# FONDUL PROPRIETATEA

## Knocking on LSE door with tender offer as overture

We initiate coverage on Fondul Proprietatea (FP), with a Buy rating and a 12M TP of RON 1.14/share, that offers a 21.3% upside potential. FP currently trades at unwarranted discounts to its 9M14 official NAV (24.4%), our fair NAV (23.6%), and peers (that mostly trade at up to 15%% discounts to their NAVs). In our view, the discounts are mainly due to the fact that ca. 42% of FP's official NAV is in unlisted holdings, mostly majority state owned with poor corporate governance and lower profitability vs. peers. We expect the valuation gap to reduce via some of FP's corporate actions such as buybacks, distributions and the secondary London Stock Exchange (LSE) listing. Hidden value of the unlisted portfolio can be unlocked in our view also via the liberalization of the energy market and BVB listings. Among risks, we would mention the regulatory and political risks and to a lesser extent litigations.

**We use a SOTP approach in setting the fair value of FP shares:** We mark to market (as at 23 Oct 2014 or latest available prices) the listed holdings, while we value the most important unlisted holdings (15 out of the 38, accounting for 92.5% of our fair value of the unlisted portfolio), using a combination of operational and financial multiples and apply hefty discounts for limited transparency and earnings visibility (the main reason of not using DCF valuation). We apply a 15% discount to our fair SOTP NAV to account for FP's holding status and the fact that some of its key holdings are not listed.

**Main catalysts:** We view buybacks (mainly the upcoming tender offer) and distributions as main tools to further reduce discounts to NAV, towards the ambitious and challenging targets as imposed in the new Investment Management Agreement (IMA) for Templeton's new 2Y mandate that started on 29 Sept 2014. They should be funded with accelerated asset sales. The LSE listing should bring increased visibility. All these factors largely explain FP's share price performance (the relative outperformances vs. BET by 26pp in 2013 and 4pp ytd). The liberalization of the energy market should improve the profitability of key portfolio companies, which together with the IPOs of some of FP's unlisted holdings (mainly from the energy sector Hidroelectrica and CE Oltenia, but also possibly of Salrom and some ports and airports, scheduled for 2015-2016), should unlock their hidden value. Should Enel exit Romania, FP is likely to follow suit in exiting these companies and negotiations with Electrica on an exit to resume soon are also likely.

**Main risks:** We see regulatory and political risks and to a lesser extent litigations as the most important. The first two are very linked and we refer here mainly to decisions of the state as majority shareholder in terms of companies' dividend and capex policies (and of the energy regulator on tariffs) that might be detrimental to the interests of the respective companies and of the minority shareholders. The authorities are also responsible for arbitrary introduction or hikes of several taxes.

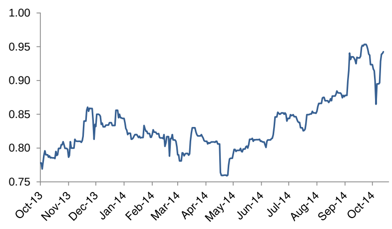
**Fondul Proprietatea – Official Value vs. our Fair Value**

| | RON mn | | RON/share | | % in NAV | |
|---|---|---|---|---|---|---|
| | Official valuation* | Fair value | Official valuation* | Fair value | Official valuation* | Fair value |
| Listed shares | 7,598 | 7,109 | 0.64 | 0.60 | 51.2 | 48.9 |
| Unlisted shares | 6,229 | 6,407 | 0.53 | 0.54 | 41.9 | 44.1 |
| **Total portolio** | **13,826** | **13,515** | **1.17** | **1.14** | **93.1** | **93.0** |
| Cash | 491 | 491 | 0.04 | 0.04 | 3.3 | 3.4 |
| Other assets | 1,188 | 1,188 | 0.10 | 0.10 | 8.0 | 8.2 |
| Total assets | 15,505 | 15,195 | 1.31 | 1.28 | | |
| **Fair NAV** | **14,850** | **14,540** | | | | |
| Fair NAV/share (RON) | 1.25 | 1.23 | | | | |
| **12M TP (RON)** | | **1.14** | | | | |

*Source: FP, IPOPEMA Research; *1H14 data*

28 October 2014

**FONDUL PROPRIETATEA**
**BUY**
***TP: RON 1.14***




| Key Ratios | 2013 | 1H14 |
|---|---|---|
| Operating margin | 88.7% | 95.5% |
| Net margin | 88.7% | 94.1% |
| EPS growth | 20.3% | 104.9% |
| ROE | 6.3% | 19.4% |

| Share data | |
|---|---|
| Number of shares (m) | 12,437.1 |
| Market Cap (€m) | 2,643.7 |
| 12M Avg daily volume (th) | 17.3 |
| 12M Average daily turnover (€m) | 3.3 |
| 52 W High / Low | 0.96 \ 0.757 |
| BET Weight (%) | 21.5 |
| Reuters | FP.BX |
| Bloomberg | FP RO |

| Performance | Abs. | vs. BET |
|---|---|---|
| 1M | 1.1% | 3.0% |
| 3M | 12.2% | 10.6% |
| 12M | 30.2% | 11.0% |

| Shareholders | Stake |
|---|---|
| Elliot Associates | 16.6% |
| City of London IM | <5% |
| SIFs | 1.5% |

*Share prices in this report as at 23 Oct 2014, unless otherwise specified*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# Highlights of the investment case

We initiate coverage on Fondul Proprietatea (FP) with a 12M TP of RON 1.14, which given the 21.3% upside potential from the current share price, implies a Buy rating. We expect FP share price to be fuelled to take off by the announcement of the price in the tender offer (expected in the coming days) at levels close to FP's official NAV, but to cool off once the tender offer is completed and awaiting the other catalysts to emerge and to drive another re-rating in 12M from now. In our view, FP's key attractions are a) its exposure to the energy, infrastructure and banking sectors, making it a proxy of the Romanian economy; b) high quality management by Franklin Templeton (FT) and c) the attractive valuation (23.6% discount to our fair NAV and 24.4% to the latest official NAV as at Sept 2014). While discount reduced since the takeover of the management in Sept 2010, it remains higher than the target set in the new Investment Management Agreement (IMA) of up to 15%, to a large extent due to a still high weight of majority state owned unlisted holdings with poor corporate governance practices and low profitability vis-à-vis their peers. We expect the valuation gap to be further reduced by unlocking the hidden value of the unlisted portfolio via listings and improved corporate governance practices, and we recognize FT's actions in the latter area. We calculate our 12M target price by applying a 15% discount to our fair NAV, which in turn is a sum of the parts of the holdings' values (we perform separate valuations for 15 out of the 38 unlisted companies, accounting for 43.8% of our fair value of the shares' portfolio (92.5% of the unlisted one) and we mark to market most of the listed portfolio). We see buybacks, distributions and the LSE listing of FP shares as well as the IPO pipeline as main catalysts for FP's share price and political, regulatory and litigations as main risks.

## Key catalysts and triggers

**Buybacks**: To date, FP has performed three buybacks: the first for 240.3mn shares (already cancelled), between May and Sept 2011 for ca. 1.7% of the share capital (at a cost of ca. RON 120mn or ca. RON 0.5/share), the second between April and Dec 2013 (1.1bn shares, of which 0.6bn via a tender offer or 7.9% of the capital) for which FP spent ca. RON 963mn or RON 0.8743/share (shares also cancelled, as of 26 Sept 2014). The third buyback for 1.89% of the capital (252.9mn shares), finalized in July 2014 had a cost of RON 205mn (RON 0.8125/share average price). The total shares acquired in the completed buybacks (1.6bn) accounted for ca. 5% of the trading volume during May 2011-July 2014 period. For the first 3 buybacks, FP spent RON 1.28bn (RON 0.81/share on average). The 4th buyback is for 990.9mn shares (7.3% of the capital), which would cost another ca. RON 941mn using the share price on 1 Oct 2014, the date at which it started. By 16 Oct, 36.5mn shares were acquired. FP also indicated that a tender offer for 750mn shares awaits for FSA approval (price yet to be announced). FP called for a GSM on 19/20 Nov to approve a 5$^{th}$ buyback of 227.5mn shares (ca. 1.8% of the current share capital) at prices between RON 0.2-2/share, which at the current share price of RON 0.94/share would cost ca. RON 214mn. This buyback would be initiated once the shares from the forth buyback are cancelled, as the fund cannot hold treasury shares more than 10% of the capital.

**Distributions/dividends:** FP's dividend policy was to distribute 100% of the dividend and interest income less opex, taxes and legal reserves, which basically translated into 7%-8% yields in 2010-2012. FP distributed gross DPSs of RON 0.0816 for FY 2008- 2009, RON 0.0314 in 2010, RON 0.03854 in 2011 and RON 0.04089 in 2012. A pre-condition for dividend distribution is to have the NAV higher than the share capital (which was not the case while Hidroelectrica was valued at zero during its first insolvency) but a waiver from the Ministry of Finance was obtained to allow for dividend distribution. For the FY 2013, FP replaced the classical cash dividends with a RON 0.05/share distribution (RON 601mn) that implied a 6.2% yield at the date of the announcement We expect FP to continue to prefer cash distributions (another RON 0.05/share distribution already announced for next year) for two key reasons: they are more fiscally efficient and the recent FSA interpretation is that the NAV from the RAS balance sheet (in which portfolio is valued at cost after impairments), i.e. RON 11.2bn in June 2014 and not marked to market or at fair value as in the official valuation (i.e. a NAV of RON 14.9bn) should be higher than the share capital so that cash dividend distributions be possible. With the switch to the IFRS as statutory reporting as of 2015, that would imply the recognition of the impairment losses in the P&L as opposed to equity currently, the bottom line would be more volatile and there could be situations of no or lower profits thus dividend distributions could become impossible anyhow.

**To fund the buybacks and distributions, FP would continue the asset sales** (after the divestments of the entire stakes in Transelectrica, Transgaz, Austrian banks Erste and Raiffeisen, Azomures and other smaller partial divestments, of which the largest was the sale of a 5% stake in Romgaz). The most important candidates would be the most liquid holdings Petrom (FP indicated it intends to reduce its stake to below 15%, which would translate into accounting losses and significant decline in FP's dividend income) and Romgaz. FP also seeks to monetize its holdings in the electricity and gas distribution and supply companies (valued ar RON 3.4bn or 22.6% of its official NAV as at end June 2014) and may sell some stakes in the IPOs of some of its holdings (Salrom). Following Electrica's IPO this summer and the election of a new board there, FP might resume talks on the sale to Electrica of its stakes in the three electricity distribution and in the supply company (valued in FP's 1H14 official NAV at RON 783mn or 5.2% of the official NAV). For now, FP is rich enough in liquid assets (RON 1.3bn as at September 2014, of which RON 894mn in Treasuries), and its dividend income (ca. RON 650mn by June 2014) funded the cash distributions (RON 601mn), but the the 4$^{th}$ and 5$^{th}$ buybacks and more distributions would soon start eating these cash reserves.

**Secondary listing:** FP's initial intention to perform a secondary listing of its shares in Warsaw was dropped as the FSA did not approve the required regulations allowing the setup of a link between the Polish and the Romanian Depositories. Meanwhile, the Polish pension funds' reform made a Warsaw listing unattractive anyhow. Thus FP is to be technically listed on the LSE in the form of Depositary Interests ("DIs") to be traded on the so called "specialist fund market" on which FP would be one of the largest funds by NAV and market capitalization. This listing would also require FSA approval (in the past delayed approval was caused by fears that FSA would lose revenues from the migration of the liquidity to the larger market, the Romgaz case alleviating these fears hopefully). While the draft FSA regulation in GDR soon to be approved, while beneficial for the market is not referring to DIs. In our opinion, a LSE listing would increase FP's (and Romanian capital market and its key issuers') visibility (as well as research coverage by brokers of FP) and would facilitate trading in FP for a larger number of investors who are currently unable to buy local shares or structured notes for compliance reasons, with a positive impact on FP's share price.

**IPO and SPO pipeline**: in our view, a significant part of FP's discount to NAV is due to the fact that a still large part of its assets is in unlisted holdings (some majority state owned, poorly managed, with low profitability vs. peers' and low transparency and disclosure), thus investors and analysts may not trust their valuations. While with the IPOs of Romgaz and Nuclearelectrica in Sept-Nov 2013, the share of the unlisted holdings declined significantly, the planned listings of Hidroelectrica and CE Oltenia were moved from this year's initial deadlines to late 2015–early 2016. Hidroelectrica should first exit from its second insolvency (the plan here is for a 15% IPO out of a 18.74% capital increase; FP's 19.94% stake is valued at RON 2,105mn in FP's 1H14 official NAV vs. RON 2,462mn our fair value). At CE Oltenia (12% IPO out of a total 15.3% rights issue; FP's 21.53% stake is valued at RON 120mn vs. RON 141mn our fair value) the coal audit reserve should be finalized fist and ideally be combined with a more meaningful company restructuring. The regional context (conflicts in Ukraine) and the local Presidential elections in November 2014 are also other factors contributing to the delays. Other possible IPOs could be of Salrom (salt mine operator in which FP has a 49% stake) and some ports and airports (Bucharest airport (CNAB) and Constanta port being the largest and where at least 5% of the capital, hopefully 10%-15% could be IPO-ed next year). The IPOs of Hidroelectrica, CE Oltenia, Salrom, CNAB and Constanta Port should bring the weight of the listed holdings in FP's NAV to ca. 69% (using their official valuations as at June 2014 end), are likely to introduce more reliable valuations for the respective holdings and eventually to improve FP's valuation also. The companies that could be subject to IPOs in 2015-2016 account for 18% of the fair NAV (RON 2.7bn-the values for FP's stakes), and 43% of the official value of the unlisted portfolio.

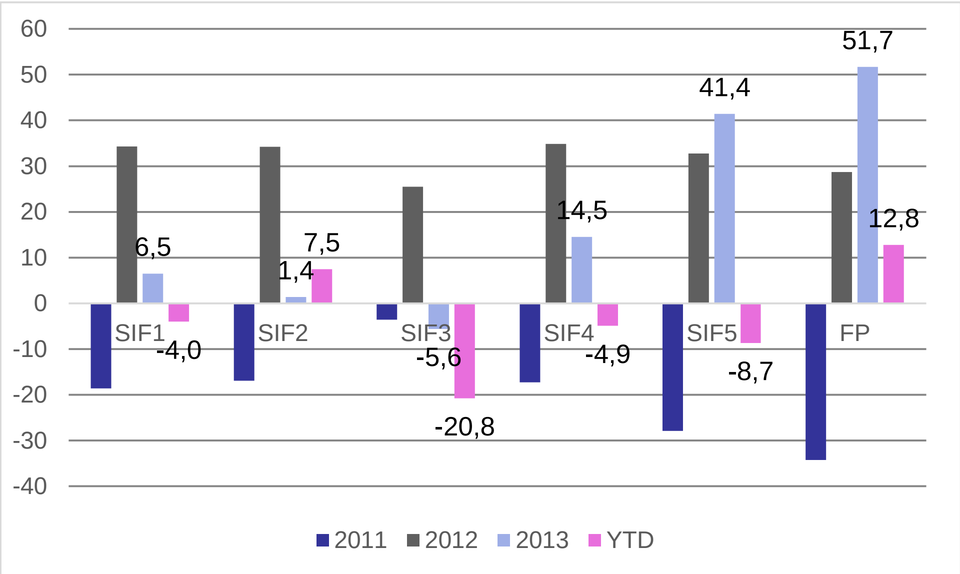
**Energy market liberalization**: to date, deregulation of the electricity prices (by January 2018 for households and already completed for non-households) seems on track, while for the gas prices, a 2.5Y postponement by July 2021 was requested by the Romanian government for households, which requires EU approval (the prices for non-households are de facto fully liberalized). The process is likely to lead to improved profitability of the energy producers in FP's portfolio (although the benefits would be partly offset by the additional taxation on incremental profits and possible declines in volumes) and eventually to improved valuations, which ultimately should also show in FP's valuation. The picture is partly spoiled by the introduction or hikes of some other taxes (such as the special construction tax), but the fact that the bilateral contracts can now be made only in a transparent manner on OPCOM remains a plus.

**Macro, energy sector and capital markets related:** Romania has been in the last 5 years under IMF agreements (although the current precautionary one is suspended de facto) and EU supervision forced Romanian authorities to reform the state owned companies (although not always at the desired pace) and to continue privatizations. Such actions have been beneficial for FP's portfolio companies as they led to improved corporate governance, better regulations and policies in the energy sector. The increase in the amounts available from the private pension funds (the 50bp annual increase in the percentage of salaries that goes into the private pension system from the current 4% to 6%) and of their equity allocations (ca. 19% as at end Aug 2014) should be beneficial for FP, as the main proxy for the Romanian equity market.

## Share price performance

FP has been a clear relative outperformer last year with a 61.3% total return, including the cash distribution (vs. the 26% increase in the BET index), on the back of buybacks (and the push offered by the tender offer of 600mn shares at RON 1/share), listing of some of FP's portfolio companies (mostly Romgaz, at a price above the one in FP's NAV) and the exit of Hidroelectrica from its first insolvency. In 2014 the performance was mixed, with the first part being impacted by the re-entry of Hidroelectrica in insolvency, while lately, positively impacted by the approval and start of the 4th buyback program (and expectation of an imminent start of a tender offer for the largest part of it an expected attractive price), proximity of a dual London listing, cash distribution. YTD, FP share price is 12.8% up (18.8% if the distribution is added) vs. the 8.8% increase in the BET Index.

**Chart 1: Share price performance FP vs. SIFs**




*Source: Company data, Bloomberg, IPOPEMA Research*

## Risks: political, regulatory and litigations

**Political risk**: is partly linked to the regulatory risk (in terms of taxation aspects, among others). The RON 400mn donation imposed to Romgaz in 2010 to the detriment of FP as minority shareholder is one example, fortunately unique in its kind to date. Delays in implementing the promised reforms in the corporate governance of the state owned companies (appointment of professional boards and executive managements, increased transparency of their activity) are other examples. The state as majority shareholder influences the capex and dividend policies of most of the companies in FPs portfolio (minimum 50% payout, in the last 2 years 85% payout). FP's activist stance related to all these risks could be considered as a mitigating factor in our view.

**Regulatory risk**: we refer here mainly to the actions of the regulators on the activity of the main portfolio companies. The most important is ANRE (energy market regulator), which sets the tariffs and quantities for the regulated market (for electricity) and wellhead prices and quantities in the consumption basket (for gas). Another important agency is ANRM (mineral resources agency) with which the new royalties are being negotiated (most relevant for OMV Petrom and Romgaz). The Romanian government has also set various types of support schemes for the renewable energy producers that negatively impact some other players in the field, mostly thermal power producers and end consumers, as their cost is included in the end user prices. The government is also responsible for the arbitrary introduction or hikes of several taxes in the sector (the special construction tax, natural monopoly tax, windfall tax etc.). In case of utilities, where business model should be steady and predictable, the way the tariffs are set (with delays, without recognizing in full all eligible costs) is in practice not always very predictable, inducing volatility in their earnings.

**With regards to the relation with the FSA,** we would note mostly the delays in approving some shareholders' decisions, which are impacting FP's activity. Changes in the bylaws, investment management agreement (IMA), number of shares etc. all require FSA approval, which often was granted either with significant delay (such as the share capital decrease with the Treasury shares from the first buyback) or refused (the additional fees on excess distributions-a litigation on the matter is ongoing-, the secondary listing-by failing to adopt the required regulation to enable the link between the Romanian and Polish Depositories, led FP to eventually change the venue to London. FP is still awaiting some FSA approvals on changes in regulations. Basically, until recently, FSA's actions or inactions had some adverse impact on FP's activity, but in our view, the appointment of a new FSA president and the institution's ongoing restructuring sounds promising (the FSA is more responsive lately).

**On the litigations front**, the most important (and numerous) are with a minority shareholder, Mrs. Ioana Sfiraiala. They create a seemingly never ending negative news flow, but in our view, they no longer represent a significant risk and have little impact (if any) on FP's activity and its share price. In our view, this is mainly because most of the recent court decisions were in FP's favor (and positive side effect was that FP should cash in some amounts as compensation for damages). The fact that there are no provisions in the Romanian law to dismiss at an early stage such litigations remains unfortunate however.

**Risks to our valuation**: apart from the regulatory risks mentioned above, some of the key holdings face also some specific risks that might impact their valuations. The introduction of taxes or changes in prices/tariffs has also indirect impact on the demand (thus volumes) of the respective businesses. In Hidroelectrica's case, the main stock specific risks are: a) in relation to its ongoing litigations that led to the second entering into insolvency (amounts in dispute as per the judicial administrator at EUR 351mn maximum). b) hydrological situation, c) the risk that some of the restructuring measures in terms of staff, operations, capex etc. are overturned after the exit of insolvency. With regards to CE Oltenia we lack visibility on staff restructuring, spin off of certain mines, capex plans (to date most of capex's company is a wish list of the capex of the merged companies, without a clear prioritization from the risk/return perspective and no clarity on the financing sources), as well on as the exact burden of the costs with the CO2 certificates (if there would be a part of the capex plan indirectly financed via the so called partly free allocation of the CO2 certificates).

## FP vs. the SIFs

The key difference playing in FP's favor is the attribute of the management which is geared towards increasing shareholder value via the embrace of an activist stance and real portfolio restructuring. However, an officially active investment strategy at FP is limited in practice to a certain extent by state's interference in various ways, while at SIFs, with their rather passive strategy (except for SIF 2, 3 and 5), the state interference is mostly related to the ownership threshold (which can be increased/removed only with parliamentary approval). FT charges each quarter a 0.6% fee of the average market capitalization of the quarter on a pro-rata basis; at SIFs there is no management fee (with the exception of SIF 4); for the other SIFs, the management is employed by the SIFs and the part of the compensation linked to the appreciation of the NAVs or share price is not significant within the overall compensation (if any);

While FP is a play on the Romanian energy sector (85% of the 1H14 official NAV), the SIFs still offer exposure mainly to the financial sector (ca. 50% on average as at June 2014), although the exposure on the energy sector has been on an upward trend.

FP still has a higher weight of unlisted holdings in total assets vis-à-vis the SIFs (42% vs. an average of 15.2% for the SIFs, based on the latest official values as at the end of September 2014).

In the official valuation, the unlisted holdings can be computed either based on fair values or book values at FP and SIF 2 while the other SIFs opted to value them only based on the most recent book values.

In the case of the SIFs, ownership restrictions are still in place (Parliament approved in December 2011 and the President promulgated in January 2012 the increase in the ownership threshold for a single shareholder or group of shareholders acting in concert from 1% to 5% of the capital; a further increase or removal of the threshold was declared by the FSA Vice President Mr. Mircea Ursache, as not being opportune in 2014, while a regulation of changing the Capital Market Law would leave at SIF's GSM discretion the possibility to remove, maintain or increase the threshold).

