

Fondul Proprietatea

Downgrading on lack of progress in HE IPO

Fondul Proprietatea (FP) has rallied an impressive 15% (including cash distribution) since early January, outperforming MSCI Frontier by around 10%. While our expectation that the new government's efforts to boost revenue (a request for higher dividend income from state-owned enterprises) to finance its election promises proved correct, the IPO process of Hidroelectrica (HE) has stalled, making a listing this year less likely, in our view. While we still like FP and its long-term value-accretive actions for shareholders, we downgrade our rating to MARKET PERFORM and would advise waiting for better entry points to re-engage. After participating in FP's Romania conference last week and meeting with company management, we are less optimistic about the short term due to a lack of catalysts and clarity on the timing/structure of HE's IPO.

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Despite a strong year, HE IPO is becoming less likely

Thanks to better hydrology, lower sales in the regulated market and a decreasing special construction tax, HE posted a 41% increase for net income in FY16. Quite strong profitability notwithstanding, we see little progress on the listing of the company. Despite a number of candidates identified by the previous technocratic government, the new government has still not appointed the board and the company continues to be run by interim management. We believe that the political distraction (after proposed changes to the criminal law were followed by massive protests across the country) and ongoing discussion regarding the possible participation in the Romanian sovereign wealth fund (also one of the election promises) might play key roles in this slowed process. Although there is no concrete decision on whether HE will be transferred to the fund, any change in HE ownership is likely to be followed by a change in the IPO mandate and lead eventually to a prolonged schedule. If this is realised, HE's IPO is likely to be postponed towards late 2018 (or beyond 2018). Moreover, there is still an ongoing issue (non-feasible investment projects worth EUR2bn that should be transferred out of the company) that needs to be addressed by the government before the IPO process moves forward. Finally, we participated in FP's Romania conference in London last week and came away with no clear indication regarding the timing or structure of the IPO and decision on non-core projects. Without clarity on these key issues, we think the HE IPO is less likely to happen in 2017.

No more catalysts in sight – downgrade to MARKET PERFORM

Although the tender offer (which continues until 20 March) is supportive for the share price in the short run, its lack of premium to the current price (just 3%) and low allocation possibility (due to oversubscription) make the tender offer less attractive to us at the current level. Furthermore, given that the ex-date for the special cash distribution (RON0.05) has passed (6 March), we don't see any catalyst to make FP's NAV discount lower in the short run. Unless we see a value-accretive deal on the rest of the portfolio, the lack of clarity and a possible delay in the long-awaited IPO of HE might create disappointment on FP shares in the short run, despite the fact that we continue to believe FP offers long-term value for investors through its minority stakes in what we view as the best possible IPO candidates including HE, Bucharest Airport, Constanta Port, Salrom, CE Oltenia and Posta Romana.

Report date: 6 March 2017
Current price, RON: 0.88
Upside/downside, %: 11

MktCap, \$mn 1,991
Average daily volume, \$mn 2
Free float, % 100
Bloomberg FP RO

Summary valuation and financials

| | RenCap | FP |
|----------------------------|--------|--------|
| NAV (RONmn) | 10,423 | 11,132 |
| Fair value per share (RON) | 1.08 | 1.16 |
| Listed % of portfolio | 27% | 23% |
| Unlisted % of portfolio | 64% | 65% |
| Cash % of portfolio | 9% | 12% |

