be included in the FSDI instead of the previous 27, and the cash contribution would amount

to RON 9 billion instead of 1.85 billion. It is also specified in the new draft law that the initial cash contribution to FSDI upon its constitution would be RON 50 million, and the rest would be paid within two years.

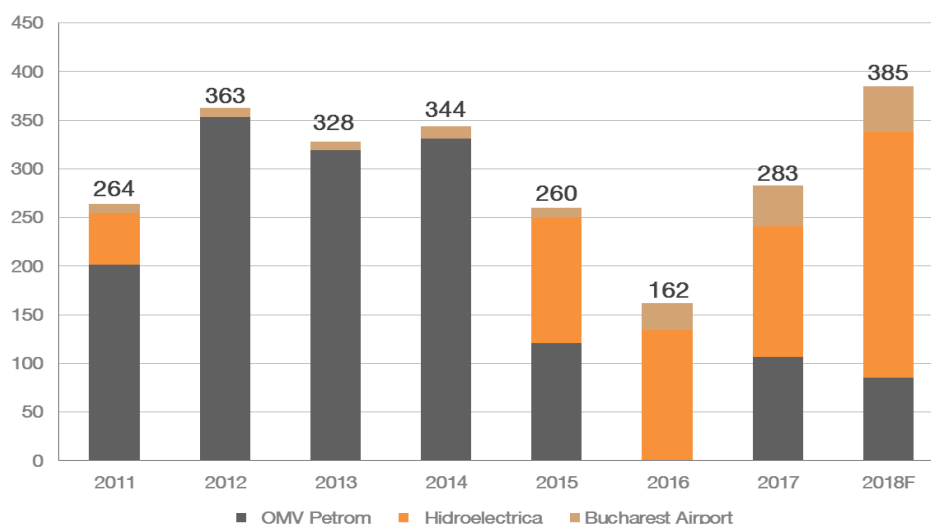
- While the 27 companies in the original proposal were chosen to meet strict profitability and sustainability criteria, the modified proposal contains many companies which are almost insolvent and clearly inefficiently operated. An illustrative example to this is TAROM, the Romanian flag carrier, which has not been profitable in ten years. Bonds issued by a fund with SOEs on the verge of bankruptcy in its portfolio would not be overly attractive.
- **Turkish benchmark:** The only similar arrangement to FSDI in the region is the Turkish Sovereign Wealth Fund launched in 2016. The Turkish SWF also holds stakes in a number of profitable state companies in its portfolio, for example Turkish Airlines or Istanbul Stock Exchange. The Turkish fund is aimed to support large-scale investment projects, contribute to economic growth and attract further investment. The operation of the fund, however, was not successful in 2017 because of internal tensions, which paralyzed its operation. It cannot be excluded that the Romanian counterpart might also become a target for political power play, as well.
- **Milestones:** The new, modified draft law is currently before the Senate awaiting opinions from parliamentary committees, some of which have already been granted. After this stage, both houses of the parliament will have to adopt the bill. Since emergency procedure has been requested, parliamentary adoption is expected in January 2018. Furthermore, Eurostat and the European Commission have to investigate whether bonds issued by the FSDI will be classified as government debt. The fund will then start its operations with a grace period of 3 years.
- **Bond issue:** The funding for the FSDI would be made primarily from earnings from dividends income, sale of portfolio shares, but also through the issuance of bonds. The bond issue might be interesting since the issue would be asset-backed, while the risk might be close like a quasi-governmental agencies' bond. Despite the extremely low yield environment in Europe regional euro and dollar denominated bonds remained positive. Local euro denominated corporate bond benchmark might be DIGI with slightly more than a year duration and roughly 3.5% yield, while Transelectrica has a RON denominated bond with almost the same yield but lower duration. On the other side, long-term Romanian government bonds remains slightly above 2.2% yield. We assume the FSDI's bond might be an attractive investment vehicle only if the first proposal with the 27 companies is in effect.

REGIONAL GOVERNMENT AND CORPORATE BONDS



Source: Bloomberg

MAJOR DIVIDEND CHANNEL OF FONDUL [RON MILLION]



Source: Fondul, Concorde's forecast

- Bottom line:** From Fondul's prospect the first FSDI proposal was very favourable since the overlap with the Development Fund is more than 60%, while Hidroelectrica is the largest component of this new portfolio (RON 13 billion) followed by Romgaz (RON 8.4 billion) and Petrom (RON 3.2 billion). Since the control over these SOEs switch from the Energy to the Eco-minister the long term outlook of these companies will transform as well. We assume that the CAPEX of the healthy companies will be cut to maintenance level, while the net cash on the balance sheets will be dealt out to the shareholders as special dividend. Due to the significant overlap, Fondul as the minority shareholder would benefit this strategy, especially if the pay-out of the SOEs increase to minimum 100%. If we sum up the dividend income from the three largest dividend channels, Fondul received roughly RON 280 million or ca. RON 0.032 per share in the past year. Due to the increase of pay-out ratio of Hidroelectrica and the Airport, Fondul might expect an extra RON 100 million or 0.01 per share. This strategy might be remarkable in case of Hidroelectrica since we do not calculate any major CAPEX needs for the forecast period however the Airport needs extra capacity, new terminal. From Fondul's shareholder point of view, the second proposal is equivalent, while the general macro environment might worsen due to the huge list of insolvent companies, which eats up cash rapidly.

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Rating	Trigger
Buy	Total return is expected to exceed 20% in the next 12 months
Accumulate	Total return is expected to be in the range of 10-20%
Neutral	Total return is expected to be in the range of 10%-(-10%)
Reduce	Total return is expected to be in the range of -10%-(-20%)
Sell	Total return is expected to be lower than -20%
Under Revision	The stock is put Under Revision if covering analyst considers new information may change the valuation materially and if this may take more time.
Coverage in transition	Coverage in transition rating is assigned to a stock if there is a change in analyst.

Securities prices:

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Valuations and risks:

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