At FP, the shareholding structure is less fragmented than for the SIFs (7,914 shareholders on 8 Sept 2014 vs. between 5.8mn and 7mn for the SIFs).

All are the most liquid stocks on the BSE, with FP's volume accounting for 45% of its share capital (for the period 3 Jan 2013-23 October 2014) vs. the SIFs' average of 52% (66.6% highest value at SIF 2 and 31.5% the lowest value at SIF 4).

**Table 1: Yoy changes in official NAVs (FP vs. the SIFs)**

| | SIF1 | SIF2 | SIF3 | SIF4 | SIF5 | Average SIFs | FP |
|---|---|---|---|---|---|---|---|
| 2011 | -4.7 | -3.8 | -11.6 | -12.7 | -9.0 | -8.4 | -5.0 |
| 2012 | 1.8 | -0.6 | -14.3 | -14.0 | 1.1 | -5.2 | 5.4 |
| 2013 | 20.9 | 16.9 | -5.5 | -0.3 | 12.0 | 8.8 | 9.4 |
| YTD (Sept) | -2.5 | 3.9 | -0.6 | -3.4 | 1.6 | -0.2 | 0.0 |

*Source: FP, SIFs, IPOPEMA Research*

**Table 2: Discounts to Sept 14 official NAV and dividend yield (FP vs. the SIFs)**

| | SIF1 | SIF2 | | SIF3 | SIF4 | SIF5 | Average SIFs | FP |
|---|---|---|---|---|---|---|---|---|
| Discount to official NAV (%) | -56,3 | -38,1 | | -45,8 | -34,0 | -37,1 | -42,2 | -24,4 |
| DPS 2013 (RON)* | 0,0 | 0,066 | | | 0,00 | 0,16 | | 0,05 |
| Dividend yield (%) | 0,0 | 4,2 | 100% bonus issue | | 0,0 | 8,8 | -38,5 | 6,2 |

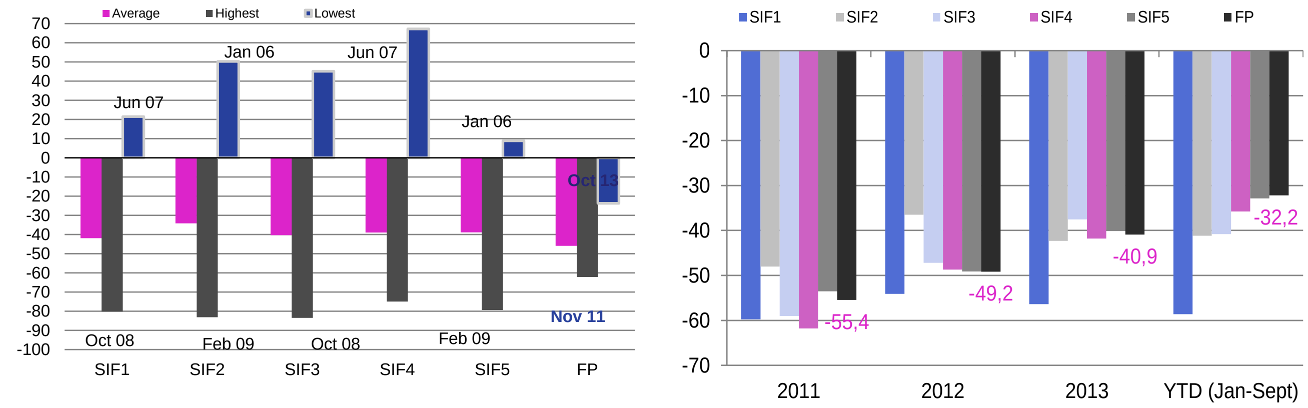
*Source: FP, SIFs, Bloomberg, IPOPEMA Research; *at FP the cash distribution*

**Table 3: FP and SIFs official NAVs as at end Sept 2014**

| RON mn | SIF 1 | SIF 2 | SIF 3 | SIF 4 | SIF 5 | FP |
|---|---|---|---|---|---|---|
| **Total shares, o/w** | **1,267** | **961** | **1,015** | **892** | **1,704** | **13,537** |
| Listed shares | 1,059 | 896 | 874 | 724 | 1,137 | 7,300 |
| Unlisted shares | 208 | 65 | 141 | 168 | 567 | 6,236 |
| T-Bills | 16 | 0 | 0 | 0 | 0 | 894 |
| Bonds | 34 | 11 | 39 | 1 | 0 | 3 |
| **Cash and deposits** | **91** | **93** | **41** | **44** | **67** | **334** |
| *mom (%)* | *9.7* | *82.0* | *88.4* | *-26.2* | *136.0* | *1.8* |
| yoy (%) | *27.2* | *57.8* | *-32.0* | *-77.7* | *127.3* | *-8.6* |
| as % of assets | *5.8* | *6.7* | *3.6* | *3.8* | *3.7* | *2.3* |
| **Total assets** | **1,580** | **1,391** | **1,162** | **1,164** | **1,811** | **14,769** |
| Liabilities | 24 | 66 | 91 | 139 | 139 | 50 |
| Provisions | 49 | 57 | 61 | 22 | 49 | 15 |
| 2013 prel. net profit | 80 | 91 | 190 | 132 | 130 | 682 |
| yoy (%) | -20 | -34 | -11 | 3 | 47 | 20 |
| 9M14 net profit | 151 | 223 | 22 | 210 | 72 | 985 |
| *9M14 as % FY budget* | *188.7* | *189.4* | *43.4* | *308.6* | *79.5* | *177.4* |
| **NAV** | **1,556** | **1,324** | **1,071** | **1,025** | **1,672** | **14,703** |
| **NAVPS (RON)** | **2.8357** | **2.5515** | **0.4903** | **1.2703** | **2.8824** | **1.2438** |
| *mom (%)* | *-2.1* | *0.0* | *1.6* | *-1.1* | *2.6* | *-1.6* |
| *yoy (%)* | *0.1* | *11.1* | *1.3* | *-4.6* | *9.9* | *7.1* |
| *ytd (%)* | *-2.5* | *3.9* | *-0.6* | *-3.4* | *4.3* | *0.0* |
| *qoq (%)* | *-4.5* | *-1.9* | *-7.3* | *-0.5* | *-2.7* | *-0.6* |
| **Current price (RON) 23 Oct 2014** | 1.24 | 1.58 | 0.27 | 0.84 | 1.81 | 0.94 |
| **Discount to official NAV (%)** | **-56.3** | **-38.1** | **-45.7** | **-34.0** | **-37.1** | **-24.4** |

*Source: FP, SIFs, IPOPEMA Research*

**Chart 2: Discounts to NAV (highest, lowest): To date (left chart) Discounts to official NAVs (yearly averages)**




***Source: Company data, Bloomberg, IPOPEMA Research*** ***Source: Company data, Bloomberg, IPOPEMA Research***

## Valuation summary

**Official valuation methodology in brief**. The listed companies traded in the previous 30 days are valued based on closing prices on the particular valuation day. Unlisted companies and listed companies that were not traded in the previous month may be valued either a) according to international valuation standards (at fair values) or b) based on the latest book values.

From June to November 2012, FP's official NAV reflected a zero valuation for Hidroelectrica, following the entry of the company in insolvency (down from RON 3,289mn). Starting December 2012, the NAV reflects the change in the official valuation methodology which allows companies in insolvency to be valued based on an independent valuation report. As a result, there was an upward revision of Hidroelectrica's valuation from zero to RON 2,001mn. Another change was a RON 195mn downward revision of CE Oltenia's valuation to RON 880mn. In Dec 2013, FP updated the valuation of several unlisted holdings, which resulted in a negative impact on its NAV of RON 75.3mn. The most important revisions were made for Hidroelectrica (+RON 238.4mn) and CE Oltenia (-RON 558.4mn), which led to valuations of FP's respective stakes of RON 2,239mn and RON 321.6mn. Following Hidroelectrica re-entering in insolvency on 25 Feb 2014, FP revised down marginally its valuation to RON 2,105mn. In 2Q14, FP updated again the valuation of some holdings (upwards for part of its electricity supply companies and downwards mainly for CE Oltenia, whose valuation was further reduced by RON 202mn to RON 120mn). The April 2013 NAV excluded the RON 0.04089 gross DPS figure, while the June 2014 NAV the RON 0.05/share cash distribution. A summary of the latest changes in the official valuation of FP's most important holdings is displayed below:

**Table 4**: **Changes in the official valuation of key holdings**

| Impact in NAV of revaluations (RONm) | Dec-12 | Dec-13 | May-14 | Jun-14 | Values as at June 2014 |
|---|---|---|---|---|---|
| Hidroelectrica | 2,001.0 | 238.4 | -134.2 | | 2,105.2 |
| Nuclearelectrica | 150.4 | | | | 1,337.4 |
| CE Oltenia | -195.1 | -558.4 | | -202.0 | 120.0 |
| EMD | -75.8 | 21.4 | | | 345.4 |
| **CNAB** | **-50.4** | **15.7** | | | **287.7** |
| Zirom SA | -16.5 | -3.9 | | | 43.5 |
| Posta Romana | -15.6 | -20.0 | | | 60.8 |
| **Sub-total** | **1,798.0** | | | | |
| EON Gaz Distributie | | -11.5 | | | 165.2 |
| EDMN | | 18.3 | | | 296.2 |
| EDTN | | 6.0 | | | 206.7 |
| EDTS | | -20.7 | | | 192.0 |
| EDB | | 87.4 | | | 573.2 |
| **EDD** | | **54.9** | | | **379.1** |
| EDM | | 38.9 | | | 473.1 |
| GDF Suez | | 58.2 | | | 404.4 |
| **Sub-total** | | **-75.3** | | | |
| Electrica Furnizare | | | 88.0 | | 88.0 |
| Constanta Airport | | | | -1.4 | 2.3 |
| E.ON Energie Romania | | | | 35.7 | 130.9 |
| Enel Energie Muntenia | | | | 15.8 | 65.1 |
| Enel Energie | | | | 24.7 | 74.3 |
| **Sub-total** | | | | **-127.2** | |

*Source: FP, IPOPEMA Research*

## Ipopema fair value calculations

We use the June 2014 portfolio of shares. We mark to market the listed companies, using the share prices as of 23 October 2014 in the case of the largest holdings such as OMV Petrom, Romgaz, Nuclearelectrica, Transelectrica (which was sold after 1H14), the two Romanian banks (BRD Groupe SG and Banca Transilvania), while for the other listed holdings we apply a 10% discount due more limited visibility and for companies that are in reorganization/insolvency or have negative book values, we assign zero value (as in the official valuation).

We value the largest unlisted companies using the most appropriate financial or operational multiples for each sub-sector. We use either transaction multiples or peers' multiples based on operational indicators: capacity and/or reserves, number of customers or number of passengers (depending on the sector), or financial multiples or combinations of the above. While this valuation approach does not fully reflect the potential (be it upside or downside) of these companies, in our view it is safer to use than DCF based valuations, with a high number of variables and limited visibility on them as most of these companies are undergoing sizeable, but often changing capex and/or operational restructuring processes. The data on these key inputs for a DCF valuation is often lacking and/or scarce and/or contradictory. We are aware however, that the multiples based valuation also has its limitations, one key reason being that finding the right peers is a difficult exercise, as most of the companies in FP's portfolio in the energy sector are not vertically integrated as its peers are. However, as we generally applied hefty discounts to peers, we consider our valuations rather conservative.

A summary of the companies for which we computed fair values (15 out of the total 38, 92.5% of our fair value of unlisted portfolio and 43.8% of the total value of the securities portfolio) and the valuation methods used are presented in the tables on the following two pages. Additional data on how we value individual holdings are presented in the company sections later in this report.

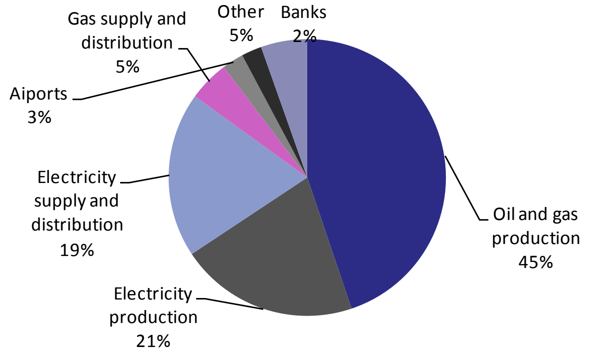
We use the official valuation for the other unlisted companies to which we applied a 25% discount to account for limited visibility.

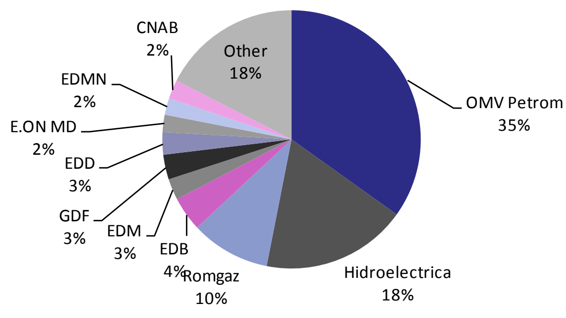
**The resulting fair NAV is RON 14,540mn or RON 1.23/share:** To the total value of the portfolio of shares determined as SOTP, we add the cash and other assets and deduct the liabilities).

We apply a 15% discount to the resulting fair NAV primarily for the holding status and high exposure to majority state-owned companies. We then roll it forward by a year, using the cost of equity, in order to derive our 12M target price of RON 1.14/share.

We use a COE of 8.7% (RFR for Romania of 4%, ERP of 6% and a beta of 0.79x).

**Chart 3: Breakdown of portfolio fair value: by sector (left chart) and top 10 holdings (right chart)**




*Source: FP, IPOPEMA Research*

*Source: FP, IPOPEMA Research*

### Table 5: Summary of valuation methods for key holdings' fair values' calculations

| Company/Sector | Valuation method |
|---|---|
| Listed companies | Mark to market as at 23 oct 2014 |
| **Unlisted companies** | |
| **Power generation** | |
| Hidroelectrica (hydro) | EV/Capacity, EV/EBITDA, P/E (simple average) |
| CE Oltenia (thermal , lignite fired) | EV/Capacity 20% weight, EV/EBITDA and EV/Sales 40% each |
| **Electricity distribution** | |
| ENEL Distributie Muntenia (EDM) | EV/EBITDA and EV/Customer (simple average) |
| ENEL Distributie Banat (EDB) | EV/EBITDA and EV/Customer (simple average) |
| ENEL Distributie Dobrogea (EDD) | EV/EBITDA and EV/Customer (simple average) |
| ELECTRICA Distributie Muntenia Nord (EDMN) | EV/EBITDA and EV/Customer (simple average) |
| ELECTRICA Distributie Transilvania Sud (EDTS) | EV/EBITDA and EV/Customer (simple average) |
| ELECTRICA Distributie Transilvania Nord (EDTN) | EV/EBITDA and EV/Customer (simple average) |
| E.ON Moldova Distributie (EMD) | EV/EBITDA and EV/Customer (simple average) |
| **Electricity supply** | |
| ENEL Energie Muntenia | Official valuation |
| ENEL Energie | Official valuation |
| Electrica Furnizare | Official valuation |
| **Gas distribution and supply** | |
| GDF Suez Energy Romania (GDF) | EV/EBITDA (80% weight), P/E (20% weight) |
| E.ON Gaz Distributie (EGD) | EV/EBITDA (80% weight), P/E (20% weight) |
| E.ON Energie Romania (E.ON ER) | EV/EBITDA (80% weight), P/E (20% weight) |
| **Airports** | |
| Bucharest Airport (CNAB) | EV/EBITDA (50% weight), EV/passenger (market multiples) (20%), P/Sales (30%) |
| Traian Vuia Timisoara Airport (TVT) | EV/EBITDA (50% weight), EV/passenger (market multiples) (20%), P/Sales (30%) |
| Mihail Kogalniceanu Constanta Airport* (MKC) | EV/EBITDA (50% weight), EV/passenger (market multiples) (20%), P/Sales (30%) |
| Other unlisted | Official valuation *0.8 |

*Source: FP, IPOPEMA Research*

### Table 6: Summary of the fair values for the key holdings vs. official values

| | | Value of FP stake (RON mn) | | as % in portfolio | | |
|---|---|---|---|---|---|---|
| **Company** | **FP stake (%)** | **icial value** | **Fair value** | **Official value** | **Fair value** | **Fair vs. official (%)** |
| Petrom (oil&gas) | 19.0 | 5,185.7 | 4,713.4 | 37.5 | 34.9 | -9.1 |
| Romgaz (natgas) | 15.0 | 1,337.4 | 1,344.8 | 9.7 | 9.9 | 0.5 |
| Nuclearelectrica (nuclear genco) | 9.7 | 221.2 | 214.9 | 1.6 | 1.6 | -2.9 |
| Transelectrica (utilities) | 13.5 | 222.6 | 267.2 | 1.6 | 2.0 | 20.0 |
| BRD Groupe SG (financials) | 3.6 | 239.4 | 205.6 | 1.7 | 1.5 | -14.1 |
| Banca Transilvania (financials) | 2.5 | 115.9 | 114.4 | 0.8 | 0.8 | -1.2 |
| Other listed | | 275.4 | 248.5 | 2.0 | 1.8 | -9.8 |
| **Total listed shares** | | **7,597.6** | **7,108.8** | **55.0** | **52.6** | **-6.4** |
| Hidroelectrica (hydro power) | 19.9 | 2,105.2 | 2,461.6 | 15.2 | 18.2 | 16.9 |
| CE Oltenia (thermal power) | 21.6 | 120.0 | 141.1 | 0.9 | 1.0 | 17.6 |
| EDB (electricity distribution) | 24.1 | 573.2 | 581.9 | 4.1 | 4.3 | 1.5 |
| EDD (electricity distribution) | 24.1 | 379.1 | 379.3 | 2.7 | 2.8 | 0.0 |
| EDM (electricity distribution) | 12.0 | 473.1 | 358.3 | 3.4 | 2.7 | -24.3 |
| EMD (electricity distribution) | 22.0 | 345.4 | 293.1 | 2.5 | 2.2 | -15.1 |
| EDMN (electricity distribution) | 22.0 | 296.2 | 282.8 | 2.1 | 2.1 | -4.5 |
| EDTS (electricity distribution) | 22.0 | 192.0 | 237.6 | 1.4 | 1.8 | 23.7 |
| EDTN (electricity distribution) | 22.0 | 206.7 | 209.4 | 1.5 | 1.5 | 1.3 |
| GDF (gas&electricity distribution& supply) | 12.0 | 404.4 | 419.1 | 2.9 | 3.1 | 3.6 |
| E. ON GD (gas distrbution) | 12.0 | 165.2 | 106.2 | 1.2 | 0.8 | -35.7 |
| E.ON ER (gas&electricity distribution& supply) | 13.4 | 130.9 | 114.8 | 0.9 | 0.8 | -12.3 |
| ENEL Energie Muntenia (electricity supply) | 12.0 | 65.1 | 65.1 | 0.5 | 0.5 | 0.0 |
| ENEL Energie (electricity supply) | 12.0 | 74.3 | 74.3 | 0.5 | 0.5 | 0.0 |
| Electrica Furnizare (electricity supply) | 22.0 | 88.0 | 88.0 | 0.6 | 0.7 | 0.0 |
| Bucharest airports | 20.0 | 287.7 | 319.7 | 2.1 | 2.4 | 11.1 |
| Timisoara airport | 20.0 | 1.7 | 17.6 | 0.0 | 0.1 | n.m. |
| Constanta airport | 20.0 | 2.3 | 2.2 | 0.0 | 0.0 | -4.0 |
| Posta Romana | 25.0 | 60.8 | 48.6 | 0.4 | 0.4 | -20.0 |
| Other unlisted | | 257.5 | 206.0 | 1.9 | 1.5 | -20.0 |
| **Total unlisted shares** | | **6,228.6** | **6,406.7** | **45.0** | **47.4** | **2.9** |
| **Total portfolio** | | **13,826.1** | **13,515.5** | **100.0** | **100.0** | **-2.2** |
| Total cash | | 491.4 | 491.4 | | | 0.0 |
| Other assets | | 1,187.8 | 1,187.8 | | | 0.0 |
| **Total assets** | | **15,505.3** | **15,194.7** | | | -2.0 |
| Liabilities | | 639.9 | 639.9 | | | |
| Tax | | 14.9 | 14.9 | | | |
| NAV | | 14,850.5 | 14,539.8 | | | |
| **NAV/share (RON)** | | **1.2518** | **1.2306** | | | |
| Discount (%) | | | 15.0 | | | |
| Fair price (RON) | | | 1.05 | | | |
| COE (%) | | | 8.71 | | | |
| **12M TP (RON)** | | | **1.14** | | | |

*Source: FP, IPOPEMA Research*

## Sensitivity analysis

In the first scenario, we apply a higher discount to our fair NAV to calculate FP's fair value: an increase by 10pp of the discount compared to the base case reduces the 12M target price by 12.3% and the upside to 6.4% vs. 21.3% in the base case. Thus, FP would deserve a Hold rating only.

A pessimistic scenario in which we account only for the stakes in a) the key listed companies (Petrom, Romgaz, Nuclearelectrica, BRD Groupe SG, BT); and b) the cash figure, would yield a 12M target price of RON 0.64, 44% lower vs. the base case and would offer a 32% downside. In this scenario, FP would deserve a Sell rating.

Scenarios 3-4 related to Hidroelectrica's valuation: Changes in the discounts applied when valuing Hidroelectrica (+/- 10pp compared to the value in the base case of 20%) would add 1.8% to our 12M target price or cut it by 2.6%.

In the last scenario, we assign a zero value to Hidroelectrica as it is currently in insolvency (although just on procedural grounds and not due to poor financial standing) and to CE Oltenia (a very distress and unstructured company). In this case, our 12M target price would be RON 0.93/share, by 18.4% lower than in the base case and given the 1.1% downside FP deserve only a Sell rating.