Source: Company data, Renaissance Capital estimates

Figure 1: Price performance – 52 weeks, RON

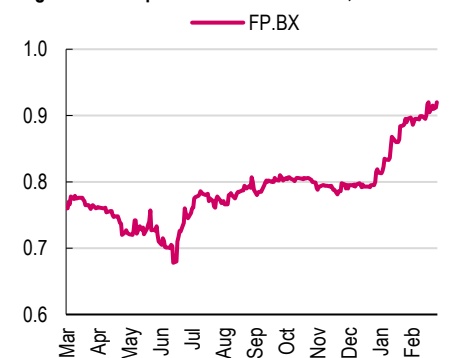
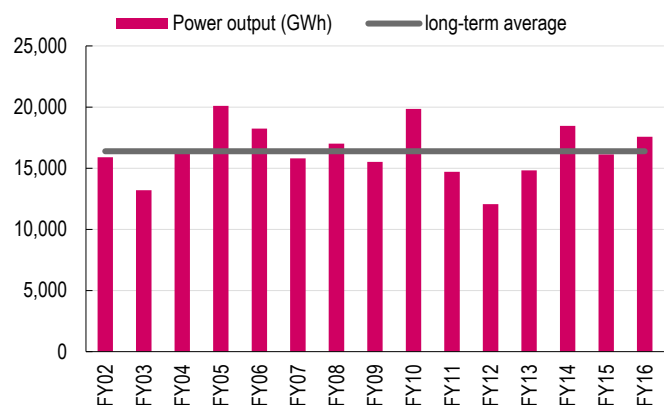
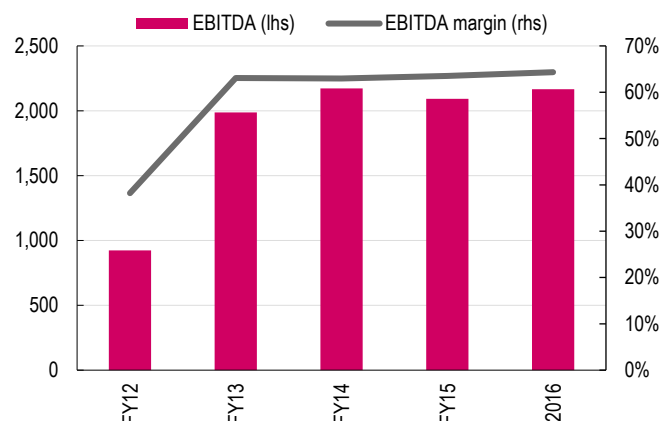


Figure 2: Hidroelectrica power output, GWh



Source: Bloomberg

Figure 3: Hidroelectrica – EBITDA, RONmn



Source: Company data

Figure 4: HE – DCF analysis, RONmn

| DCF | 2016 | 2017E | 2018E | 2019E | 2020E | 2021E | 2022E | 2023E | 2024E | 2025E | Terminal |
|-------------------------------|--------|-------|----------------|-------|-------|-----------------|-------|-------|-------|-------|----------|
| EBIT | 1,454 | 1,585 | 1,671 | 1,688 | 1,704 | 1,721 | 1,739 | 1,756 | 1,774 | 1,791 | |
| EBIT*(1-tax) | 1,221 | 1,331 | 1,404 | 1,418 | 1,432 | 1,446 | 1,461 | 1,475 | 1,490 | 1,505 | |
| Depreciation | 712 | 671 | 653 | 660 | 666 | 673 | 680 | 686 | 693 | 700 | |
| Maintenance capex | -250 | -250 | -250 | -250 | -250 | -250 | -250 | -250 | -250 | -250 | |
| New capex | 0 | -725 | -725 | -725 | -725 | -725 | -725 | 0 | 0 | 0 | |
| FCF | 1,683 | 1,027 | 1,082 | 1,102 | 1,123 | 1,144 | 1,165 | 1,912 | 1,933 | 1,955 | 1,505 |
| Discount factor | | 1.08 | 1.17 | 1.26 | 1.36 | 1.47 | 1.59 | 1.71 | 1.85 | 2.00 | |
| Discounted cash flow | | 951 | 927 | 875 | 825 | 779 | 734 | 1,115 | 1,044 | 978 | |
| Value for FY17E-FY25E | 8,230 | | Rfr | 4.0% | | Terminal growth | 0.0% | | | | |
| Terminal value with 0% growth | 9,409 | | Beta | 0.8 | | | | | | | |
| Net cash (as of FY16E) | 1,695 | | Equity premium | 5.0% | | | | | | | |
| Fair value | 19,334 | | CoE | 8.0% | | | | | | | |

Source: Company data, Renaissance Capital estimates

Figure 5: HE – peer group P/E and EV/EBITDA comparison, x

| | FY17E EV/EBITDA | FY17E P/E |
|------------------|-----------------|-------------|
| Rushydro | 5.0 | 6.9 |
| Cez As | 6.7 | 16.9 |
| Aes Tiete Energi | 6.7 | 11.6 |
| Entel | 7.7 | n.m. |
| Nhpc Ltd | 8.9 | 12.0 |
| Enel Generacion | 8.2 | 14.6 |
| Aksa Enerji Uret | 6.3 | 14.7 |
| Akenerji Elektri | 15.1 | n.m. |
| Average | 8.1 | 12.8 |

Note: *Intraday prices as of 6 Mar 2017

Source: Bloomberg

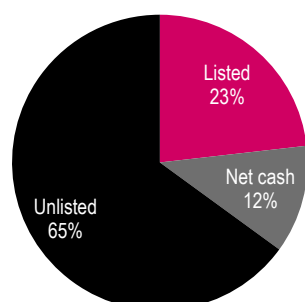
Figure 6: Hidroelectrica – valuation summary, RONmn (unless stated otherwise)

| | FY17E EBITDA | FY17E net profit | 40% EV/EBITDA | 40% P/E | 20% DCF | Total value | FP stake | Discount | RenCap NAV |
|----------------|--------------|------------------|---------------|---------|---------|-------------|----------|----------|------------|
| Hidroelectrica | 2,256 | 1,339 | 19,910 | 17,120 | 19,334 | 18,679 | 20% | 15.0% | 3,166 |