**Table 7: Sensitivity analysis for FP's 12M TP**

| 12M TP (RON) Base case | 1.14 | |
|---|---|---|
| **Scenario 1** | | **Discount to fair NAV 10pp higher than in the base case** |
| **12M TP (RON)** | **1.00** | |
| Difference vs. base case (%) | -12.3 | |
| **Scenario 2** | | **Only cash and holdings in the key listed companies** |
| **12M TP (RON)** | **0.64** | |
| Difference vs. base case (%) | -43.9 | |
| **Scenario 3** | | **Discount used in the valuation of Hidroelectrica 10pp higher than in the base case** |
| **12M TP (RON)** | **1.11** | |
| Difference vs. base case (%) | -2.6 | |
| **Scenario 4** | | **Discount used in the valuation of Hidroelectrica 10pp lower than in the base case** |
| **12M TP (RON)** | **1.16** | |
| Difference vs. base case (%) | 1.8 | |
| **Scenario 5** | | **Hidroelectrica's and CE Oltenia fair values reduced to zero** |
| **12M TP (RON)** | **0.93** | |
| Difference vs. base case (%) | -18.4 | |

*Source: FP, IPOPEMA Research*

## Key background information and latest news

FP is a ca. RON 15bn in assets restitution fund created in 2005 initially to compensate individuals' whose properties where nationalized during the communist regime. Currently the state has finalized the compensation process (the Ministry of Finance remained a shareholder of only some 2.7% of the capital in the form of unpaid shares). Since end Sept 2010, FP is managed by Franklin Templeton (FT), one of the largest global asset managers (ca. USD 880bn AUM) and a lead investor in emerging and frontier markets. FP is listed on the Bucharest Stock Exchange (BVB) since January 2011 and has EUR 2.6bn MCap (100% free float).

### Management and Board of Nominees

**Franklin Templeton Investment Management UK Ltd. is FP's sole director and investment manager** after winning in 2009 an international tender (it effectively took over the management on 30 Sept 2010 and in its first 4Y mandate was remunerated with an annual fee of 0.479% of the market capitalization payable quarterly). The proposal of the largest shareholders (Elliot Associates) approved in the April 2012 EGM of an additional fee (of 1% on additional distributions in 2014) (buybacks, special dividends, asset sales) was not approved by the FSA on grounds that it was not part of the terms under which FT won the original mandate. For the second 2Y mandate, a new type of remuneration applies based on an annual fee linked to market cap (0.6%) payable quarterly and a variable fee linked to exceptional distributions similar to the ones approved in the April 2012 EGM (200bp by 31 Oct 2015 and 100bp onwards). FT's mandate is subject to meeting certain performance criteria (discount to NAV/share of max. 15%, increase in NAV/share during 30 Sept 2014 and 30 June 2015), which if not met after 1 year, oblige FT to call for an EGM that can vote the early termination of the mandate. The new IMA was partly approved by the FSA (FSA has again not approved the variable fee). However, the FSA seems to agree that some changes in the law that sets FP's activity are required to reflect changes in FP's ownership structure so that the shareholders be the ones approving the way the fund manager is appointed and remunerated (basically the changes would refer to the elimination of the references to an international tender offer, which would also allow the reinstatement of the variable Distribution Fee).

**The Board of Nominees (BoN)** is the entity representing the shareholders in relation with the fund manager, whose activity is also monitoring. The current BoN has 5 members (with 4 year mandates), of which Piotr Rymaszewski (CEO & Fund manager of the Polish privatization fund Octavia), Steven van Groningen (President and CEO of Raiffeisen Bank Romania) and Mark Gitenstein (former US Ambassador to Romania) were proposed by FP's largest shareholder (Elliot) and Julian Healy was proposed by City of London (at the time second largest shareholder with a 7.2% stake). The 19/20 November 2014 GSM is to elect 3 new board members, given that the mandates of Mr. Healy, Rymaszewki and van Groningen expire in April 2015 (they submitted their candidacies).

### Shareholding structure- foreign investors own ca. 55% of the paid capital

The main shareholder remains Elliot Associates with a 16.6% stake, via two fully owned funds Manchester Securities (15.22%) and Beresford Ltd., followed by City of London (just under 5%) and Mrs. Georgia Palade van Dusen, the granddaughter of the Romanian industrialist Nicolae Malaxa. Part of the shares are held including via swaps and structured products issued by likes of Morgan Stanley (ca. 5% stake), RBS (ca. 3.5%) and Raiffeisen (without voting rights). Overall, foreign institutional shareholders held 53.6% of the subscribed capital (on 8 Sept 2014), up from 20.4% in March 2011, while Romanian individuals' stake declined during the same period from 28.3% to 19.1% (Ministry of Finance had 36.8% in March 2011). Foreign individuals hold 5.36% of the capital, while Romanian institutional shareholders 9.22% (of which 1.53% was in the SIFs hands as at the end of June 2014). 10% of the share capital were Treasury shares (currently only ca. 2% as the shares from the second buyback were cancelled) and 2.72% of the share capital is still in the hands of the Ministry of Finance (as unpaid shares).

## Portfolio management

Investment guidelines for the new portfolio provide for minimum 70% of the assets to be invested in Romanian listed shares, maximum 20% in unlisted shares and maximum 10% exposure on a single issuer. Some of the holdings in the legacy portfolio do not comply with the above mentioned thresholds, meaning FP cannot further invest in those companies, but it is allowed to participate in capital increases in order not to be diluted (and is not obliged to sell stakes either). FP has only 2 holdings above the 10% threshold in a single company (OMV Petrom with a 34.4% weight in its Sept 2014 official NAV, Hidroelectrica (14.3%). FP's unlisted holdings account for 42.4% of the Sept 2014 official NAV (before the Romgaz and Nuclearelectrica's IPOs last autumn, the figure was 54.2%). Top 10 holdings account for ca.77% of the official NAV. Sector wise, energy in the largest sense accounts for 84.5% of the official NAV (oil and gas 44.7%, electricity production ca. 16.7%, electricity and gas supply and distribution ca. 23.1%), infrastructure (2.7%) and banks (2.4%).

## Asset sales vs. acquisitions

FP has currently holdings in 56 companies (of which 18 listed and 38 unlisted). Their number decreased over time via mergers or disposals. Compared to the initial portfolio, the only acquisitions were the Austrian banks Erste Bank and Raiffeisen International and the Romanian banks BRD and BT.

**Table 8: Main FP's acquisitions**

| Company | Date | Stake purchased | Value (RON mn) | Stake held end of period |
|---|---|---|---|---|
| BRD-Groupe SG | 1Q11 | 1.13% | 96.8 | 1.69% |
| | 2Q11 | 0.55% | 53.2 | 2.24% |
| | **3Q11** | 1.37% | 95.2 | 3.60% |
| | 4Q11 | 0.04% | 2.6 | 3.64% |
| Erste Group | 1Q11 | 0.26% | 138.8 | 0.25% |
| | 2Q11 | 0.07% | 34.1 | 0.32% |
| Banca Transilvania | 2Q11 | 0.13% | 2.0 | 0.12% |
| | 3Q11 | 2.18% | 31.2 | 2.30% |
| | 4Q11 | 0.63% | 8.4 | 2.93% |
| Raiffeisen International | 1Q11 | 0.43% | 133.8 | 0.43% |
| | 2Q11 | 0.12% | 30.6 | 0.55% |
| Conpet | 3Q11 | 9.64% | 25.9 | 29.69% |
| Azomures | 1Q11 | 1.07% | 3.5 | 8.75% |
| | **2Q11** | 1.98% | 8.2 | 10.74% |
| | 3Q11 | 0.35% | 1.5 | 11.09% |
| | 4Q11 | 0.03% | 0.2 | 11.12% |
| Nuclearelectrica | 3Q13 | Preemption rights before IPO | 30.6 | 9.73% |
| **Total investments (RON mn)** | | | **696.6** | |

*Source: FP, IPOPEMA Research*

In the last 1-2 years, FP officials often stated that the best investment is not in other companies (yet FP participated in capital increases of some of its holdings such as in Nuclearlelectrica's IPO in order not to be diluted) but rather in its own shares. This indeed was profitable for FP, especially when the shares were trading at a high discount to the official NAV.

Asset disposals were mostly of smaller holdings (inefficient as they were no dividend plays or not brought capital gains but rather administrative hassle). Stakes in Azomures, Transgaz and Transelectrica, Erste Bank and Raiffeisen International (full exit) as well as in OMV Petrom (sale of a 1.1% stake from the initial 20.1%) and Romgaz (sale of a 5% stake from the initial 15%) were the largest trades to date. Total proceeds from asset disposals in 2013 reached RON 573mn (FP sold its entire holdings in Carom Broker de Asigurare, Mecanoenergetica, Ciocirlia, Telerom Proiect, Celuloza si Otel and Transgaz (for RON 303m), finalized the disposal of its holding in Commetex and sold a stake in Raiffeisen International. In 1H14, FP sold its stakes in Resib, Turdapan and Austrian banks (Erste and Raiffeisen) and part of the holding in Oil Terminal (in 1Q14) as well as in Primcom and Romgaz (in 2Q14).

**Table 9: Main FP's sale trades**

| Company | Date | Stake sold | Value (RON mn) | Stake held end of period |
|---|---|---|---|---|
| Erste Group | 2Q12 | 0.21% | 49.4 | 0.10% |
| Raiffeisen International | 2Q12 | 0.12% | 22.2 | 0.43% |
| Azomures | 2Q12 | 11.13% | 129.9 | 0.00% |
| OMV Petrom | 2Q13 | 1.11% | 246.7 | 18.99% |
| Trangaz | 4Q13 | 14.98% | 303.5 | 0.00% |
| Erste Group | 1Q14 | 0.10% | 47.9 | 0.00% |
| Raiffeisen International | 1Q14 | 0.43% | 79.2 | 0.00% |
| Romgaz | 2Q14 | 4.99% | 644.6 | 10.00% |
| Transelectrica | 3Q14 | 13.49% | 212.7 | 0.00% |
| **Total (RON mn)** | | | **1,736.3** | |

*Source: FP, IPOPEMA Research*

The sale of OMV Petrom and Transelectrica stakes in the two ABBs were performed at prices that led FP to book some accounting losses (RON 71mn and RON 50mn respectively). Accounting losses were also booked when selling the stakes in the Austrian banks. However, the benefit of such sales was the increase in the free float of the respective companies, which eventually helped their share price appreciations. The other two ABBs for Romgaz and Trangaz were performed at relatively hefty accounting gains.

Going forward, as part of its portfolio management and in order to satisfy shareholders' requests in terms of cash distributions and buybacks, FP is likely to be more aggressive as to the sale of other liquid (listed) assets from its portfolio. In the table below, we present our estimates on the accounting profit or loss from such sales (assuming the entire stakes as at the end of June 2014 would be sold at once at prices on 23 October 2014). As the table show, most such sales would translate into accounting losses (BT and Romgaz being the most notable exceptions). Announced disposals refer to the entire stake in Conpet and to the reduction of the stake in Petrom to below 15%.

**Table 10: Potential gain/loss on future asset sales**

| RON/share | RON/share Cost | Current price | Potential profit or loss (RON mn) |
|---|---|---|---|
| Petrom | 0,50 | 0,44 | -683,6 |
| Romgaz | 10,80 | 34,89 | 928,5 |
| Nuclearlectrica | 35,31 | 7,84 | -753,0 |
| Alro | 2,42 | 1,18 | -90,5 |
| BRD | 12,85 | 8,10 | -120,5 |
| BT | 0,92 | 1,77 | 54,6 |
| Conpet | 26,95 | 50,50 | 60,5 |
| Oil Terminal | 0,27 | 0,10 | -6,3 |
| Primcom | 17,77 | 13,14 | -6,6 |
| Romaero | 44,62 | 13,00 | -41,5 |

***Source: FP, IPOPEMA Research***

**Table 11: Gain/loss on ABB's performed to date.**

| | RON/share Cost | RON/share Price in ABB | Discount vs. reference price | Accounting loss RON mn |
|---|---|---|---|---|
| Petrom | 0.50 | 0.39 | 9.3% | -70.6 |
| Trangaz | 100.5 | 172.0 | 9.7% | 126.2 |
| Romgaz | 10.8 | 33.5 | 5.9% | 436.8 |
| Transelectrica | 26.5 | 21.5 | 8.0% | -49.9 |

***Source: FP, IPOPEMA Research***

**Would FP be liquidated?** In our opinion, no, but in time, FP is likely to become a much smaller fund than today. FP would need to gradually sell most of its liquid assets to return money to shareholders in the form of buybacks and distributions (as other sources such as dividend income from portfolio companies and interest income could prove insufficient). Obviously this would be a slow process, and FP has proven to date a good manager of its liquidities (it can also leverage to a certain limited extent). FP's CEO was quoted in Ziarul Financiar daily saying that "FP is a too large fund for this market".

## Latest developments

### Pipeline of deals

FP has been pushing for companies in its portfolio to become listed, as a way of their re-rating and eventually reducing the discount to NAV at which FP shares trade. The most important completed and future transactions are displayed in the table below (for future deals, the potential deal values are based on the valuation in FP's latest official NAVs). In our opinion, Hidroelectrica's IPO is to take place after the company exits from its technical insolvency. CE Oltenia story is a difficult one (due to the lack of a meaningful restructuring to date; also the audit of the coal reserves awaiting completion towards the year end is a pre-requisite for the IPO). As a result, these two seemingly largest deals are more likely for 2015-2016.

The other possible deals look small in size. Another potentially interesting transaction could occur in Salrom (the operator of Romania's salt mines). Initially, FP officials indicated that FP might decide to sell 10%-15% out of its 49% stake in the company in conjunction with the sale by the State of part of its 51% stake. Lately, statements from government officials seem to suggest that due to the strategic nature of the company, the state might not sell after all, but as majority shareholder would still take the decision in case of an IPO in which FP may sell part of its stake.

Companies that are majority owned by the Ministry of Transportation in which FP is also shareholder seem less attractive, mainly some of the ports, as the stakes to be IPO-ed are very small and several changes in the ministry created additional difficulties in handling the process. Another potential candidate for an IPO of a company majority owned by the Ministry of Transportation is Bucharest Airports (CNAB).

FP is seeking to sell to Electrica its 3 electricity distribution subsidiaries and the supply subsidiary (Electrica is to use part of the IPO proceeds for this purpose). FP is a minority shareholder in 13 such companies (including gas distribution and supply companies) with a cumulative value of ca. RON 3.4bn or 22.6% in FP's June 2014 NAV. FP announced its intention to sell them, mandating in March 2012 Citigroup Global Markets as exclusive intermediary. To date, there was no transaction closed (delays were mainly due to various litigations between the Romanian state and their majority shareholders (mostly deriving from different interpretation of provisions in the initial privatization contracts) and/or unclear sector related regulations.

**Table 12: IPO, SPO, ABB and other potential deals' calendar**

| Company | Offering stake (%) | Value (EUR mn) | Discount vs. ref. price (%) | Seller | Investment consortium | Timing |
|---|---|---|---|---|---|---|
| Transelectrica SPO | 15.0 | 38 | | Romanian State | BCR, Swiss Capital, Intercapita | Mar-12 |
| Transgaz SPO | 15.0 | 72 | | Romanian State | Raiffeisen, Wood&Co, BT Secu | Apr-13 |
| OMV Petrom ABB | 5.0 | 57 | 9.3 | FP | Wood&Co, Raiffeisen | May-13 |
| Nuclearelectrica IPO | 10.0 | 63 | | New shares | Swiss Capital, BT Securities | Sep-13 |
| Romgaz IPO | 15.0 | 391 | | Romanian State | Goldman Sach, Erste-BCR, Ra | Nov-13 |
| Transgaz ABB | 15.0 | 68 | 9.7 | FP | Citi, Raiffeisen, Wood&Co. | Dec-13 |
| Romgaz ABB | 5.0 | 146 | 5.9 | FP | Goldman Sach, Erste-BCR | Jun-14 |
| Electrica IPO | 51.0 | 444 | | New shares | Citi, Raiffeisen, Swiss Capital, | Jun-14 |
| Transelectrica ABB | 13.5 | 48 | 8.0 | FPP | Raiffesen, UniCredit, SSIF Bro | Jul-14 |
| **Sub total completed deals** | | **1,327** | | | | |
| Hidroelectrica IPO | 15 | 352 | | New shares | Raiffeisen, Morgan Stanley | 2H15-1H16 |
| CE Oltenia IPO | 12.3 | 15 | | New shares | BRD Groupe SG, Swiss Capita | 1H15 |
| Posta Romana | >50 | 55 | | New shares | KPMG, Tuca, Zbarcea & Asso | 1H15 |
| **Sub-total future deals** | | **422** | | | | |
| **Other** | **FP stake (%)** | **Value (EUR mn)** | **Market cap (EUR mn)** | | | |
| Constanta Port | 20 | 16 | 80 | | | |
| Bucharest Airport | 20 | 65 | 325 | | | |
| Salrom | 49 | 24 | 49 | | | |

*Source: FP, IPOPEMA Research*

FP's long term objective is that such IPOs to increase to 100% the weight in total NAV of the listed holdings (from the Sept 2014 value of 49.7%, as per the FSA valuation).

## FP as an activist shareholder

**FP has representation at the board level in 33 companies and has nominated 185 board members and 42 executive directors in companies that account for a cumulative stake in NAV of ca 83.2% (mid April 2014 data).** FP has been actively involved in the implementation of the new corporate governance regulations, with most of its portfolio companies having now their boards and CEOs appointed on the basis of the emergency ordinance 109/2011 applying to state owned companies (SOEs). FP also supported the introduction of a fair taxation on the additional revenues from gas price liberalization, it encouraged companies in the portfolio to put pressure on the energy market regulator (ANRE) to start recognizing all production costs, increase regulated prices and reduce quantities to be supplied on the regulated market. FP proposed and shareholders approved a new variable remuneration scheme for the management of the listed SOEs linked to the share price performance (apart from Transelectrica's case, where the stake was meanwhile sold, FP was less successful to date in Romgaz and Nuclearelectrica's cases).

**FP has been active at the board level in taking actions aiming at protecting and increasing the value of the underlying holdings,** on top of the above mentioned general actions. FP gas been closely working with Hidroelectrica's judicial administrator during insolvencies to ensure an efficient restructuring process while significantly improving its cash flow. FP has initiated litigations to stop actions detrimental for portfolio companies such as the 2010 Romgaz donation, Hidroelectrica's bilateral contracts, the set-up of the energy champions and the compensations granted to CE Oltenia's management. FP's actions also led to the cancellation of a EUR 800mn Carbon Capture and Storage (CCS) project that would have implied significant capex and financing needs for two of FP's most important portfolio companies (Romgaz and CE Oltenia). FP also persuaded SOEs to resist commercial offers from Arcelor Mittal to sell electricity on OPCOM at prices significantly lower than the market prices and encouraged Romgaz to fully eliminate the practice of granting discounts to certain customers and to improve the profitability of the imported gas trading activity.

**FP's stance on the Tarnita-Lapustesti project and the Turkey-Romania submarine interconnection cable**

The Tarnita plant would be located in Cluj county, in Western Romania and would have 1,000 MW installed capacity and 1,625TW/year production (investment cost estimated at EUR 1.2bn). The current estimate for the feasibility study is EUR 78.6mn, according to some GSM materials published by Nuclearelectrica, however the estimate is from 2010-2011 and takes into account estimates for capex and energy volumes from 2008.

The Romania-Turkey submarine electricity interconnection cable would have a 400km length (400KV), would allow 800 MW worth of exports and would cost EUR 583mn, according to a feasibility study drafted in 2006.

The 2 projects are claimed to be necessary by the Romanian authorities in order to ensure the safety of the national grid given the volatility of wind power production and the potential commissioning of Units 3&4 of Cernavoda nuclear plant (in SNN) for Tarnita and higher export capabilities for the submarine cable. The project companies would have common shareholders (the power producers Hidroelectrica, CE Oltenia, SNN and CE Hunedoara, along with Romgaz and Electrica (also Transelectrica for the submarine cable project company yet to be set up). In both projects, the participations of SNN and CE Oltenia (and in the cable company also of CE Hunedoara) were approved by the respective companies' GSM, while in Romgaz case, the quorum was not met in the GSM and in Hidroelectrica's case, the participation was approved pending the approval of the Credit Committee also. The initial contributions per company should be RON 8.9mn (Tarnita) and EUR 2m (the cable). Studies on whether the projects could be partly financed with EU funds were ordered by the Ministry of Economy. In both projects, FP has challenged in court the GSM decisions referring to the participations of SNN, Hidroelectrica and CE Oltenia, as FP claims that the utility and economic efficiency of the two projects need to be demonstrated first (market conditions have changed significantly compared to the date of the initial feasibly studies in 2006-2008: decline in electricity demand in Romania makes uncertain the construction of new capacities, the fact that Turkey started to ensure alternative sources, to name only the most important aspects).

## Taxes impacting the energy sector at large

The Romanian government is planning to amend several taxes impacting the companies in the sector, as a way of offsetting the decline in budget revenues as a result of the 5pp reduction as of Oct 2014 of the the social security contributions. While discussions on the changes are likely to intensify ahead of November presidential elections, we expect most changes to be implemented next year. They refer to the special construction tax, excises (for fuels) and oil and gas royalties.

**The special construction tax might be cut by 33% in 2015.** The tax applies to the gross value of special infrastructure assets according to the previous year's financial statements. The tax was implemented as of 1 Jan 2014 and is payable twice a year on 25 May and 25 September on hydro, nuclear and thermal power plants, oil, gas and salt pipelines, electricity transportation infrastructure, runways and platforms, port and waterway infrastructure. The government's initial estimate on the proceeds from the tax was at ca. RON 448mn, while FP calculated RON 700-900mn tax for the companies in its portfolio and the amounts cashed in 1H14 were ca. RON 1.5bn. In many cases, the tax has been an important drag for private investments ytd as it accounted for a significant portion of the respective companies' 2013 net profits as follows: CE Oltenia (RON 31mn vs. a 2013 net profit of RON 4.6mn), Electrica Distributie Transilvania Nord and Sud (RON 15mn and RON 17mn respectively, i.e. 28% and 37% respectively), Hidroelectrica (RON 168mn, 24% of 2013 net profit), Nuclearlectrica (RON ca. 90mn vs. RON 423mn net profit in 2013), OMV Petrom (RON 265-330mn vs. RON 4.8bn 2013 net profit). The tax is likely to be reduced to 1% as of next year and included in full in the prices (to date this only applies to electricity generators, via inclusion in the tariff for the energy sold on the regulated market). Earlier in the year discussions revolved around changing the taxable base from the gross to the net value of assets. It is possible for offshore assets to be exempt having in view the Black Sea gas discovery and Romania's aim to become energy independent.

**The methodology for excise taxes might be revisited** as a result of an unfavorable (lower) fx rate. The authorities do not exclude a potential change in the excise taxes formula for 2015 as the 1 October 2014 EURRON rate (-0.9% yoy) would lead to lower revenues. For 2014 the tax formula took into account a 4.77% inflation rate (vs. 1.2% in September this year) and the 1 Oct 2012 fx rate. Such a calculation would put a further pressure on companies' earnings, after the introduction in April 2014 of the EUR 0.07/l excise tax on fuels that led to a significant reduction in fuel sales volumes.

**A new oil & gas royalty regime expected next year.** The talks with Romgaz and Petrom on the topic are likely to resume at the beginning of 2015, meaning a change might be implemented as of 2H15. PM Ponta indicated that a balance in ensuring a stable environment for investments in the longer run and in collecting revenues to the State budget close to the European average is to be sought. The royalty taxes on ongoing license agreements may remain unchanged (the average for Petrom and Romgaz is 7%-8%) and increased only for new licenses, and there is also the possibility of an additional tax to be introduced as it would be easier than to modify the taxes in the current contracts. Due to the Black Sea gas discovery (further results are expected early in 2015), we believe that Petrom has an increased negotiation power therefore the hike in royalties could be lower than the market expectations of a close to tripling of the average tax rate to ca. 20%.

## Litigations update

**Litigations with Mrs. Sfiraiala, a major hassle in FP's activity**: Over the past 3 years, FP has been involved in many lawsuits related to portfolio companies, the Romanian state, the regulator ANRE and shareholders (currently, there are more than 200 cases ongoing). In the latter category, the most numerous are by far the litigations with Mrs. Ioana Sfiraiala (to June 2014, FP won more than 170 cases against her and is in the process of the enforcement for recovering costs amounting to ca. RON 0.5mn). From the cases where so far Mrs. Sfiraiala is the winner we would mention only the most important as follows:

On 10 Oct 2012, the Bucharest Court of Appeal upheld a claim of Mrs. Sfiraiala to annul 4 resolutions of the Sept 2010 GSM in which Franklin Templeton (FT) was officially appointed as Fund Manager, on the grounds of a technical fault in the convening notice. After this, Mrs. Sfiraiala filed a significant number of other claims, all based on the argument that this decision meant that FT was not FP's valid fund manager. However, the matters to which the 4 annulled GSM resolutions relate had been approved and ratified by the shareholders with vast majority in other GSMs. Moreover, the GSM resolutions of 23 November 2012 and 25 April 2013 for the re-appointment of Franklin Templeton as Fund Manager were registered with the Trade Registry and published in the Official Gazette.

In Nov 2013, the Court of Appeal ruled against FP in a case filed by Mrs. Sfiraiala for the annulment of the EGM resolution no. 5/2010 for modifying FP's Constitutive Act approved by shareholders on 29 Nov 2010, and thus annulled the said EGM resolution. FP appealed the decision. We outline that FP's constitutive act was modified, ratified and re-approved by the shareholders in separate and subsequent resolutions in November 2011, April 2012, November 2012, April 2013, November 2013 and finally in February, April and September 2014.

Earlier in Oct 2013, the Bucharest Court ruled against FP and annulled 2 EGM and 2 OGM resolutions in a case initiated by Hidrosind, Hidroelectrica's trade union. These cases are in connection with cases initiated by Mrs. Sfiraiala in that the decisions in question are also linked with FT appointment as follows: the two EGM decisions refer to the ratification/re-adoption of 6 Sept 2010 EGM decisions that were irrevocably confirmed as annulled in other proceedings and the Trade Registry has already been updated, while the two OGM decisions relate to the ratification/re-adoption of the legal acts of FT as Sole Director during 29 Sept 2010 and 25 April 2012 and during 29 Sept 2010 and 23 Nov 2013 GSMs and the Court upheld these decisions.

FP's shareholders started to get used to these litigations and thus FP's share price tends not to react to news related to litigations irrespective of their outcome. In our view, the contradicting court rulings represent an inconvenient in FP's activity and we fail to understand their relevance especially given the fact that Templeton's first mandate following the wining of an international tender ended and shareholders have approved the extension of the mandate for a 2 year term starting 30 Sept 2014 under new terms and conditions.

In the same context, we fail to understand why the FSA was blocking the implementation of several GSM decisions (eg. the secondary listing-Warsaw listing was aborted after 2.5 years from the date of initial GSM approval, and meanwhile also the private pension reform in Poland made it less attractive), or the approval of the additional fees for the fund manager (approved 2 years ago by the shareholders) or delaying them (the share capital reduction with the treasury shares from the first buyback was approved after 2.5 years of the buyback completion). To date, the FSA also refused to approve the amendments to the IMA related to the introduction of additional incentives for FT to perform special distributions on the grounds that these were not within the scope of the initial IMA signed with the Ministry of Finance (irrespective of the fact that meanwhile, the Ministry only has some 2.6% in the form of unpaid shares and thus it should be the shareholders' will that should prevail). The FSA claims that it would be supportive of a change in the regulations on FP's activity in the Parliament, which is compulsory for changing the way the fund manager is elected and remunerated (basically, the reference to an international tender should be eliminated).

# Latest financials' review

## 2Q14 results review

FP ended 2Q14 with a RAS net profit of RON 1,133mn up from a RON 79mn net loss in 1Q14 and a RON 520mn net profit in 2Q13. In 2Q14, profitability in RAS significantly improved both qoq and yoy on increase in net gains from asset sales (the most important transaction was the sale of a 5% stake in Romgaz).

**P&L:** The main net revenue contributors in 2Q14 were net dividend income (RON 650mn, up 7.4% yoy) and net gains from asset sales (RON 506mn, favorably comparing with the losses in 1Q14 and 2Q13 of ca. RON 72mn). Interest income amounted to RON 4.8mn, up 30% qoq and down 53% yoy. Overall, net revenues came in at RON 1,173mn up 116% yoy. All cost items showed yoy and qoq increases. The main cost item remains the management fee for Templeton (RON 7.3mn, down 38% yoy and 2% qoq); the commission to the FSA was at RON 3.7mn and the depository fees RON 0.5mn.

**Differences between IFRS (unconsolidated) and RAS financials**: In IFRS, FP reported a 2Q14 net profit of RON 1,374mn vs. a net loss of RON 638mn in 1Q14 and a net profit of RON 680mn in 2Q13. The major difference between the RAS and IFRS figures was of higher (in IFRS) net gains from asset sales (RON 506mn in RAS and RON 745mn in IFRS) and of a higher tax expense.

**Changes in the portfolio in 2Q14**: The value of the financial assets decreased by RON 334mn mainly due to and the impairment adjustments for investments in CE Oltenia and Hidroelectrica (RON 202mn and RON 134mn respectively impact), partly offset by the reversal of impairments for OMV Petrom (RON 121.3mn) and Transelectrica (RON 66.4mn). FP's portfolio of shares was down 5% yoy to RON 10.2bn in RAS, partly as a result of asset sales (the most important being the 5% stake in Romgaz with a RON 138.8mn impact).

FP's current assets increased on the back of increases in cash and deposits (which in turn was a result of dividend income inflows (RON 420mn) and of the sale of the 5% stake in Romgaz, net of cash outflows for the third buyback program (RON 161.2mn)), and of placements in Treasuries. The increase in liabilities was mainly due to amounts related to distributions (RON 601.3mn).

**Table 13: Balance sheet**

| Balance Sheet (RON m) | 2Q14 | qoq (%) | yoy (%) | ytd (%) | 2Q14 | qoq (%) | yoy (%) | ytd (%) |
|---|---|---|---|---|---|---|---|---|
| **Non-current assets** | **10,158** | **3.4** | **-4.8** | **-3.2** | **13,839** | **0.7** | **28.6** | **-4.4** |
| **Financial investments** | **10,157** | **3.4** | **-4.9** | **-3.2** | **13,839** | **0.7** | **28.6** | **-4.4** |
| Equity investments | 10,157 | 3.4 | -4.9 | -3.2 | 13,839 | 0.7 | 28.6 | -4.4 |
| Current assets | 1,660 | 202.6 | 19.4 | 265.5 | 1,661 | 202.4 | -6.4 | 264.8 |
| Cash and equivalents | 491 | 237.9 | -43.4 | 106.8 | 491 | 237.9 | -43.5 | 106.8 |
| ST fin. Investments | 933 | 222.9 | 100.0 | 336.9 | 933 | 222.9 | 100.0 | 336.9 |
| Receivables | 235 | 106.6 | 326.2 | n.m. | 230 | n.m. | 328.2 | n.m. |
| Other current assets | 0 | -26.4 | 4.2 | 258.3 | 6 | -94.8 | -98.5 | 49.1 |
| Total assets | 11,818 | 13.9 | -2.1 | 8.0 | 15,499 | 8.4 | 23.6 | 3.8 |
| **Shareholders' equity,** | **11,153** | **8.0** | **-4.0** | **2.5** | **14,838** | **4.1** | **22.6** | **-0.4** |
| Share capital | 12,861 | -5.0 | -6.7 | -6.7 | 12,861 | -5.0 | -6.7 | -6.7 |
| Reserves o/w | -2,409 | -16.6 | -5.5 | -4.8 | 433 | 0.0 | -82.3 | 38.4 |
| Impairment for loss in | 2,878 | -14.0 | 0.9 | 0.3 | | n.m. | -100.0 | n.m. |
| Retained earnings | 1,788 | 173.2 | 198.0 | 143.8 | 2,632 | 109.2 | -167.4 | 38.8 |
| Treasury shares | -1,087 | 11.0 | 402.7 | -0.7 | -1,087 | 11.0 | 402.7 | -0.7 |
| **Total liabilities** | **665** | **n.m.** | **46.9** | **n.m.** | **661** | **n.m.** | **51.9** | **n.m.** |
| **Total liabilities and** | **11,818** | **13.9** | **-2.1** | **8.0** | **15,499** | **8.4** | **23.6** | **3.8** |

*Source: FP, IPOPEMA Research*

### Table 14: Profit and loss account

| P&L (RON m) | RAS | | | | | | IFRS uncosolidated | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2Q14 | qoq (%) | yoy (%) | 1H14 | yoy (%) | 1H14 as % FY B | 2Q14 | qoq (%) | yoy (%) | 1H14 | yoy (%) |
| Dividend income | 649.8 | n.m. | 7.4 | 649.8 | 7.4 | 104.8 | 655.1 | n.m. | 7.6 | 655.1 | 7.6 |
| Net income from | 12.0 | -25.1 | n.m. | 28.1 | n.m. | n.a. | 13.8 | n.m. | n.m. | 13.8 | n.m. |
| Net fin. investm. gains | 506.2 | n.m. | n.m. | 434.2 | n.m. | n.a. | 745.0 | n.m. | n.m. | 130.8 | 117.2 |
| Net forex gain/(loss) | -0.4 | 0.2 | n.m. | -0.8 | n.m. | n.a. | -0.4 | 0.2 | n.m. | -0.8 | n.m. |
| Interest income | 4.8 | 30.4 | -53.3 | 8.4 | -59.4 | 69.4 | 4.8 | 30.4 | -53.3 | 8.4 | -59.4 |
| Other operating revenues | 0.5 | 206.8 | 142.8 | 0.7 | 72.8 | n.a. | 0.0 | n.m. | n.m. | 0.0 | n.m. |
| **Total revenues** | **1,172.8** | **n.m.** | **115.6** | **1,120.3** | **102.1** | **185.6** | **1,418.3** | **n.m.** | **108.6** | **807.4** | **17.0** |
| Personnel expenses | -0.3 | 0.0 | 16.1 | -0.5 | 34.6 | 24.0 | 0.3 | n.m. | 60.2 | | n.m. |
| Fees | -9.5 | 106.3 | 34.0 | -14.1 | 22.9 | 55.6 | -28.7 | 31.2 | -27.5 | -50.5 | 27.7 |
| Other opex | -19.0 | 10.1 | 15.4 | -36.2 | 30.2 | 32.4 | 0.0 | n.m. | n.m. | 0.0 | n.m. |
| Total opex | -28.8 | 30.0 | 20.9 | -50.9 | 28.1 | 37.4 | -28.4 | 28.4 | 20.1 | -50.5 | 27.7 |
| **Operating profit** | **1,144.1** | **n.m.** | **119.9** | **1,069.4** | **107.8** | **206.1** | **1,389.9** | **n.m.** | **111.8** | **756.9** | **16.4** |
| Income tax | -10.6 | 144.8 | n.m. | -15.0 | n.m. | n.m. | -16.0 | 240.4 | 36.5 | -20.6 | 91.1 |
| **Net profit** | **1,133.4** | **n.m.** | **117.9** | **1,054.5** | **104.9** | **204.2** | **1,373.9** | **n.m.** | **113.2** | **736.3** | **15.1** |

*Source: FP, IPOPEMA Research*

### Table 15: Top dividend contributors (RON mn)

| | 1H14 | | 2013 | 2012 |
|---|---|---|---|---|
| OMV Petrom | 331.4 | OMV Petrom | 319.0 | 353.1 |
| Romgaz | 148.5 | Romgaz | 158.9 | 140.6 |
| GDF Suez Energy | 33.6 | Transgaz | 37.6 | 52.5 |
| Nuclearelectrica | 27.9 | E.ON Ga Distributie | 29.9 | 0.0 |
| EDMN | 23.2 | GDF Suez Energy | 22.8 | 0.0 |
| Transelectrica | 22.0 | EDTN | 16.2 | 1.8 |
| EDTS | 12.7 | CE Oltenia | 10.3 | 6.5 |
| EDTN | 11.7 | CNAB | 9.1 | 9.4 |
| Adm Porturilor Maritime | 10.1 | Salrom | 9.3 | 0.1 |
| Conpet | 8.8 | Electrica Furnizare | 9.3 | 0.0 |
| | | Conpet | 8.4 | 6.6 |
| | | Adm Porturilor Maritime | 5.4 | 6.6 |
| | | Raiffeisen International | 4.2 | 3.8 |
| | | Transelectrica | 4.0 | 10.9 |
| | | Nuclearelectrica | 2.3 | 0.0 |
| | | Admin. Canalelor Navigabile | 0.9 | 0.5 |
| | | Traian Vuia Timisoara airport | 0.7 | 1.7 |
| | | Erste Bank | 0.7 | 0.0 |
| | | Admin. Dunarii Fluviale | 0.5 | 0.6 |
| | | Admin. Porturilor Dunarii Maritime | 0.2 | 0.2 |
| **Sub-total** | **630** | | **650** | **595** |
| FY budgeted dividend | 620 | | 618.2 | 509.5 |
| **Sub-total as % in budgeted** | **101.6%** | | **105.1%** | **116.8%** |

*Source: FP, IPOPEMA Research*

### Table 16: Key data on buybacks performed to date

| | No. of shares (mn) | Average price (RON/share) | Value (RON mn) | % of capital | Period | Status |
|---|---|---|---|---|---|---|
| First | 240 | 0,50 | 120 | 1,70 | May -Sept 2011 | Completed, shares cancelled |
| Second | 1.101 | 0,87 | 963 | 7,99 | Apr-Dec 2013 | Completed, shares cancelled |
| Third | 253 | 0,81 | 205 | 2,02 | March-July 2014 | Completed, shares yet to be cancelled |
| Forth | 991 | 0,94 | 931 | 7,30 | Oct 2014-Nov 2015 | Initiated |
| Fifth | 228 | 0,94 | 214 | 1,80 | | To be approved by 19/20 Nov 2014 GSM |
| **Sub total first 3 buybacks** | **1.594** | **0,81** | **1.288** | | | |

*Source: FP, IPOPEMA Research; 4$^{th}$ and 5th buyback at RON 0.94 price on 23 Oct 2014*

## FP's Sept 2014 official NAVPS at RON 1.2438/share, down 1.6% mom

FP's September 2014 official NAV was RON 1.2438/share, down 1.6% mom and 0.6% qoq but up 7% yoy and flat ytd. The highlights are presented below:

▪ The unlisted holdings' value was flat mom at RON 6.2bn and accounted for 42.2% of total assets;

▪ The portfolio of listed shares reached RON 7.3bn, down 3% mom, as a result of the mom decreases in the share prices of Petrom and Romgaz by 4% and 0.8% respectively (first and third largest holdings), as well as of the prices of the banking holdings;

▪ Liquid assets decreased by 2.7% mom to RON 1,228mn, as the 1.8% mom increase of the cash and deposits to RON 334mn was offset by the 4.2% mom decline of the T-bills to RON 894mn;

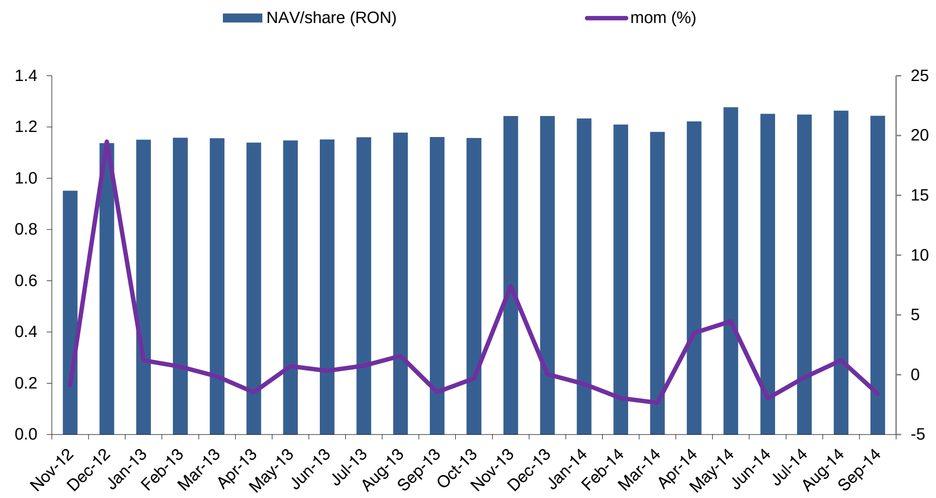
▪ The 9M14 preliminary profit came in at RON 984.5mn, up 84% yoy and represented 177% of FP's FY budgeted figure (in September alone there was a net loss of RON 25mn while the 3Q14 figure was also a loss of RON 80mn, vs. net profits of RON 1,143mn in 2Q14 and RON 20.6mn in 3Q13).

### Table 17: Official NAV evolution

| Official NAV (RON m) | Dec-12 | Mar-13 | Jun-13 | Sep-13 | Dec-13 | Mar-14 | Jun-14 | Sep-14 | mom (%) | yoy (%) | qoq (%) | ytd (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **LT financial assets, o/w** | **8,152** | **8,129** | **8,443** | **8,109** | **6,386** | **6,252** | **6,253** | **6,246** | **0.0** | **-23.0** | **-0.1** | **-2.2** |
| Listed shares | 35 | 13 | 24 | 12 | 10 | 10 | 24 | 9 | 0.0 | -28.9 | -64.0 | -14.5 |
| Unlisted shares | 8,116 | 8,115 | 8,418 | 8,096 | 6,375 | 6,241 | 6,229 | 6,236 | 0.0 | -23.0 | 0.1 | -2.2 |
| Total fixed assets | 8,152 | 8,129 | 8,443 | 8,109 | 6,386 | 6,252 | 6,253 | 6,246 | 0.0 | -23.0 | -0.1 | -2.2 |
| Receivables | 3 | 3 | 55 | 12 | 3 | 114 | 235 | 3 | 172.9 | -75.2 | -98.7 | 9.9 |
| Cash | 2 | 1 | 11 | 2 | 6 | 1 | 1 | 1 | -50.8 | -51.9 | 51.8 | -79.8 |
| **ST financial assets, o/w** | **6,861** | **7,142** | **6,932** | **6,858** | **8,680** | **7,934** | **8,998** | **8,519** | **-2.9** | **24.2** | **-5.3** | **-1.9** |
| Listed shares | 6,089 | 6,376 | 5,608 | 6,012 | 8,234 | 7,501 | 7,574 | 7,292 | -3.0 | 21.3 | -3.7 | -11.4 |
| T Bills | 455 | 534 | 467 | 482 | 214 | 289 | 933 | 894 | -4.2 | 85.4 | -4.3 | 318.3 |
| Deposits | 317 | 233 | 858 | 364 | 232 | 144 | 491 | 333 | 2.2 | -8.4 | -32.1 | 43.6 |
| **Total current assets** | **6,865** | **7,146** | **7,009** | **6,873** | **8,688** | **8,050** | **9,252** | **8,523** | **-2.9** | **24.0** | **-7.9** | **-1.9** |
| **Total assets** | **15,017** | **15,275** | **15,451** | **14,982** | **15,074** | **14,301** | **15,505** | **14,769** | **-1.7** | **-1.4** | **-4.8** | **-2.0** |
| Trade payables | 10 | 10 | 12 | 11 | 17 | 14 | 19 | 15 | 41.9 | 26.5 | -21.7 | -15.6 |
| Other liabilities | 11 | 10 | 423 | 21 | 14 | 21 | 621 | 36 | -40.8 | 66.9 | -94.3 | 154.7 |
| **Total current liabilities** | **21** | **20** | **435** | **33** | **31** | **35** | **640** | **50** | **-28.8** | **52.8** | **-92.2** | **60.8** |
| **Net current assets** | **6,844** | **7,126** | **6,574** | **6,840** | **8,657** | **8,015** | **8,612** | **8,473** | **-2.7** | **23.9** | **-1.6** | **-2.1** |
| Provisions | 17 | 17 | 18 | 29 | 29 | 13 | 15 | 15 | 0.2 | -48.6 | 0.5 | -48.8 |
| **Total non current liabilities** | **17** | **17** | **18** | **29** | **29** | **13** | **15** | **15** | **0.2** | **-48.6** | **0.5** | **-48.8** |
| **Total liabilities** | **38** | **37** | **453** | **62** | **60** | **48** | **655** | **65** | **-23.7** | **5.0** | **-90.1** | **7.7** |
| Share capital | 13,778 | 13,778 | 13,778 | 13,778 | 13,778 | 13,538 | 12,861 | 11,815 | -8.1 | -14.2 | -8.1 | -14.2 |
| Revaluation reserve | 3,142 | 3,163 | 3,385 | 3,432 | 3,994 | 3,928 | 3,688 | 3,748 | -2.1 | 9.2 | 1.6 | -6.2 |
| Reserves | -2,564 | -2,319 | -2,765 | -2,911 | -3,493 | -3,868 | -3,496 | -2,578 | -26.2 | -11.4 | -26.3 | -26.2 |
| Retained earnings prev. years | 55 | 622 | 85 | 85 | 85 | 734 | 734 | 734 | 0.0 | 758.3 | 0.0 | 758.3 |
| YTD net profit | 567 | -6 | 515 | 535 | 648 | -79 | 1,064 | 985 | | 84.0 | | |
| **Shareholders' equity** | **14,979** | **15,239** | **14,998** | **14,920** | **15,014** | **14,253** | **14,850** | **14,703** | **-1.6** | **-1.5** | **-1.0** | **-2.1** |
| P/Official NAVPS (23 Oct 2014) | 0.83 | 0.81 | 0.82 | 0.81 | 0.76 | 0.80 | 0.75 | 0.76 | | | | |
| *Discount to official NAV (%)* | *-17.3* | *-18.7* | *-18.4* | *-19.0* | *-24.4* | *-20.4* | *-24.9* | *-24.4* | | | | |
| **Net asset value** | **14,979** | **15,239** | **14,998** | **14,920** | **15,014** | **14,253** | **14,850** | **14,703** | **-1.6** | **-1.5** | **-1.0** | **-2.1** |
| **NAV/share (RON)** | **1.1371** | **1.1568** | **1.1514** | **1.1610** | **1.2436** | **1.1813** | **1.2518** | **1.2438** | **-1.6** | **7.1** | **-0.6** | **0.0** |

*Source: FP, IPOPEMA Research*

### Chart 4: Official NAV mom evolution




*Source: FP, IPOPEMA Research*

## FP's 2015 budget remains conservative

FP targets a net profit of RON 487.2mn, down 48% yoy compared to the 2014 forecast figure (based on Jan-July 2014 figures and Aug-Dec estimates) on revenues of RON 598.3mn, down 10.7% yoy, of which almost all would be dividend income. On the expenses side, the biggest item would remain the management fee to Franklin Templeton estimated at RON 64.4mn (0.6% p.a. vs. 0.479% per year for the period Jan – Sept 2014 and 0.6% for 4Q14) calculated based on FP's average share price for the period 1 January-31 July 2014. Additional fees related to additional distributions (2% by 1 Oct 2015 and 1% afterwards) were also considered.