Note: *Intraday prices as of 6 Mar 2017

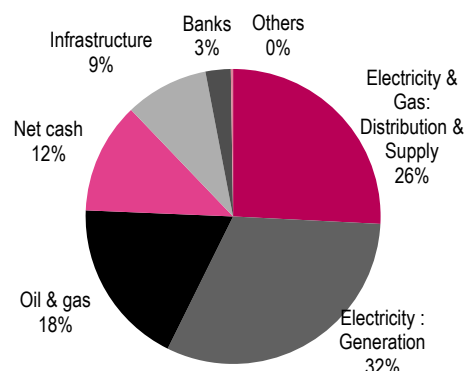
Source: Company data, Bloomberg, Renaissance Capital estimates

Figure 7: Portfolio structure by asset type, as of January 2017



Source: Company data

Figure 8: Portfolio structure by sector, as of January 2017



Source: Company data

Figure 9: Fondul NAV

| Listed | RenCap NAV (RONmn) | Methodology | % of NAV |
|--------------------------------|--------------------|--------------|--------------|
| OMV Petrom SA | 2,117 | Market price | 20.3% |
| BRD-Groupe Societe Generale SA | 293 | Market price | 2.8% |
| Nuclearelectrica SA | 173 | Market price | 1.7% |
| Alro Slatina SA | 107 | Market price | 1.0% |
| Conpet SA | 50 | Market price | 0.5% |
| Romaero SA | 28 | Market price | 0.3% |
| Primcom SA | 13 | Market price | 0.1% |
| Banca Transilvania SA | 23 | Market price | 0.2% |
| Alcom SA | 4 | Market price | 0.0% |
| Oil Terminal SA | 7 | Market price | 0.1% |
| Palace SA | 3 | Market price | 0.0% |
| IOR SA | 1 | Market price | 0.0% |
| Mecon SA | 0 | Market price | 0.0% |
| Total listed | 2,818 | | 27.0% |

| Unlisted | RenCap NAV (RONmn) | Methodology | FP NAV (RONmn) | Variation | % of NAV |
|--|--------------------|---|----------------|-----------|--------------|
| Hidroelectrica | 3,166 | Peer comparison & DCF with 15% discount | 3,384 | -218 | 30.4% |
| CN Aeroporturi Bucuresti SA | 826 | Peer comparison | 761 | 65 | 7.9% |
| Electrica Distributie Muntenia Nord SA | 480 | Fair valuation with 20% discount | 600 | -120 | 4.6% |
| Electrica Distributie Transilvania Nord SA | 304 | Fair valuation with 20% discount | 380 | -76 | 2.9% |
| Electrica Distributie Transilvania Sud SA | 360 | Fair valuation with 20% discount | 449 | -90 | 3.4% |
| Electrica Furnizare SA | 204 | Fair valuation with 20% discount | 255 | -51 | 2.0% |
| Enel Distributie Banat SA | 167 | Fair valuation with 20% discount | 208 | -42 | 1.6% |
| Enel Distributie Dobrogea SA | 197 | Fair valuation with 20% discount | 246 | -49 | 1.9% |
| Enel Distributie Muntenia SA | 134 | Fair valuation with 20% discount | 168 | -34 | 1.3% |
| Enel Energie Muntenia SA | 56 | Fair valuation with 20% discount | 70 | -14 | 0.5% |
| Enel Energie SA | 60 | Fair valuation with 20% discount | 75 | -15 | 0.6% |
| Engie Romania SA | 363 | Fair valuation with 20% discount | 453 | -91 | 3.5% |
| Other unlisted assets | 396 | Fair valuation with 20% discount | 495 | -99 | 3.8% |
| Total unlisted | 6,712 | | | | 64.4% |

Source: Company data, Bloomberg, Renaissance Capital

Figure 10: Fondul NAV summary, RONmn (unless otherwise stated)

| Fondul NAV summary | |
|--|---------------|
| Cash & receivables | 892 |
| Total NAV | 10,423 |
| Shares outstanding (excluding treasury shares) | 9,611 |
| Fair value per share (RON) | 1.08 |
| Target closed-end fund discount | 10% |
| Rencap NAV / share (RON) | 0.98 |
| Current price | 0.88 |
| Upside potential | 11% |

Source: Company data, Bloomberg, Renaissance Capital