The budget is based on the following assumptions:

- FP would not acquire stakes in new companies, sell from its holdings and participate in rights issues in companies from its portfolio. This is not FP's strategy for 2015, but amounts from such operations could not be included in the budget as they cannot be forecasted; also not in the budget are the amounts in connection to buybacks (distribution fee, depository trade settlement fees, brokerage fees, etc). FP expects the shares from the third buyback to be cancelled in 1Q15, while those from the 4th buyback to be cancelled in 2015;

- FP will return capital to shareholders through a share capital reduction by RON 0.05/share. The distributions are expected to start in June 2015 and to be made as follows: 75% in June, 20% in July, 3% in August and the rest of 2% in September. Using FP's share price on 23 Oct 2014, these distributions would translate into a yield of 5.3%. Such distributions are tax free for FP and free of withholding tax for the shareholders;

- Dividend income from portfolio companies is estimated to be cashed 65% in June, 30% in July and 5% in August. FP budgeted similar dividend income as the amounts effectively cashed during Jan-July 2014, excluding dividends for sold holdings;

- Interest income was budgeted based on a 2.5% average interest rate, to be applied to FP's placements in deposits; FP assumed that all available cash from dividend income and asset disposals would be placed in money market instruments and the buyback program;

- FSA commission of 0.1% p.a. and the depository fee were calculated based on the average official NAV for Jan-July 2014;

- FP also has a budget of ca. RON 6.2mn as post-secondary listing expenses, some RON 8.8mn as legal fees for litigations, flat yoy and RON 4.2mn as fees for audits, fiscal advisory services and portfolio valuation (vs. RON 2.1mn 2014 forecasted figure for the latter item, the increase being mostly related to portfolio valuation expenses).

**Table 18: FP's 2015 budget**

| RON mn | 2015B | 2014B revised | 2014F | yoy |
|---|---|---|---|---|
| Dividends received | 598.3 | 619.8 | 669.8 | -10.7 |
| Interest income | *0.0* | *12.1* | *18.6* | *-99.8* |
| Revenues from reversal of impairment adj. and prov. | | n.a. | 30.0 | n.m. |
| Other income | | n.a. | 1.4 | n.m. |
| Net gain on disposal of equity investments | | n.a. | 385.6 | n.m. |
| Total revenues | **598.3** | **631.9** | **1,105.4** | **-45.9** |
| Commission and fees | -14.9 | -15.2 | -15.2 | -2.1 |
| FSA, Central Depositiory and BoN remuneration | -1.1 | -1.1 | -1.1 | 0.0 |
| Third party costs | -87.0 | -54.9 | -88.4 | -1.5 |
| Other opex | *-1.2* | *-0.4* | *-0.9* | *41.7* |
| Secondary listing expenses | | -20.5 | -20.5 | n.m. |
| Net Fx loss | | n.a. | -0.8 | n.m. |
| Net change in fair value of other financial instruments | | *n.a.* | *-2.7* | |
| Costs related to disposals | | n.a. | -11.8 | n.m. |
| Expenses with provisions and impairment adj. | | n.a. | -1.8 | n.m. |
| Total operating expenses | -111.1 | -97.4 | -148.6 | -25.3 |
| **Operating profit** | **487** | **534.5** | **957** | **-49.1** |
| Income tax | 0.0 | 0.0 | -23.1 | n.m. |
| **Net profit** | **487.2** | **534.5** | **933.7** | **-47.8** |
| Capex | 0.3 | 0.5 | 0.5 | -29.8 |

*Source: FP, IPOPEMA Research*

### Table 19: IFRS Balance sheet

| | Unconsolidated | | | | | Consolidated | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Balance sheet (RON m)** | **2011** | **2012** | **2013** | **%** | **yoy** | **2011** | **2012** | **2013** | **% assets** | **yoy** |
| **Total assets, o/w** | **11,760** | **12,410** | **14,763** | **100.0** | **19.0** | **12,309** | **12,106** | **14,768** | **100.0** | **22.0** |
| Cash | 2 | 2 | 6 | 0.0 | 198.9 | 2 | 2 | 6 | 0.0 | 198.9 |
| Deposits | 296 | 317 | 232 | 1.6 | -26.9 | 296 | 317 | 232 | 1.6 | -26.9 |
| T-bills | 196 | 455 | 214 | 1.4 | -53.0 | 196 | 455 | 214 | 1.4 | -53.0 |
| Dividends receivable | 52 | 1 | 0 | 0.0 | n.m. | 52 | 1 | 0 | 0.0 | n.m. |
| Receivables in respect of equity contributions | 0 | 0 | 0 | 0.0 | n.m. | 0 | 0 | 0 | 0.0 | n.m. |
| ***Equity investments, o/w*** | ***10,732*** | ***11,270*** | ***14,442*** | ***97.8*** | ***28.2*** | ***7,428*** | ***11,100*** | ***14,313*** | ***96.9*** | ***28.9*** |
| at fair value | 4,768 | 6,071 | n.a. | n.a. | n.a. | 1,465 | 1,195 | 8,978 | 60.8 | n.m. |
| at cost | 5,963 | 5,198 | n.a. | n.a. | n.a. | 5,963 | 5,198 | 275 | 1.9 | -94.7 |
| Deferred tax assets | 479 | 363 | 0 | 0.0 | n.m. | 93 | 229 | 0 | 0.0 | -99.9 |
| Other assets | 3 | 2 | 4 | 0.0 | 65.6 | 3 | 2 | 4 | 0.0 | 65.6 |
| Investment in associate | 0 | 0 | 0 | 0.0 | n.m. | 4,239 | 4,707 | 5,059 | 34.3 | 7.5 |
| **Shareholders' equity, o/w** | **11,718** | **12,389** | **14,855** | **100.6** | **19.9** | **12,267** | **12,085** | **14,726** | **99.7** | **21.8** |
| Share capital | 13,778 | 13,778 | 13,778 | 93.3 | 0.0 | 13,778 | 13,778 | 13,778 | 93.3 | 0.0 |
| Fair value reserve on AFS assets | 1,240 | 2,494 | 7,309 | 49.5 | 193.0 | 197 | 130 | 4,043 | 27.4 | n.m. |
| Other reserves | 250 | 278 | 313 | 2.1 | 12.2 | 250 | 278 | 313 | 2.1 | 12.2 |
| Tresury shares | -120 | -120 | -1,095 | -7.4 | n.m. | -120 | -120 | -1,095 | -7.4 | n.m. |
| Accumulated losses | -3,431 | -4,042 | -5,450 | -36.9 | 34.8 | -1,839 | -1,981 | -2,313 | -15.7 | 16.7 |
| **Liabilities, o/w** | **42** | **21** | **42** | **0.3** | **n.m.** | **42** | **21** | **42** | **0.3** | **100.7** |
| Deferred tax | n.a. | n.a. | n.a. | n.a. | n.a. | 0 | | | 0.0 | n.m. |
| Other liabilities | n.a. | n.a. | n.a. | n.a. | n.a. | 42 | 21 | 42 | 0.3 | 100.7 |
| **Total liabilities and equity** | **11,760** | **12,410** | **14,763** | **100.0** | **19.0** | **12,309** | **12,106** | **14,768** | **100.0** | **22.0** |

*Source: FP, POPEMA Research*

### Table 20: IFRS profit and loss account

| | Unconsolidated | | | | Consolidated | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **P&L (RON m)** | **2011** | **2012** | **2013** | **yoy (%)** | **2011** | **2012** | **yoy (%)** | **2013** | **yoy (%)** |
| Net investment income/(loss) , o/w | 573.4 | -134.0 | 141.4 | n.m. | 1,127.7 | 306.4 | -72.8 | 608.6 | 98.7 |
| Gross dividend income | 522.4 | 623.7 | 652.4 | 4.6 | 320.8 | 270.5 | -15.7 | 333.4 | 23.2 |
| Interest income | 41.1 | 34.9 | 36.1 | 3.5 | 41.1 | 34.9 | -15.1 | 36.1 | 3.5 |
| Impairment losses on equity | -51.7 | -772.4 | -835.8 | 8.2 | -51.7 | -772.4 | n.m. | -835.8 | 8.2 |
| Impairment losses on dividends | 28.3 | -46.2 | 46.9 | n.m. | 28.3 | -46.2 | n.m. | 46.9 | n.m. |
| Other impairments (net) | | 4.3 | -9.2 | n.m. | 11.5 | 4.3 | n.m. | -9.2 | n.m. |
| Gains/(losses) on disposal of equity | 8.8 | 17.9 | 247.8 | n.m. | 8.8 | 17.9 | 103.2 | 117.9 | 559.6 |
| Net FX gains | 0.7 | -0.2 | 0.0 | n.m. | 0.7 | -0.2 | n.m. | 0.0 | n.m. |
| Share of profit in associates (net of | 11.5 | | | n.m. | 755.9 | 793.6 | 5.0 | 916.1 | 15.4 |
| Other operating income | 12.2 | 3.9 | 3.1 | -20.7 | 12.2 | 3.9 | -67.6 | 3.1 | -20.7 |
| **Operating expenses, o/w** | **-54.9** | **-59.6** | **-88.6** | **48.8** | **-54.9** | **-59.6** | **8.5** | **-88.6** | **48.8** |
| Personnel expenses | -0.6 | -0.7 | -0.9 | 43.9 | -0.6 | -0.7 | 2.3 | -0.9 | 43.9 |
| Other opex | -54.2 | -58.9 | -87.7 | 48.8 | -54.2 | -58.9 | 8.6 | -87.7 | 48.8 |
| **Profit/(loss) before tax** | **518.5** | **-193.6** | **52.8** | **n.m.** | **1,072.8** | **246.8** | **-77.0** | **520.0** | **110.7** |
| Income tax (expense)/credit | -0.5 | 118.7 | -890.1 | n.m. | -0.5 | 118.7 | n.m. | -280.7 | n.m. |
| **Net profit/(loss)** | **518.1** | **-75.0** | **-837.3** | **n.m.** | **1,072.3** | **365.5** | **-65.9** | **239.3** | **-34.5** |
| Attributable to equity holders of the | | | | | | | | | |
| Attributable to minority interest | | | | | | | | | |
| Net change in fair value of available | -846.3 | 1,492.9 | 4,512.8 | 202.3 | -333.7 | -80.2 | -76.0 | 4,064.1 | n.m. |
| Income tax on other comprehensive | 135.4 | -238.9 | 167.8 | n.m. | 53.4 | 12.8 | -76.0 | 16.9 | 31.6 |
| Decrease in fair value reserve after | | | | | | | | -168.2 | n.m. |
| Net other comprehensive income | -710.9 | 1,254.0 | 4,680.6 | 273.2 | -280.3 | -67.4 | -76.0 | 3,912.9 | n.m. |
| **Net profit/(loss)** | **-192.8** | **1,179.1** | **3,843.2** | **226.0** | **792.0** | **298.1** | **-62.4** | **4,152.1** | **n.m.** |

*Source: FP, IPOPEMA Research*

### Table 21: Equity investments

| **Equity investments (RON m)** | **2013** | **2012** | **yoy (%)** | |
|---|---|---|---|---|
| **Equity investments, o/w** | **14,313** | **11,100** | **28.9** | |
| **At fair value, o/w** | **8,978** | **1,195** | **651.4** | |
| Petrom | 5,059 | 4,707 | 7.5 | |
| Transgaz | 0 | 385 | -100.0 | |
| Alro | 105 | 146 | -27.6 | |
| BRD Groupe SG | 228 | 206 | 11.0 | |
| Raiffeisen International | 78 | 119 | -34.6 | |
| Conpet | 116 | 93 | 24.5 | |
| BT | 107 | 71 | 50.6 | |
| Hidroelectrica | 2,105 | 2,001 | 5.2 | at cost in 2012 |
| Romgaz | 1,976 | 416 | 374.6 | at cost in 2011 |
| Enel Distributie Banat | 573 | 142 | 304.9 | at cost in 2012 |
| Enel Distributie Muntenia | 473 | 107 | 341.0 | at cost in 2013 |
| GDF Suez Energy Romania | 404 | 0 | n.m. | at cost in 2012 |
| Enel Distributie Dobrogea | 379 | 115 | 230.4 | at cost in 2011 |
| E.ON Moldova Distributie | 345 | 131 | 163.5 | at cost in 2012 |
| CE Oltenia | 322 | 670 | -52.0 | at cost in 2013 |
| Nuclearelectrica | 307 | 582 | -47.3 | at cost in 2012 |
| Electrica Distributie Muntenia Nord | 296 | 165 | 79.3 | at cost in 2011 |
| Bucharest Airports | 288 | 131 | 119.3 | at cost in 2012 |
| Electrica Distributie Transilvania Nord | 207 | 116 | 78.6 | at cost in 2013 |
| Electrica Distributie Transilvania Sud | 192 | 126 | 52.5 | at cost in 2012 |
| E.ON Gaz Distributie | 165 | 0 | n.m. | |
| Transelectrica | 156 | 126 | 24.4 | |
| Posta Romana | 61 | 81 | -24.8 | at cost in 2012 |
| Zirom | 43 | 0 | n.m. | |
| Romserv | 1 | 0 | n.m. | |
| Other | 51 | 50 | 1.1 | |
| **At cost, o/w** | **275** | **5,198** | **-94.7** | |
| Salrom | 76 | 76 | 0.0 | |
| Administratia Porturilor Maritime | 53 | 53 | 0.0 | |
| E.ON Energie Romania | 46 | 46 | 0.0 | |
| Primcom | 25 | 25 | 0.0 | |
| Other | 76 | 216 | -65.0 | |

*Source: FP, IPOPEMA Research*

# HIDROELECTRICA

## A clear restructuring play

Hidroelectrica is the largest domestic hydropower producer (with 95%+ market share on the hydro power market and 24% overall in 2013) and FP's second largest holding (valued at RON 2.1bn as per FSA methodology vs. RON 2.46bn our fair value). It was again placed under insolvency in Feb 2014 on procedural grounds. Hidroelectrica's 15% IPO (18.74% rights issue) was postponed for end 2015–early 2016, once the company is supposed to get out of the insolvency. We see upside potential from electricity market liberalization while main risks are in relation to litigations, the regulatory and fiscal framework, and changes in energy supply and demand which currently put downward pressure on domestic prices.

**Latest financials show the success of the continued restructuring during insolvencies:** after difficult 2011-1H12 due to low prices for the electricity sold, poor weather, high number of staff and no prioritised capex that were responsible for Hidroelectrica entering its first insolvency (June 2012-June 2013), a transformational period followed (when the company terminated several loss making contracts (with traders, on maintenance, capex etc) and underwent operational and staff restructuring). As a result, 2013 came with much improved results (EBITDA margin was up from 38% to 65% while EBIT and net margins returned to positive values), while production increased 23% yoy after 2 years of declines. While the company re-entered insolvency in Feb 2014, the restructuring continued and 7M14 results were also encouraging (although sales marginally declined while margins slightly deteriorated: EBITDA by 2.6pp yoy to 62.6%, mostly caused by the special construction tax and the decline in electricity prices). The 2014 budget is likely to be exceeded.

**The main trigger** for the company's financials is the liberalization of the electricity market, with the weight of the sales to the regulated market to gradually decline to zero by end 2017 (and prices for this segment to gradually increase and cover a higher part of opex, including some taxes). The 15% IPO (out of a total 18.74% planned rights issue) to take place after the company exits insolvency should also lead to a re-rating of the company as by then, the restructuring measures should further improve the company's profitability.

**Main risks:** regulatory (quantities and prices of electricity to be sold on the regulated market set by ANRE, new taxes), litigations (ongoing lawsuits filed by clients for allegedly faulty insolvency related procedures, asking for damages for the unilateral termination of bilateral agreements (total claims at RON 1.6bn) or regarding the enforcement of the force majeure clause in 2012), price evolutions (their decline on the free market due to lower demand coupled with oversupply), weather conditions, corporate governance (state is the majority shareholder).

**HIDROELECTRICA – Summary Financial Data**

| | 2011 | 2012 | 2013 | 1H14 | 12TM | 2013B | 2014B | 2015B |
|---|---|---|---|---|---|---|---|---|
| Revenues (RONm) | 3,021 | 2,403 | 3,083 | 1,554 | 3,037 | 2,695 | 2,875 | 2,971 |
| EBITDA (RONm) | 895 | 906 | 2,008 | 975 | 1,962 | 1,528 | 1,788 | 1,860 |
| EBIT (RONm) | 161 | -322 | 1,016 | 495 | 987 | 601 | 816 | 839 |
| Net profit (RONm) | 7 | -508 | 719 | 410 | 746 | 368 | 641 | 675 |
| EPS (RON) | 0.0 | -1.1 | 1.6 | 0.9 | 1.7 | 0.8 | 1.4 | 1.5 |
| DPS (RON) | 0.0 | 0.0 | 0.0 | 1.0 | 2.0 | 3.0 | 4.0 | 5.0 |
| EV/EBITDA (x)* | 16.5 | 16.1 | 6.8 | 6.6 | 6.6 | 8.5 | 7.2 | 6.9 |
| P/E (x)* | n.m. | Neg. | 17.2 | 15.1 | 16.5 | 33.6 | 19.2 | 18.3 |

*Source: Hidroelectrica, IPOPEMA Research*

28 October 2014

**HIDROELECTRICA**
*NOT LISTED*

| Key Ratios | 12TM | 2014B |
|---|---|---|
| EBITDA Margin | 64.6% | 62.2% |
| EBIT Margin | 32.5% | 28.4% |
| ROE | 4.5% | n.a. |
| Bank debt/ Assets | n.a. | n.a. |

| Shareholders | Stake |
|---|---|
| Ministry of Economy | 80.1% |
| Fondul Proprietatea | 19.9% |

**Valuation multiples using IPOPEMA fair value*

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| P&L (RON m) | 2011 | 2012 | 2013 | 1H14 | 12TM | 2013B | 2014B | 2015B |
|---|---|---|---|---|---|---|---|---|
| **Revenues** | **3,047** | **2,418** | **3,150** | **1,584** | **3,114** | **2,708** | **2,941** | **3,037** |
| *- yoy change* | | *-20.6%* | *30.2%* | *-2.2%* | *-1.1%* | *12.0%* | *8.6%* | *3.3%* |
| **Sales** | **3,021** | **2,403** | **3,083** | **1,554** | **3,037** | **2,695** | **2,875** | **2,971** |
| *- yoy change* | | *-20.5%* | *28.3%* | *-2.9%* | *-1.5%* | *12.1%* | *6.7%* | *3.3%* |
| **EBIT** | **161.4** | **-321.5** | **1,016.1** | **495.4** | **987.0** | **601.2** | **815.6** | **838.8** |
| *- yoy change* | | *n.m.* | *n.m.* | *-5.5%* | *-2.9%* | *n.m.* | *35.7%* | *2.8%* |
| Depreciation cost | 733.3 | 1227.2 | 992.2 | 479.9 | 974.9 | 926.3 | 972.6 | 1021.3 |
| **EBITDA** | **894.7** | **905.7** | **2,008.3** | **975.3** | **1,961.9** | **1,527.5** | **1,788.3** | **1,860.1** |
| *- yoy change* | | *1.2%* | *121.7%* | *-4.5%* | *-2.3%* | *68.7%* | *17.1%* | *4.0%* |
| Financial Income / (Cost) | -121.5 | -166.1 | -114.5 | 14.4 | -57.0 | -167.5 | -68.8 | -52.5 |
| **Pretax Profit** | 39.8 | -487.6 | 901.6 | 509.8 | 930.0 | 433.6 | 746.8 | 786.4 |
| *- yoy change* | | *n.m.* | *n.m.* | *5.9%* | *3.1%* | *n.m.* | *72.2%* | *5.3%* |
| Income tax | -33.2 | -20.4 | -182.8 | -99.8 | -184.0 | -65.9 | -105.5 | -111.5 |
| **Net Income** | **6.6** | **-508.0** | **718.8** | **410.0** | **746.0** | **367.7** | **641.3** | **674.9** |

| Profitability Ratios | 2011 | 2012 | 2013 | 1H14 | 12TM | 2013B | 2014B | 2015B |
|---|---|---|---|---|---|---|---|---|
| EBITDA Margin | 29.6% | 37.7% | 65.1% | 62.7% | 64.6% | 56.7% | 62.2% | 62.6% |
| EBIT Margin | 5.3% | -13.4% | 33.0% | 31.9% | 32.5% | 22.3% | 28.4% | 28.2% |
| Net Margin | 0.2% | -21.1% | 23.3% | 26.4% | 24.6% | 13.6% | 22.3% | 22.7% |
| ROE | 0.0% | -3.2% | 4.3% | 4.8% | 4.4% | n.a. | n.a. | n.a. |

| Balance Sheet (RON m) | 2009 | 2010 | 2011 | 2012 | 2013 | 1H14 |
|---|---|---|---|---|---|---|
| **Total Fixed Assets** | **22,602** | **19,667** | **20,339** | **19,914** | **19,065** | **18,686** |
| Tangible Assets | 19,066 | 19,600 | 20,273 | 19,848 | 19,036 | 18,654 |
| Other Fixed Assets | 3,536 | 67 | 66 | 66 | 29 | 32 |
| **Total Current Assets** | **388** | **477** | **623** | **412** | **467** | **756** |
| Cash and Equivalents | 28 | 100 | 89 | 57 | 86 | 296 |
| Other Current Assets | 360 | 377 | 534 | 355 | 381 | 460 |
| **Total Assets** | **22,990** | **20,144** | **20,962** | **20,326** | **19,532** | **19,442** |
| **Stockholders` Equity** | **16,555** | **16,822** | **16,529** | **16,079** | **16,737** | **17,148** |
| **Long Term Liabilities** | **4,640** | **1,593** | **1,794** | **1,646** | **1,413** | **1,215** |
| Long -Term Debt | 804 | 1,200 | 1,419 | 1,202 | 799 | 764 |
| Other Long - Term liabilities | 3,836 | 393 | 375 | 444 | 614 | 452 |
| **Short Term Liabilities** | **1,796** | **1,729** | **2,639** | **2,601** | **1,383** | **1,079** |
| Short -Term Debt | 677 | 701 | 1,099 | 1,070 | 606 | 100 |
| Other Short Term Liabilities | 1,119 | 1,028 | 1,540 | 1,531 | 777 | 979 |
| **Total Equity & Liabilities** | **22,990** | **20,144** | **20,962** | **20,326** | **19,532** | **19,442** |

| Balance Sheet Ratios | 2009 | 2010 | 2011 | 2012 | 2013 | 1H14 |
|---|---|---|---|---|---|---|
| Current Ratio | 0.22 | 0.28 | 0.24 | 0.16 | 0.34 | 0.70 |
| Quick Ratio | 0.18 | 0.23 | 0.20 | 0.12 | 0.26 | 0.64 |
| Bank Debt/Assets | 6.4% | 9.4% | 12.0% | 11.2% | 7.2% | 4.4% |
| **Bank Debt/Equity** | **8.9%** | **11.3%** | **15.2%** | **14.1%** | **8.4%** | **5.0%** |

| Cash Flow (RON mn) | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|
| Net Profit | 292 | 7 | -508 | 719 |
| Depreciation and Amortisation | 874 | 733 | 1,227 | 992 |
| Other (incl. WC change) | -108 | 355 | 170 | -779 |
| **Operating Cash Flows** | **1,058** | **1,095** | **889** | **932** |
| Capital Expenditures (Net) | 535 | 673 | -425 | -812 |
| Other | -3,469 | -1 | -1 | -37 |
| **Cash Flows from Investing Activities** | **-2,935** | **672** | **-425** | **-848** |
| Change in Debt | 420 | 617 | -246 | -867 |
| Issuance of Shares | 0 | 0 | 0 | 0 |
| Other | 1,384 | -2,373 | -185 | 755 |
| **Cash Flows from Financing Activities** | **1,805** | **-1,756** | **-432** | **-112** |
| Beginning Cash | 28 | 100 | 89 | 57 |
| Increase/(Decrease) in Cash | -72 | 11 | 32 | -29 |
| **Ending cash** | **100** | **89** | **57** | **86** |

*Source: Hidroelectrica, IPOPEMA Research*

## Hidroelectrica Valuation

We valued Hidroelectrica based on its peers' 2014E EV/Capacity, EV/EBITDA and P/E multiples to which we applied certain discounts. We used Hidroelectrica's available installed capacity at end-2013, which excludes the permanent reductions in capacity and as to the EBITDA and net profits we used the 12TM EBITDA (1H14 data), and 1H14 net debt and book values. We applied equal weightings to the results of the three methods, thus we arrived at a fair value for FP's stake of RON 2,462mn, about 17% higher than the official valuation and representing 16.2% of the fair value of FP's assets.

We used a reference capacity multiple of EUR 0.76mn/MW, a reference 2014E EV/EBITDA of 9.6x and a reference P/E of 11.3x (the median values for our peers' selection) to which we applied a discount of 20%. We believe that our valuation based on EV/capacity is conservative if compared to the estimated cost for the Tarnita-Lapustesti power plant of EUR 1.3mn/MW (which is however outdated), the valuation (by an independent evaluator) of the small power plants in Hidroelectrica's portfolio of ca. EUR 1mn/MW and the actual price the company obtained from the sale of some of its small plants in Jan 2014 of EUR 1.2mn/MWh (for 2.08MW). We believe the discount vs. peers is justified by Hidroelectrica's regulatory risks, current insolvency status, smaller size and not diversified business model. Moreover, we do not have a clear view on its investment plans (including capacity expansion), as the judicial administrator announced the intention to drop some of the less profitable investments. On the other hand, we note that Hidroelectrica's operating margins are more appealing than those of its peers.

**Table 22: Valuation of Hidroelectrica**

| | Capacity | EBITDA | Net profit |
|---|---|---|---|
| Hidroelectrica indicator (MW/RON mn) | 6,072 | 1,962 | 746 |
| Reference indicator EV/Capacity, EV/EBITDA, P/E | 0.76 | 9.6 | 11.3 |
| discount (%) | 20 | 20 | 20 |
| Discounted indicator (x) | 0.61 | 7.7 | 9.1 |
| EV (RON mn) | 16,297 | 15,113 | 7,320 |
| 1H14 net debt (RON mn) | 567 | 567 | 567 |
| FP stake (%) | 19.94 | 19.94 | 19.94 |
| Equity value (RON mn) | 15,729 | 14,545 | 6,753 |
| **Fair value of FP stake (RON mn)** | **3,137** | **2,901** | **1,347** |
| Difference vs. official valuation (%) | 49.0 | 37.8 | -36.0 |
| **Final fair value of FP stake (RON mn)** | **2,462** | | |
| Official valuation | 2,105 | | |
| Difference (%) | 16.9 | | |

*Source: Hidroelectrica, IPOPEMA Research*

We compared the profitability of Hidroelectrica with that of its peer companies, and noticed that Hidroelectrica has higher margins than peers' median in 2014E-2015E based on the company's budget (around 62%-65% for Hidroelectrica's EBITDA margin compared to 25%-27% its peers' median and 23%-25% for Hidroelectrica's the net margins vs. single digit median values of the peers). Moreover, the 12TM figures of Hidroelectrica (using the 1H14 data) are higher than the 2014 budgeted figures (64.6% for EBITDA margin and 24.6% for net margin).

Using our fair valuation, Hidroelectrica looks cheaper than the median multiples of the peers we selected (those having a higher weight of their production and capacities generated from hydro sources), by 15%-32% in 2013-2015E EV/EBITDA terms and 24%-37% in EV/capacity terms. This does not apply to Hidroelectrica's P/E and EV/sales multiples.

**Table 23: Hidroelectrica's peers' margins**

| | EBITDA margin (%) | | | Net margin (%) | | |
|---|---|---|---|---|---|---|
| **CEE peers** | **2013** | **2014E** | **2015E** | **2013** | **2014E** | **2015E** |
| CEZ | 37.8 | 34.6 | 32.4 | 16.2 | 14.3 | 12.2 |
| Enea | 21.5 | 18.6 | 17.8 | | 5.1 | 5.5 |
| PGE | 27.5 | 26.9 | 25.0 | 14.2 | 12.9 | 11.3 |
| Tauron | 17.3 | 19.5 | 19.1 | 7.6 | 6.4 | 5.6 |
| Energa (PL) | 17.9 | 19.4 | 18.8 | 4.4 | 5.1 | 4.7 |
| **Median CEE peers** | **21.5** | **19.5** | **19.1** | **10.9** | **6.4** | **5.6** |
| European majors | | | | | | |
| E.ON (GE) | 7.0 | 6.9 | 7.0 | 1.8 | 1.5 | 1.6 |
| RWE | 17.0 | 13.1 | 13.0 | 4.2 | 2.5 | 2.5 |
| EDF (FR) | 22.8 | 22.9 | 23.0 | 4.7 | 5.2 | 5.2 |
| Enel (IT) | 21.2 | 19.7 | 19.9 | 4.2 | 3.8 | 4.1 |
| **Median European majors** | **19.1** | **16.4** | **16.5** | **4.2** | **3.2** | **3.3** |
| **Hydro peers** | | | | | | |
| Ayen Enerji (TR) | 24.6 | 43.5 | 42.6 | -13.8 | 13.3 | 11.3 |
| Akenerji (TR) | 24.3 | 14.3 | 18.0 | -9.6 | -6.3 | 1.5 |
| RusHydro (RU) | 22.1 | 23.4 | 24.0 | 10.4 | 11.2 | 11.1 |
| Verbund (AU) | 51.3 | 26.5 | 30.2 | 8.9 | 2.5 | 3.4 |
| Fortum (FH) | 38.8 | 47.1 | 36.3 | 20.0 | 20.6 | 20.0 |
| Alpiq (SW) | 8.4 | 6.2 | 6.2 | 0.2 | 1.3 | 1.3 |
| **Median hydro peers** | **24.4** | **25.0** | **27.1** | **9.7** | **6.9** | **7.3** |
| Nuclearelectrica | 46.2 | 38.5 | 46.4 | 22.1 | 15.8 | 13.7 |
| CE Oltenia | 20.5 | 18.1 | 14.2 | 0.2 | 0.1 | -10.2 |
| **Hidroelectrica** | **65.1** | **64.6** | **62.6** | **23.3** | **24.6** | **22.7** |
| **Hidro vs. hydro peers median (pp)** | **40.7** | **39.6** | **35.5** | **13.6** | **17.7** | **15.4** |

*Source: Company data, Bloomberg, IPOPEMA Research*

**Table 24: Hidroelectrica's peers' financial multiples**

| | | | P/E (x) | | | EV/EBITDA (x) | | | EV/Capacity (EUR/MWh) | | | EV/Sales (x) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **CEE peers** | **Price** | **Mcap** | **2013** | **2014E** | **2015E** | **2013** | **2014E** | **2015E** | **2013** | **2014E** | **2015E** | **2013** | **2014E** | **2015E** |
| CEZ | 21.2 | 11,404 | 8.4 | 10.8 | 12.8 | 5.6 | 6.9 | 7.4 | 1.16 | 1.17 | 1.15 | 2.1 | 2.4 | 2.4 |
| Enea | 30.5 | 32,271 | | 20.1 | 23.8 | 4.0 | 7.4 | 9.7 | 2.27 | 3.66 | 3.60 | 0.9 | 1.4 | 1.7 |
| PGE | 5.1 | 9,591 | 9.5 | 11.1 | 12.2 | 4.6 | 5.2 | 6.0 | 0.55 | 0.72 | 0.82 | 1.0 | 1.4 | 1.5 |
| Tauron | 1.3 | 2,218 | 6.0 | 8.1 | 8.9 | 4.4 | 4.7 | 5.2 | 0.61 | 0.72 | 0.80 | 0.7 | 0.9 | 1.0 |
| Energa (PL) | 5.8 | 1,553 | 8.7 | 10.9 | 11.5 | 3.6 | 4.4 | 4.6 | 1.34 | 1.83 | 1.92 | 0.6 | 0.9 | 0.9 |
| **Median CEE peers** | | | **8.6** | **10.9** | **12.2** | **4.4** | **5.2** | **6.0** | **1.16** | **1.17** | **1.15** | **0.9** | **1.4** | **1.5** |
| European majors | | | | | | | | | | | | | | |
| E.ON (GE) | 13.2 | 26,453 | 11.8 | 14.6 | 14.0 | 5.4 | 5.6 | 5.5 | 1.17 | 1.19 | 1.17 | 0.4 | 0.4 | 0.4 |
| RWE | 27.3 | 15,735 | 7.3 | 12.6 | 12.5 | 5.5 | 4.3 | 4.0 | 0.91 | 0.54 | 0.51 | 0.9 | 0.6 | 0.5 |
| EDF (FR) | 22.4 | 41,608 | 10.4 | 10.9 | 10.5 | 4.4 | 4.8 | 4.9 | 0.54 | 0.58 | 0.60 | 1.0 | 1.1 | 1.1 |
| Enel (IT) | 3.8 | 35,977 | 8.3 | 12.0 | 11.3 | 5.9 | 5.9 | 5.8 | 1.02 | 0.96 | 0.96 | 1.2 | 1.2 | 1.2 |
| **Median European majors** | | | **9.3** | **12.3** | **11.9** | **5.4** | **5.2** | **5.2** | **0.96** | **0.77** | **0.78** | **1.0** | **0.8** | **0.8** |
| **Hydro peers** | | | | | | | | | | | | | | |
| Ayen Enerji (TR) | 1.1 | 70 | -4.3 | 6.0 | 7.1 | 9.1 | 9.8 | 10.3 | 0.61 | 0.87 | 0.88 | 2.2 | 4.3 | 4.4 |
| Akenerji (TR) | 1.0 | 297 | -13.1 | -12.7 | 33.9 | 15.2 | 19.6 | 10.1 | 1.34 | 1.59 | 1.59 | 3.7 | 2.8 | 1.8 |
| RusHydro (RU) | 0.5 | 4,898 | 7.2 | 6.7 | 6.5 | 5.4 | 5.2 | 5.3 | 0.21 | 0.21 | 0.23 | 1.2 | 1.2 | 1.3 |
| Verbund (AU) | 15.5 | 2,635 | 9.3 | 37.3 | 27.9 | 4.4 | 9.5 | 8.3 | 0.66 | 0.65 | 0.63 | 2.3 | 2.5 | 2.5 |
| Fortum (FH) | 16.7 | 15,999 | 13.2 | 15.9 | 16.4 | 10.4 | 9.0 | 11.7 | 2.02 | 1.72 | 1.71 | 4.0 | 4.3 | 4.3 |
| Alpiq (SW) | 127.7 | 2,186 | 122.3 | 24.2 | 25.6 | 6.1 | 9.7 | 9.8 | 0.60 | 0.65 | 0.63 | 0.5 | 0.6 | 0.6 |
| **Median hydro peers** | | | **9.3** | **11.3** | **21.0** | **7.6** | **9.6** | **10.0** | **0.63** | **0.76** | **0.76** | **2.2** | **2.7** | **2.2** |
| Nuclearelectrica | | | 5.9 | 8.7 | 7.5 | 4.2 | 4.2 | 2.6 | 0.48 | 0.48 | 0.48 | 1.5 | 1.6 | 1.2 |
| CE Oltenia | | | 142.7 | 142.7 | n.m. | 5.3 | 4.7 | 7.8 | 0.80 | 0.80 | 0.80 | 1.1 | 0.6 | 1.1 |
| **Hidroelectrica** | | | **17.2** | **16.5** | **18.3** | **6.4** | **6.6** | **6.9** | **0.48** | **0.48** | **0.48** | **4.2** | **4.3** | **4.3** |
| **Hidro premium vs. hydro** | | | **85.2** | **46.2** | **-13.0** | **-15.3** | **-31.7** | **-30.4** | **-24.2** | **-36.6** | **-36.4** | **86.3** | **59.5** | **100.3** |

*Source: Company data, Bloomberg, IPOPEMA Research*

## Business overview

Hidroelectrica is the largest hydropower producer in the country (ca. 24.5% of total electricity consumption in an average hydrological year (24% market share in 2013) and is the main system services supplier (72% market share in 2013). At end 2013, it had 261 hydropower plants and pumping stations. Annual production was 17.5TWh in an average hydrological year and the installed capacity was of 6,464 MW at end-2013 (the permanent one was 6,072 MW).

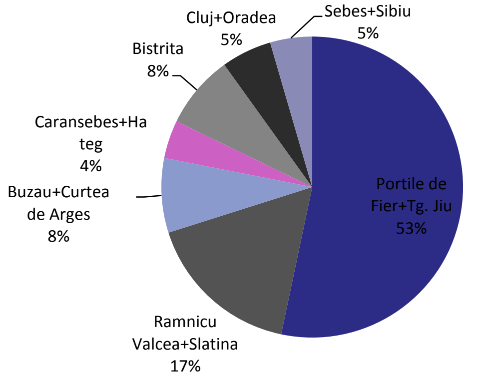
In 2013, Hidroelectrica generated 14.8TWh, but sold 14.6TWh (15.03TWh including the energy resold). This is due to the fact that electricity generated is adjusted downwards with technological consumption (1.08% in 2013 down from 2.5%-2.8% in 2009-2011) and upwards with the energy acquired. Hidroelectrica may end up acquiring energy from other producers mainly in order to meet its contractual obligations when production is below company's estimates. Moreover, before its insolvency was declared, it acquired more electricity than it actually needed (according to a judicial administrator report from 2012) from other producers, such as the thermal power plants whose selling price is the highest on the market. The transactions were considered similar to a financial aid for the other producers from the judicial administrator's perspective. Starting 2012, bilateral contracts can only be signed through public auctions on the OPCOM platform. Overall, the quantities of acquired electricity accounted for 17.3% of energy sold in 2009, 14.1% in 2010 and 22.3% in 2011 (a draught year).

**Table 25: Hidroelectrica net sales breakdown**

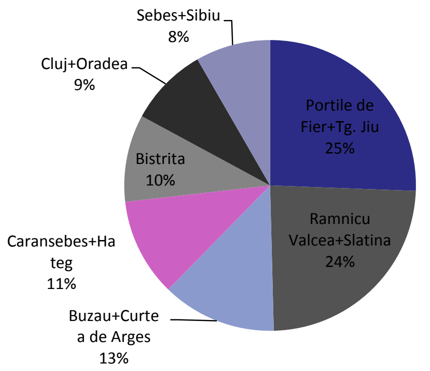
| RON mn | 2009 | 2010 | 2011 | 2012 | 2013 | 7M14 |
|---|---|---|---|---|---|---|
| Electricity sold | 2,005 | 2,745 | 2,540 | 1,926 | 2,667 | 1,601 |
| System services | 391 | 497 | 451 | 402 | 341 | 135 |
| Other | 25 | 31 | 30 | 74 | 75 | 110 |
| **Net sales (RON mn)** | **2,421** | **3,274** | **3,021** | **2,403** | **3,083** | **1,846** |
| **Electricity sold (TWh)** | **18.3** | **22.5** | **18.3** | **12.7** | **15.0** | **10.4** |
| Regulated market | 3.9 | 4.1 | 3.9 | 4.1 | 4.0 | 3.3 |
| Free market | 13.0 | 16.0 | 12.9 | 6.8 | 9.7 | 6.4 |
| Other markets | 1.4 | 2.5 | 1.5 | 1.8 | 1.4 | 0.6 |
| **Average price (RON/MWh)** | **110** | **122** | **139** | **152** | **178** | **154** |
| Regulated market | 84 | 86 | 86 | 72 | 125 | 117 |
| Free market | 108 | 126 | 133 | 154 | 187 | 164 |
| Other markets* | 193 | 157 | 328 | 323 | 263 | 251 |

*Source: Company data, IPOPEMA Research*

**Chart 5: Breakdowns by branches: production (left chart) and capacity (right chart) (2012)**

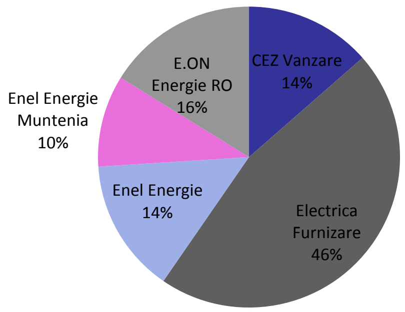


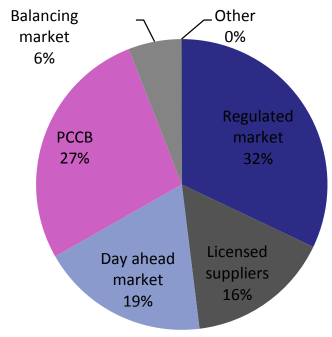

*Source: Hidroelectrica, IPOPEMA Research*




*Source: Hidroelectrica, IPOPEMA Research*

**Chart 6: Breakdown of regulated market sales volumes by key clients (left chart) and of sales by markets (7M14)**




*Source: Hidroelectrica, IPOPEMA Research*

*Source: Hidroelectrica, IPOPEMA Research*

**Table 26: Hidroelectrica's net output evolution**

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 8M14 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Output (GWh)** | **15,902** | **13,195** | **16,433** | **20,103** | **18,235** | **15,807** | **17,006** | **15,516** | **19,852** | **14,710** | **12,065** | **14,823** | **12,201** |
| yoy (%) | | -17.0 | 24.5 | 22.3 | -9.3 | -13.3 | 7.6 | -8.8 | 27.9 | -25.9 | -18.0 | 22.9 | |

*Source: Company data, IPOPEMA Research*

**Hidroelectrica was placed back under insolvency towards end-February, on procedural grounds**

On 25 Feb the Bucharest Court of Appeal admitted several appeals related to Hidroelectrica's insolvency during June 2012—June 2013 thus cancelling the initial decision of the Bucharest Court whereby the insolvency procedure was closed. The company was thus placed again under insolvency on procedural grounds. EuroInsol was re-appointed as judicial administrator.

Several types of appeals were admitted by the Court of Appeal in Feb: against the closing/opening of the insolvency procedure, the unilateral termination of bilateral contracts, the enforcement of the force majeure clause and appeals related to the creditors' table. The Court of Appeal admitted several appeals and sent them back to the first degree court for retrial on merit. Total amounts in dispute are around RON 1.6bn (for the unilateral termination of the bilateral contracts). Meanwhile, the reorganization plan approved by the Creditors' Meeting with 94.6% For votes on 18 June 2013 was reconfirmed on 20 June 2013 by the Bucharest Court.

The first entry in insolvency led to the downward revision of the valuation of FP stake in the company from RON 3.3bn to zero. In Dec 2012, the changes in the FSA methodology allowing FP to value companies in insolvency based on fair value led to a valuation of RON 2bn (revised up by RON 239mn in Dec 2013). The entry in the second insolvency led to a downward revision of the holding value to the current level of RON 2,105mn.

**Water contributions**

One of the main components of Hidroelectrica's production cost is the water contribution paid to Apele Romane (the national agency for the preservation and management of the water resources). This tariff jumped yoy by 4.2x in 2011 (it accounted for 15% of the production cost in 2013, 9.6% in 2012, 10.5% in 2011 and 6.5% in 2010).

**Regulated selling prices versus production costs**

The regulated price set by ANRE for Hidroelectrica has constantly been below the unit generation cost during 2011-2013 and this may be the case this year as well. Moreover, according ANRE Order No. 83/2013, Hidroelectrica and Nuclearelectrica are required to deliver to the regulated market up to 50% and 40% respectively of their electricity sales, by end-2017 to ensure reasonable prices for household consumers. For 2014, ANRE decided that only hydro and nuclear producers are to deliver electricity on the regulated segment, with thermal power generators being excluded as their energy is too expensive.

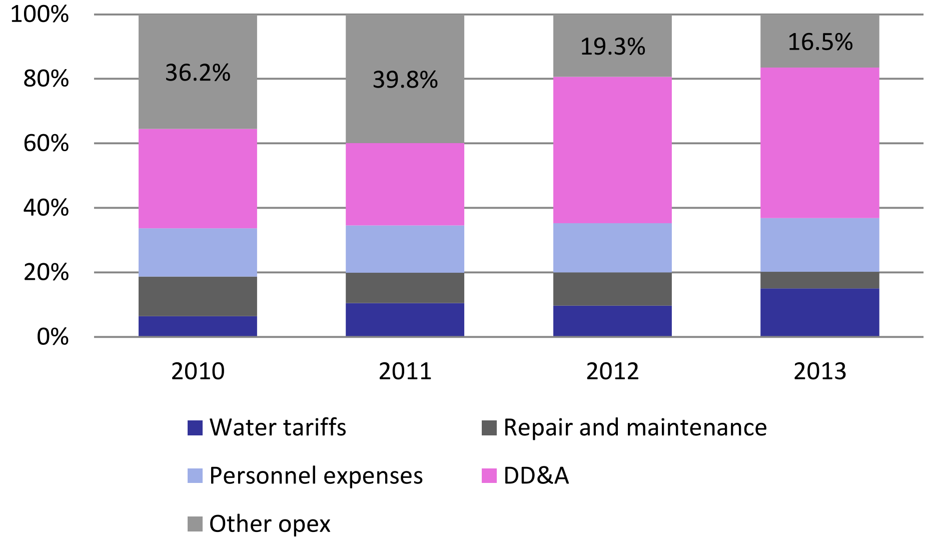
This year, ANRE decided that Hidroelectrica is to deliver 5.3TWh at an initial price of RON 115.2/MWh on the regulated segment (RON 125/MWh as of 1 July). The 2014 tariffs have not included the 1.5% special constructions tax in 1H14, as the tax base was not clearly defined (RON 168mn tax impact estimated by FP for the FY). In Jan 2014, Hidroelectrica filed a complaint with the Competition Council and also started a lawsuit against ANRE for setting the regulated price at levels not covering all opex. The Competition Council's president was quoted in the local media saying that a decision is to be made in 2H14 at the earliest.

**Table 27: Hidroelectrica's regulated price vs. unit costs**

| RON/MWh | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|
| Regulated price | 83.5 | 86.1 | 86.4 | 71.6 | 125.0 | 120.1 |
| **Unit generation cost** | **87.7** | **84.7** | **111.8** | **163.7** | **144.0** | **148.5** |
| Difference (%) | -4.8 | 1.7 | -22.7 | -56.3 | -13.2 | -19.1 |

*Source: Company data, IPOPEMA Research*

**Chart 7: Breakdown of opex**




*Source: FP, IPOPEMA Securities*

### Latest financial results review and 2014-2015 company budget

The January-July 2014 electricity production reached 12.2TWh, of which 10.4TWh was the electricity sold. Net sales amounted to RON 1.85bn, 0.6% down yoy, of which sales of electricity reached RON 1.6bn. 7M14 net sales represented 73% of the company's full year budget.

EBITDA came in at RON 1.16bn down 4.5% yoy (but representing 94% of the FY budgeted figure), with personnel expenses continuing to decline, as well as costs with acquired energy, but other opex significantly up yoy mainly due to the introduction of the special construction tax. Overall EBITDA margin slightly deteriorated from 65.2% in 7M13 to 62.6% in 7M14. Pre-tax profit reached RON 588mn, 2% down yoy but was at 177% of the FY budgeted figure. A decline in the net financial loss by 75% yoy (most likely on lower interest expenses and net FX gain vs. a net FX loss in 7M13) explains the better pre-tax profit performance vs. EBITDA's. It looks like the 2014 budget would be exceeded, while for 2015, the company expects a significant increase in profitability vs. the 2014 budgeted figures, on the back of higher sales (+17.7%) and continued opex declines (mainly for personnel expenses and COGS) and lower interest expenses. However, compared to the 12TM figures based on 7M14 data, the 2015 budget looks less impressive (3.3% yoy decline in sales and ca. 5% yoy decline in EBITDA and net profit). We believe the 2015 figures would be revised mainly to account for the special construction tax (likely to be lowered to 1%) and revised electricity prices and volumes.

In the 1H14 balance sheet (no detailed 7M14 balance sheet was available), we would note the significant decline in the bank net debt to RON 567mn, from RON 1.3bn in Dec 2013, as several loans were repaid and no new loans were taken. The credit lines were RON 94mn in Aug 2014 (from RON 813mn in 1H12, the date when the first insolvency was declared), while the debt service for Hidroelectrica's long term loans reached EUR 231.7mn (principal) and EUR 30.2mn (interests and fees) (the amounts payable in 2014 being EUR 108mn). The debt service (principal and interest) is to significantly decline from 2015 onwards (EUR 60mn in 2015, EUR 47mn in 2016 and to single digit figures of EUR 6-8mn in 2019-2021). The decline in bank loans was the main responsible for the slump in the amounts due as per the Creditors Table (from RON 4.3bn in 1H12 to RON 1.3bn as at end Aug 2014) and for the improvement in the company's net treasury from a negative RON 763mn in 1H12 to a positive RON 265mn as at end July 2014.

**Main risks refer to regulatory, litigations and prices' evolutions**. On litigations, thing to watch are: the ongoing lawsuits filed by Hidroelectrica' clients for allegedly faulty procedures (on closing or opening of the insolvency), or in which clients are asking for damages for the unilateral termination of bilateral agreements (RON 1.6bn total claims) or are challenging decisions regarding the enforcement of the force majeure clause in 2012. Regulatory risk mainly refers to the quantities and prices of the electricity to be sold on the regulated market set by ANRE (as to prices, often below unit costs as not all opex are recognised by ANRE). The evolution of the prices on the free market is also a major determinant of the company's financial performance (their decline might continue due to lower demand (mainly from industrial consumers focused on efficiency and/or on building their own generation units) coupled with oversuppy (due to higher renewables output). Risk of overturning some of the restructuring measures taken during insolvency after the company exits the process should not to be neglected (as the company is majority state owned, thus decisions on board and management elections, capex, dividends could be taken untransparently). High operating leverage makes Hidroelectrica's financials highly dependent on weather conditions.

# CE OLTENIA

## The least restructured one

28 October 2014

**CE OLTENIA**
*NOT LISTED*

CE Oltenia is the largest domestic lignite producer (with 24% market share in 2013 and ca. 12TWh production from 3,570 MW capacity). It is valued at RON 120mn as per FSA methodology vs. RON 141mn our fair value. It was set up in May 2012 via the merger of three lignite fired power plants (Turceni, Rovinari and Craiova commissioned between 1978-1987) with their lignite supplier SNLO. Its 12% IPO (15.3% rights issue) was postponed for 1H15, to finalize the coal reserves' audit and allow the company to perform a deeper operational restructuring (although probably most of it is to take place after the IPO). It is probably the least restructured company from FP's portfolio, which could be both a source of major risks but also of upside potential (via staff reductions from the ca. 18,500 in 1H14, mainly in the mining division, spin off of some mines, capex prioritization etc). Its export opportunities (given Turceni's plant connection with Iron Gates interconnection node), its vertical integration (all lignite needs are covered by own mines) and its role in the stable functioning of the Romanian power system are CE Oltenia's main strengths.

**Latest results are the inverted reflection of Hidroelectrica's:** bad years for the latter (2011-2012) where good years for CE Oltenia, while in 2013-1H14, apart from better hydrological years, CE Oltenia's financials were also impacted negatively by higher output from renewables, associated costs for their support schemes and lower demand in electricity, which all exerted a downward pressure on prices. After a mere RON 4.6mn net profit in 2013, in 1H14 CE Oltenia recorded negative EBIT and net profit of RON 157mn and RON 194mn respectively, largely due to higher CO2 certificates costs, the introduction of the special construction tax (RON 31mn for the FY) and net FX losses associated with FX loans (vs. FX gains in 2012). While the 3Q14 budget is based on the assumption of a return to a positive EBIT (RON 55mn), the 2014 budget is likely to be missed. While CE Oltenia no longer sells its electricity on the regulated market, its unit production costs, although down yoy are still below selling prices (except for Rovinari and Craiova II plants). The company has high capex needs, to be financed from an already high and on an upward trend net debt (RON 2.2bn in 1H14), thus its debt related ratios are at dangerously high levels (Net debt/EBITDA at close to 6x using 12TM EBITDA).

**Risks:** we mention here mainly the company specific ones**:** complete capex to meet EU standards by YE, finance the acquisition of CO2 certificates in the context of a downward trend in electricity prices as a result of oversupply and declining consumption. The volatility of supplies from the renewable energy producers is likely to continue to cause major disruptions in CE Oltenia's activity with impact on its profitability. Other risks refer to corporate governance (as the state is the majority shareholder), FX (the company has FX loans) and non-cashing its overdue receivables (RON 916mn in 1H14).

| Key Ratios | 2013 | 12TM |
|---|---|---|
| EBITDA Margin | 20.5% | 14.2% |
| EBIT Margin | -1.1% | -8.1% |
| ROE | 0.1% | n.a. |
| Bank debt/ Assets | 23.0% | n.a. |

| Shareholders | Stake |
|---|---|
| Ministry of Economy | 77.2% |
| Fondul Proprietatea | 21.5% |
| Termoelectrica | 0.9% |
| SCIM | 0.4% |

**Valuation multiples using IPOPEMA fair value*

**CE OLTENIA – Summary Financial Data**

| | 2011 | 2012 (7M) | 2013 | 2013B | 1H14 | 2014B | 12TM |
|---|---|---|---|---|---|---|---|
| Sales (RONm) | 2,819 | 2,237 | 2,649 | 2,797 | 1,175 | 3,384 | 2,604 |
| EBITDA (RONm) | 858 | 410 | 543 | 569 | 131 | 614 | 370 |
| EBIT (RONm) | 348 | 44 | -28 | 85 | -157 | 104 | -212 |
| Net profit (RONm) | 180 | 118 | 5 | 125 | -194 | 5 | -266 |
| EPS (RON) | 1.4 | 0.9 | 0.0 | 1.0 | -1.5 | 0.0 | -2.1 |
| DPS (RON) | n.a. | n.a. | 0.4 | 0.3 | NA | 0.2 | n.a. |
| EV/EBITDA (x)* | 2.4 | 3.1 | 5.3 | 4.4 | 10.9 | 4.7 | 7.8 |
| P/E (x)* | 3.6 | 3.2 | 142.7 | 5.2 | Neg. | 142.7 | Neg. |

*Source: CE Oltenia, IPOPEMA Research*

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| P&L (RON m) | 2011 | 2012 (7M) | 2013 | 1H13 | 1H14 | 2013B | 2014B | 12TM |
|---|---|---|---|---|---|---|---|---|
| **Revenues** | **4,026** | **3,347** | **4,278** | **2,024** | **1,899** | **4,491** | **4,834** | **4,154** |
| *- yoy change* | | *n.m.* | *n.m.* | *n.m.* | *-6.2* | *n.m.* | *13.0%* | *-2.9%* |
| **Sales** | **2,819** | **2,237** | **2,649** | **1,220** | **1,175** | **2,797** | **3,384** | **2,604** |
| *- yoy change* | | *n.m.* | *n.m.* | *n.m.* | *-3.7* | *n.m.* | *27.8%* | *-1.7%* |
| **EBIT** | **348.0** | **44.5** | **-28.0** | **26.5** | **-157.4** | **84.8** | **104.4** | **-211.9** |
| *- yoy change* | | *n.m.* | *n.m.* | *n.m.* | *n.m.* | *n.m.* | *n.m.* | *n.m.* |
| Depreciation cost | -509.8 | -365.3 | -571.0 | -277.9 | -288.5 | -484.7 | -509.6 | **-581.7** |
| **EBITDA** | **857.8** | **409.8** | **543.0** | **304.4** | **131.1** | **569.5** | **614.0** | **369.8** |
| *- yoy change* | | *n.m.* | *n.m.* | *n.m.* | *-56.9* | *n.m.* | *13.1%* | *-31.9%* |
| Financial Income / (Cost) | -276.0 | 131.7 | 101.0 | 84.2 | -36.1 | 95.4 | -67.5 | **-19.3** |
| **Pretax Profit** | **n.a.** | **176.1** | **73.0** | **110.7** | **-193.5** | **180.2** | **36.9** | **-231.3** |
| *- yoy change* | | *n.m.* | *n.m.* | *n.m.* | *n.m.* | *n.m.* | *-49.5%* | *n.m.* |
| Income tax | n.a. | -57.8 | -68.4 | -33.8 | 0.0 | -54.9 | -5.8 | **-34.6** |
| **Net Income** | **179.9** | **118.3** | **4.6** | **77.0** | **-193.5** | **125.2** | **4.6** | **-265.9** |

| Profitability Ratios | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| EBITDA Margin | 30.4% | 18.3% | 20.5% | 25.0% | 11.2% | 20.4% | 18.1% | 14.2% |
| EBIT Margin | 12.3% | 2.0% | -1.1% | 2.2% | -13.4% | 3.0% | 3.1% | -8.1% |
| Net Margin | 6.4% | 5.3% | 0.2% | 6.3% | -16.5% | 4.5% | 0.1% | -10.2% |
| ROE | 3.6% | 2.2% | 0.1% | n.a. | -7.4% | n.a. | n.a. | n.a. |

| Balance Sheet (RON m) | 2010 | 2011 | 2012 | 9M13 | 2013 | 1H14 |
|---|---|---|---|---|---|---|
| **Total Fixed Assets** | **6,271** | **6,613** | **6,859** | **6,796** | **6,970** | **7,043** |
| Tangible Assets | n.a. | n.a. | 6,832 | 6,772 | 6,949 | 7,022 |
| Other Fixed Assets | n.a. | n.a. | 27 | n.a. | 21 | 21 |
| **Total Current Assets** | **1,403** | **1,535** | **1,482** | **1,506** | **1,627** | **1,535** |
| Cash and Equivalents | 139 | 240 | 224 | n.a. | 136 | 47 |
| Other Current Assets | n.a. | n.a. | 1,210 | n.a. | 1,443 | 1,489 |
| **Total Assets** | **7,674** | **8,148** | **8,341** | **8,302** | **8,597** | **8,579** |
| **Stockholders` Equity** | **4,813** | **4,991** | **5,482** | **5,508** | **5,398** | **5,205** |
| **Long Term Liabilities** | **1,576** | **1,896** | **1,974** | **1,616** | **2,286** | **2,359** |
| Long -Term Debt | 1,028 | 1,377 | 1,534 | n.a. | 1,648 | 1,849 |
| Other Long - Term liabilities | n.a. | n.a. | 440 | n.a. | 639 | 510 |
| **Short Term Liabilities** | **1,285** | **1,260** | **884** | **814** | **912** | **1,014** |
| Short -Term Debt | 203 | 266 | 198 | n.a. | 326 | 412 |
| Other Short Term Liabilities | n.a. | n.a. | 686 | n.a. | 586 | 602 |
| **Total Equity & Liabilities** | **7,674** | **8,148** | **8,341** | **8,302** | **8,597** | **8,579** |

| Balance Sheet Ratios | 2010 | 2011 | 2012 | 9M13 | 2013 | 1H14 |
|---|---|---|---|---|---|---|
| Current Ratio | 1.09 | 1.22 | 1.68 | 1.85 | 1.78 | 1.51 |
| Quick Ratio | n.a. | n.a. | 1.30 | n.a. | 1.32 | n.a. |
| Bank Debt/Assets | 16.0% | 20.2% | 20.8% | n.a. | 23.0% | 26.4% |
| **Bank Debt/Equity** | **25.6%** | **32.9%** | **31.6%** | n.a. | **36.6%** | **43.4%** |

*Source: CE Oltenia, IPOPEMA Research*

**Table 28: Key volume and pricing related budget assumptions**

| | 1H13 | 1H14 | yoy (%) | 1H14B | % of deviation | 3Q14B | 9M14B |
|---|---|---|---|---|---|---|---|
| Electricity produced (TWh) | 5,0 | 6,1 | 21,5 | 7,0 | -13,5 | 4,0 | 10,0 |
| Electricity sold, o/w (TWh) | 4,5 | 5,5 | 21,6 | 6,4 | -13,4 | 3,6 | 9,1 |
| own production | 4,1 | 5,1 | 24,4 | 5,9 | -13,4 | 3,4 | 8,5 |
| other sources | 0,6 | 0,1 | -76,3 | 0,5 | -69,2 | 0,2 | 0,4 |
| Coal production (mn t), o/w | 10,1 | 10,1 | -0,4 | 13,0 | -22,8 | 6,5 | 16,5 |
| to third parties | n.a. | 2,0 | n.a. | 3,5 | -41,7 | 1,2 | 3,2 |
| Electricity price (MWh) | 208,3 | 181,3 | -12,9 | 196,7 | -7,8 | 188,8 | 177,0 |
| Electricity price regulated market | 202,8 | NA | NA | NA | NA | NA | NA |
| Electricity price competitive market | 234,9 | 183,0 | -22,1 | n.a. | n.a. | n.a. | n.a. |
| Electricity cost (MWh) | 226,6 | 209,4 | -7,6 | 199,4 | 5,0 | 179,7 | 197,7 |
| Coal price (RON/t) | 61,8 | 59,7 | -3,4 | 60,0 | -0,5 | n.a. | n.a. |
| Unit coal cost (RON/t) | 73,6 | 67,0 | -9,0 | 59,1 | 13,3 | n.a. | n.a. |
| Average staff number | 18.649 | 18.526 | -0,7 | 19.130 | -3,2 | | |
| Capex (RON mn) | 324,8 | 476,3 | 46,6 | 560,0 | -15,0 | | |

*Source: CE Oltenia, IPOPEMA Research*

## CE Oltenia's Valuation

**We value CE Oltenia based on a combination of EV/capacity and financial multiples**: the reference EV/Capacity is EUR 0.69mn/MW, the reference EV/Sales multiple is 1.06x and the reference EV/EBITDA multiple is 5.6x (the median values of a narrow selection of peers, with 2014 multiples for peers based on Bloomberg). To these reference multiples, we applied hefty discounts (60% for capacity multiples, in correlation with the company s low CUR of ca. 38% in 2013 and 25% for the financial multiples) to account for the differences in profitability, ageing factor, capex, size, unlisted status (thus limited visibility and weaker corporate governance), as well as country and sector related risks. CE Oltenia's productivity is way below peers' average (it is overstaffed mainly in the mining division), while high and increasing cost of its CO2 certificates and high capex needs likely to be largely financed from an increasing net debt figure (RON 2.2bn in 1H14) are the main reasons for lower than average profit margins.

Valuation based on EV/capacity (20% weight in the final valuation) yields significantly higher figure compared to that based on EV/EBITDA (40% weight) or EV/Sales (40%). For CE Oltenia we used 2014 budgeted P&L data and 1H14 net debts, while the 2015 estimates are in fact 12TM data based on 1H14 numbers.

CE Oltenia is valued in FP's official NAV as at June 2014 at RON 120mn, while our fair value is RON 141mn.

**Table 29: Fair Value of CE Oltenia based on various valuation methods**

| | Fair value of equity based on | | | | Fair value | | | | |
|---|---|---|---|---|---|---|---|---|---|
| RON mn | EV/sales | EV/EBITDA | EV/Capacity | Average | EV/sales | EV/EBITDA | EV/Capacity | Average | Official valuation |
| CE Oltenia | 259,4 | 299,5 | 2.159,5 | 655,5 | 55,8 | 64,5 | 464,9 | 141,1 | 120,0 |

*Source: Company data, Bloomberg, IPOPEMA Research*

**Limited comparability to peers:** finding peers for a purely lignite fired genco such as CE Oltenia was a real challenge as in Europe, practically there are no pure coal fired electricity producers. Moreover, from the group of integrated players (which also have distribution and/or supply activities), finding peers predominantly using lignite as main raw material proved an even more difficult exercise, as most use a mix of resources. Given the above limitations, we selected the companies with a fairly sizeable weight of coal in both total capacity and production (and whenever possible, of lignite fired units). From our selection of six companies (three in CEE and three in Western Europe), we consider PGE (in Poland) and RWE (in Germany) as the closest peer as visible from the table below:

**Table 30: Key relevant data for the closest peers**

| | RWE (Germany) | PGE (Poland) | Tauron (Poland) | CEZ (Czech R) | PPC (Greece) | Drax (UK) |
|---|---|---|---|---|---|---|
| % of installed capacity based on coal, o/w | 44.2 | 85.6 | 97.6 | 57.2 | n.a. | 83.3 |
| Lignite | 47.8 | 61.1 | 100.0 | 68.2 | n.a. | n.a. |
| Period to which data refers | 2012 | 2009 | 2009 | 2012 | n.a. | 2013 |
| % of electricity production based on coal, o/w | 61.1 | 92.8 | 87.0 | 48.2 | 40.2 | 88.9 |
| Lignite | 61.3 | 72.0 | 37.6 | 84.3 | 100.0 | n.a. |
| Period to which data refers | **2013** | **9M13** | **2012** | **9M13/2012** | **9M13** | **2013** |

*Source: Company data, IPOPEMA Research*

As the table below shows, CE Oltenia's EBITDA margin is lower than the CEE peers' median (being higher than levels of RWE and Drax), while the net margin differential is even higher (as CE Oltenia's figures have been lately either negative or close to breakeven at best). The company has high financial expenses (high interest expenses and net FX losses for its FX loans) and high effective tax rates. CE Oltenia also has lower CUR than most of its peers (the 2013 figure was particularly low as the company was often forced during the year to temporarily halt its production to grant preferential access to the grid to the renewable energy producers).

**Table 31: Peer companies' margins and CUR**

| Peers | EBITDA margin (%) 2013 | 2014E | 2015E | Netmargin (%) 2013 | 2014E | 2015E | Capacity TW | Production TWh | CUR % |
|---|---|---|---|---|---|---|---|---|---|
| CEZ (Chech R) | 37.8 | 34.6 | 32.4 | 16.2 | 14.3 | 12.2 | 15.2 | 66.7 | 50.1 |
| PGE (Poland) | 27.5 | 26.9 | 25.0 | 14.2 | 12.9 | 11.3 | 12.9 | 57.0 | 50.6 |
| Tauron (Poland) | 17.3 | 19.5 | 19.1 | 7.6 | 6.4 | 5.6 | 5.5 | 19.4 | 40.2 |
| RWE | 17.0 | 13.1 | 13.0 | 4.2 | 2.5 | 2.5 | 52.0 | 216.7 | 47.6 |
| PPP (Greece) | 15.3 | 17.4 | 19.4 | 0.7 | 2.1 | 4.0 | 12.8 | 50.8 | 45.4 |
| Drax (UK) | 11.2 | 9.5 | 10.7 | 10.2 | 3.8 | 5.1 | 3.9 | 26.2 | 77.3 |
| **Median** | **17.2** | **18.5** | **19.2** | **8.9** | **5.1** | **5.3** | | | **48.8** |
| CE Oltenia | 20.5 | 18.1 | 14.2 | 0.2 | 0.1 | -10.2 | 3.6 | 12.0 | 38.4 |

*Source: Company data, Bloomberg, IPOPEMA Research*

Using our fair value, CE Oltenia's EV/EBITDA is relatively close to the median value of the peers in our sample (even slightly lower in 2013-2014). In EV/Capacity terms, CE Oltenia is more expensive than the median of the peers we selected (being cheaper only compared to CEZ, and with a value close to that of Drax), while in P/E terms, comparisons are meaningless (this was the reason for us not using this multiple in setting a fair value for CE Oltenia).

**Table 32: Peer companies' financial and operational multiples**

| Peers | Mcap (EUR mn) | P/E (x) 2013 | 2014E | 2015E | EV/EBITDA (x) 2013 | 2014E | 2015E | EV/capacity (EUR 000/MW) 2013 | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|---|---|
| CEZ (Chech R) | 11,404 | 8.4 | 10.8 | 12.8 | 5.6 | 6.9 | 7.4 | 1,158.3 | 1,169.9 | 1,152.6 |
| PGE (Poland) | 9,591 | 9.5 | 11.1 | 12.2 | 4.6 | 5.2 | 6.0 | 546.6 | 721.0 | 816.0 |
| Tauron (Poland) | 2,218 | 6.0 | 8.1 | 8.9 | 4.4 | 4.7 | 5.2 | 614.2 | 720.7 | 799.7 |
| RWE | 15,735 | 7.3 | 12.6 | 12.5 | 5.5 | 4.3 | 4.0 | 914.4 | 538.6 | 505.2 |
| PPP (Greece) | 1,578 | 39.1 | 12.9 | 6.5 | 6.9 | 6.0 | 5.5 | 519.7 | 491.4 | 496.7 |
| Drax (UK) | 3,055 | 12.3 | 27.1 | 17.7 | 11.1 | 11.2 | 8.8 | 771.1 | 810.2 | 825.1 |
| **Median** | | **9.0** | **11.9** | **12.4** | **5.6** | **5.6** | **5.8** | **692.6** | **720.8** | **807.8** |
| CE Oltenia | | 142.7 | 142.7 | n.m. | 5.3 | 4.7 | 7.8 | 803.9 | 803.9 | 803.9 |

*Source: Company data, Bloomberg, IPOPEMA Research*

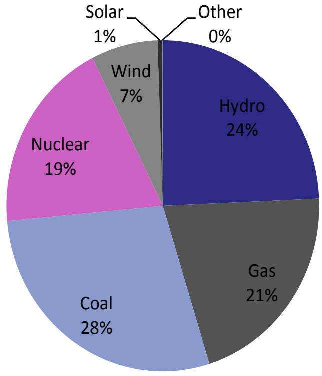
**Risks to our valuation:** CE Oltenia is a new company with a very short history of financials (only 7M data for 2012, data for 2013, 1H14 and a 2014 budget are available). Being so recently set up, the company has not finalized the prioritization of the key investment projects (to date, capex remains largely a sum of the capex of the merged components and the company may end up in contributing to projects related to the national energy system with unknown amounts). The company is also fine tuning its operational restructuring plan (number of personnel to be laid off and related redundancy payments, number of the mines or other assets to be divested), thus the earnings visibility is very limited.

## Business overview

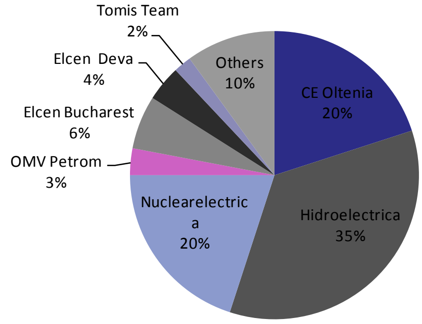
CE Oltenia weight in FP's June 2014 official NAV was of 0.8% only at an official valuation of RON 120mn, revised downwards in several steps from RON 1,075mn in June 2012, to RON 880mn in Sept 2013, and RON 321.6mn in Dec 2013. FP has a 21.53% stake in CE Oltenia.

CE Oltenia was set up on 31 May 2012 via the merger of three thermal power plants Turceni, Rovinari and Craiova with their lignite supplier SNLO. It is Romania's largest integrated lignite fired power producer (24% market share in 2013), with an installed capacity of 3,900 MW (13 units), of which only 3,570 MW operational, an average annual production of 18TWh of electricity and 30mn tones of lignite (from 15 open pits and 3 underground mines). CE Oltenia is also one of Romania's largest employers (18,526 people of which 12,344 in the mining division in June 2014). The company's audited lignite reserves are ca. 820mn tons, expected to cover needs for ca. 45 years (production started in 1957). The company targets a 17%-25% market share in electricity production (and increasing it to 30% in 2017).

**Chart 8: Romania's electricity production by sources (left chart- Feb 2014) and key producers (right chart) (2013)**




*Source: ANRE, IPOPEMA Research*




*Source: ANRE, IPOPEMA Research*

CE Oltenia sells now all its electricity production on the competitive market, while for the period 2010-2013 a larger part went to the competitive market (56% in 2010, 61% in 2011, 62% in 7M12 and ca. 80% in 2013). The prices on the competitive market were higher than on the regulated market by 26% in 2010, 30% in 2011 and 35% in 2012. The company has for all its plants the Authorization for the CO2 Certificates Emissions valid for 2013-2020, as well as the Integrated Environmental Authorization valid until 2016.

## Latest (1H14) results review and outlook

The next two pages summarize in the form of charts and tables the evolution of CE Oltenia's key indicators:

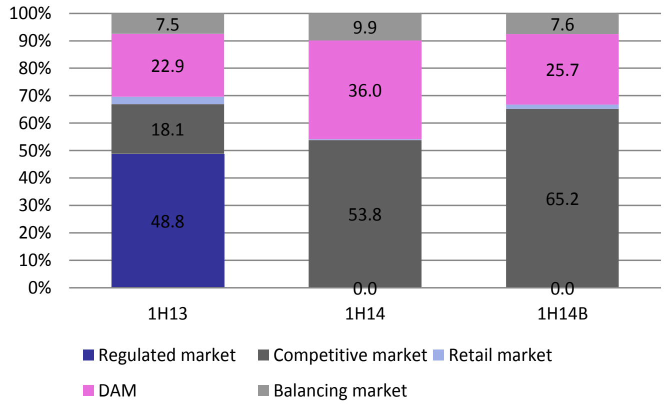
**Table 33: Key 1H14 data on CE Oltenia and its constituents**

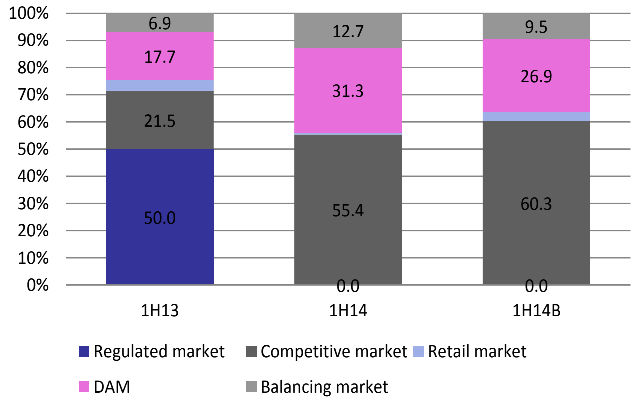
| | Turceni | Rovinari | Craiova II | Isalnita | Chiscani | Total |
|---|---|---|---|---|---|---|
| Production capacities (MW) | 1,320 | 1,320 | 630 | 300 | 0 | **3,570** |
| No. of units | 4.0 | 4.0 | 2.0 | 2.0 | | **12** |
| Commissioning dates | 1978 | 1972 | 1987 | 1967 | | |
| Electricity produced (TWh) | 2.4 | 2.3 | 0.5 | 0.8 | 0.1 | 6.1 |
| Electricity sold (TWh), o/w | 2.2 | 2.1 | 0.5 | 0.8 | 0.0 | 5.5 |
| from own production | 2.0 | 2.0 | 0.4 | 0.7 | 0.0 | 5.1 |
| Price (RON/MWh) | 182.0 | 181.3 | 175.7 | 181.9 | 0.0 | 181.3 |
| Unit cost (RON/MWh) | 214.6 | 179.1 | 168.1 | 220.5 | 0.0 | 209.4 |
| **Electricity sales (RONmn)** | **396.7** | **382.4** | **83.8** | **137.0** | **0.0** | |
| EBIT (RON mn) | -89.4 | 0.0 | 8.1 | -35.1 | -7.9 | |
| Net financial gain/(loss) (RON | -23.2 | -13.0 | 0.0 | 7.0 | 0.0 | |
| Pre-tax profit (RON mn) | **-112.6** | **-13.0** | **8.1** | **-28.1** | **-7.9** | |
| Capex | 24.8 | 180.3 | 134.7 | 98.7 | 35.1 | 476.3 |

*Source: CE Oltenia, IPOPEMA Research*

In 1H14, CE Oltenia sales of electricity were flat yoy, on the back of increased volumes offset by declining prices on the competitive market. Coal sales were also significantly down yoy on lower sales volumes to third parties (20% of total) and lower prices. The need to acquire a higher quantity of CO2 certificates (4.7mn vs. 0.37mn in 1H13) at higher prices (RON 23.7 in 1H14 vs. RON 17.5/certificate in 1H13) translated into RON 111.8mn costs for this item in 1H14 vs. only RON 6.5mn in 1H13)

**Chart 9: CE Oltenia's sales breakdown by market segments: volumes-(left chart) and values (right chart)**

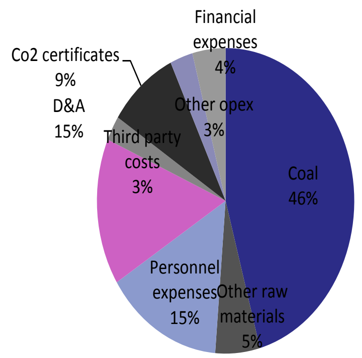


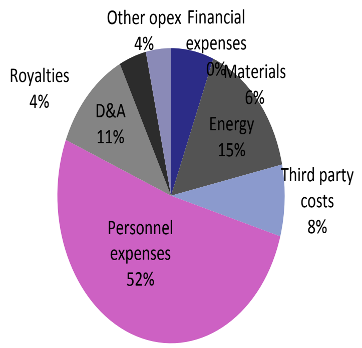




***Source: CE Oltenia, IPOPEMA Research*** ***Source: CE Oltenia, IPOPEMA Research***

In the electricity production division, the cost of producing 1MWh was RON 209.4, down 7.6% yoy mainly on the back of cheaper raw materials (of which coal costs, with the highest weight of 46% in total costs in 1H14, were down by 10.3% to RON 95.7/MWh). Personnel expenses, the third largest cost item (14.8% weight in opex in 1H14) declined by 11% yoy. In fact, except for the CO2 certificates' cost, all cost items (for producing 1MWh) declined yoy, largely due to a higher production. In the mining division we note the 10.3% yoy decline in the cost per ton to RON 67, mainly as a result of declines in third party costs (by 23% yoy), in the cost of electricity purchased (by RON 15% to RON 10.4/ton of coal) and of personnel expenses (10% down yoy). Unit costs' declines for 8 out of the 13 mines managed to offset the yoy increases at the other 5 mines. The division was profitable with a RON 11.2mn EBIT in 1H14.

**Chart 10: Unit costs breakdown: electricity (RON/MWh) (left chart) and coal (RON/ton) (right chart)**

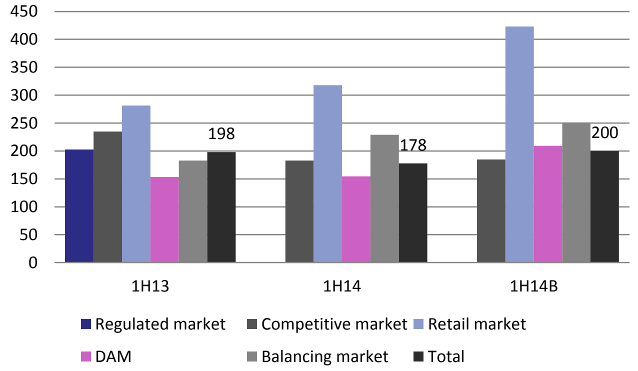


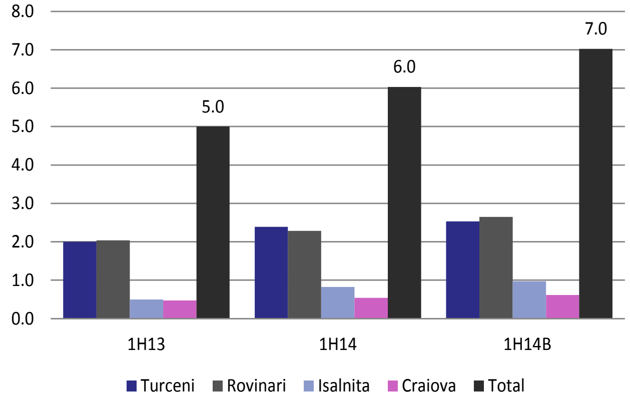




***Source: CE Oltenia, IPOPEMA Research*** ***Source: CE Oltenia, IPOPEMA Research***

In the electricity production division, despite the unit costs' declines, the RON 209.4/MWh figure remains higher than the RON 181.3/MWh unit selling price. In fact, in 1H14, only Rovinari and Craiova II plants managed to sell their electricity above costs.

**Chart 11: Unit prices of electricity (RON/MWh): by markets (left chart); Production by plants (TWh) (right chart)**

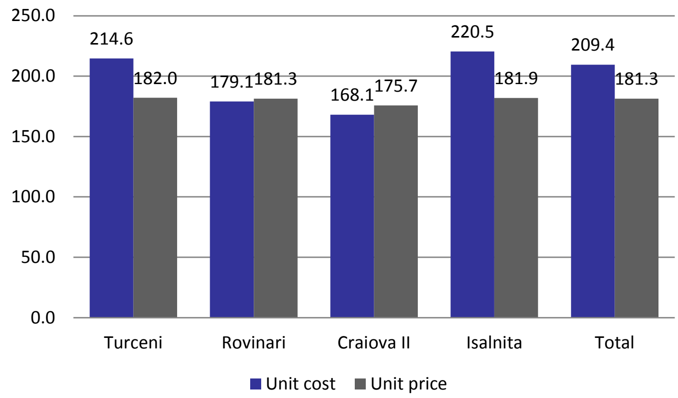


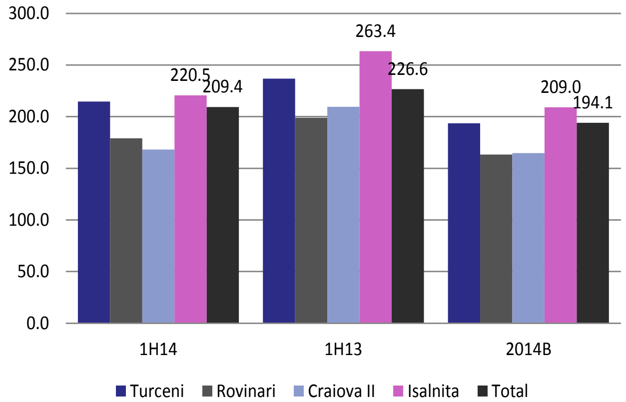




*Source: CE Oltenia, IPOPEMA Research*

*Source: CE Oltenia, IPOPEMA Research*

**Chart 12: 1H14 unit prices vs. costs of electricity (RON/MWh) (left chart); Evolution of unit costs (right chart)**




*Source: CE Oltenia, IPOPEMA Research*

*Source: CE Oltenia, IPOPEMA Research*

**Table 34: CE Oltenia sales by markets**

| | 1H14 | | | yoy (%) | | |
|---|---|---|---|---|---|---|
| | Quantity (TWh) | Price (RON/MWh) | Value (RON mn) | Quantity | Price | Value |
| Regulated market | 0.0 | 0.0 | 0.0 | n.m. | n.m. | n.m. |
| Competitive market | 2.8 | 183.0 | 519.0 | 231.9 | -22.1 | 158.6 |
| Retail market | 0.0 | 317.9 | 5.5 | -86.4 | 13.0 | -84.6 |
| DAM | 1.9 | 154.7 | 293.2 | 75.9 | 0.9 | 77.5 |
| Balancing market | 0.5 | 229.0 | 118.9 | 46.8 | 25.1 | 83.7 |
| **Total** | **5.3** | **177.8** | **936.5** | **11.7** | **-10.2** | **0.3** |

*Source: CE Oltenia, IPOPEMA Research*

**Table 35: 1H14 sales breakdown by activities**

| | | | | % of total | |
|---|---|---|---|---|---|
| RON mn | 1H13 | 1H14 | yoy (%) | 1H13 | 1H14 |
| **Sales, o/w** | **1,220** | **1,175** | **-3.7** | **100.0** | **100.0** |
| Electricity | 858.3 | 866.5 | 1.0 | 70.4 | 73.8 |
| Heat | 48.2 | 37.5 | -22.3 | 4.0 | 3.2 |
| Coal | 172.1 | 121.0 | -29.7 | 14.1 | 10.3 |
| System services | 57.2 | 85.1 | 48.8 | 4.7 | 7.2 |
| Co generattion | 38.4 | 40.3 | 5.0 | 3.1 | 3.4 |
| Other | 0.3 | 1.3 | 309.7 | 0.0 | 0.1 |
| Other revenues | 4.2 | 2.9 | -29.5 | 0.3 | 0.3 |
| Merchandise sales | 40.9 | 20.3 | -50.2 | 3.3 | 1.7 |

*Source: CE Oltenia, IPOPEMA Research*

**The company's capex by key units is largely to be financed from bank loans.** On 5 May 2014, CE Oltenia has submitted the applications for the financing of two investments Unit 7 at Isalnita and Unit 4 at Rovinari. The company seeks the inclusion of these projects in the PNI (National Investment Plan), a scheme in which ca. 25% of the eligible investment value can be financed against free allocation of CO2 certificates (in fact, the allocation of the CO2 certificates, is linked to the existence of projects eligible for inclusion in the National Investment Plan. Amounts spent can be claimed back against proof of progress (via controls from external auditors and Ministry representatives) in the eligible investments. Initially CE Oltenia was included in PNI with 8 projects (3 at Rovinari, 2 at Turceni and 3 at Craiova). The allocations for the two projects are RON 92.3mn for Rovinari and RON 33.6mn for Isalnita, partly to be reimbursed in 2014.

During 2007-2012, CEO Oltenia received from the government 93.6mn CO2 certificates for free. CE Oltenia might be eligible to receive 32mn free certificates (out of the 71.4mn allocated to Romania), translating into an annual average of 4.6mn free certificates for 2013-2019 that represent some 30% of the annual average of the 2008-2010 period. The company has to pay in 2 tranches in 2Q and 4Q the value of the certificates based on the reference prices set on 1 April and 1 Oct (as average auction prices on the EEX platform).

**Table 36: CO2 certificates allocations for CE Oltenia for 2013-2019 (mn)**

| Plant | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Total |
|---|---|---|---|---|---|---|---|---|---|
| Craiova II | 0.72 | 0.62 | 0.51 | 0.41 | 0.31 | 0.21 | 0.10 | 0.00 | 2.87 |
| Isalnita | 1.69 | 1.45 | 1.21 | 0.96 | 0.72 | 0.48 | 0.24 | 0.00 | 6.75 |
| Rovinari | 2.78 | 2.38 | 1.98 | 1.59 | 1.19 | 0.79 | 0.40 | 0.00 | 11.11 |
| Turceni | 2.83 | 2.43 | 2.02 | 1.62 | 1.21 | 0.81 | 0.40 | 0.00 | 11.32 |
| **Total CE Oltenia** | **8.01** | **6.87** | **5.72** | **4.58** | **3.43** | **2.29** | **1.14** | **0.00** | **32.05** |

*Source: CE Oltenia, IPOPEMA Research*

In 1H14, CE Oltenia's capex was RON 476mn, 15% below the 1H14 budgeted figure and only 32% of the FY planned figure. Some 37% of 1H14 capex was financed from loans. Going forward, we see unlikely CE Oltenia to meet its FY capex target of RON 1.5bn. , of which RON 1.2bn is in the energy segment and RON 197mn in the mining division. There is limited visibility as to future capex (amounts, breakdown by years and financing sources). Most important ongoing projects refer to: the rehabilitation of unit 4 at Rovinari (RON 334mn investment started in 2012 that was to be finalized in Sept 2014), desulphurization plant at units 1&2 at Craiova II (RON 355.3mn investment started in 2012 to be commissioned this month). The rehabilitation of units 3&6 at Turceni is delayed (RON 245mn capex is planned for 2014).

**Table 37: Capex breakdown by business units (RON mn)**

| | 1H13 | 1H14 | yoy (%) | 2014B | 1H14B | % dev. | 1H14 as % FY B |
|---|---|---|---|---|---|---|---|
| Electricity | 290.1 | 439.2 | 51.4 | 1,249.1 | 518.0 | -15.2 | 35.2 |
| Mining | 33.5 | 35.1 | 4.7 | 201.0 | 40.0 | -12.3 | 17.5 |
| Rovinari | 107.5 | 180.3 | 67.7 | 417.1 | 182.0 | -0.9 | 43.2 |
| Turceni | 35.0 | 24.8 | -29.1 | 436.4 | 102.4 | -75.8 | 5.7 |
| Isalnita | 123.2 | 98.7 | -19.9 | 172.4 | 99.0 | -0.3 | 57.2 |
| Craiova II | 24.4 | 134.7 | 452.1 | 222.5 | 134.5 | 0.1 | 60.5 |
| Chiscani | 0.0 | 0.8 | n.m. | 0.7 | 0.1 | 477.0 | 112.1 |
| HQ | 1.2 | 2.0 | 57.1 | 40.7 | 2.0 | -0.2 | 4.8 |
| **Total, o/w** | **324.8** | **476.3** | **46.6** | **1,490.7** | **560.0** | **-15.0** | **31.9** |
| Environmental | | 208.9 | | 545.2 | 270.1 | | |

*Source: CE Oltenia, IPOPEMA Research*

The most important new planned investments are: the rehabilitation of unit 5 at Rovinari (to start in 4Q14 with RON 40mn cost planned for 2014), of unit 7 at Turceni (RON 58.5mn investment, mostly from loans, with the feasibility study approved) and a 10MW photovoltaic unit (RON 300mn capex from own sources, for which the feasibility study is in preparation).

**The company's 3Q14 budget looks overoptimistic in our view** (revenues at 60% of the 1H14 figure and a return to a positive EBIT of RON 55mn vs. the 1H14 loss of RON 157mn). We note that 1H14 EBITDA was 59% below 1H14 budget and only 19% of the FY targeted figure. The 3Q14 numbers are based on a production of 3.96TWh of electricity (of which 3.6TWh to be sold) and 6.5mn tons of coal (of which 1.168mn to be sold to third parties).

**Table 18: CE Oltenia estimates for 3Q14**

| RON mn | 1H14 | 3Q14B | 9M14B | 9M14B as % FY | 2014B |
|---|---|---|---|---|---|
| Operating revenues | 1,899 | 1,185 | 3,084 | 63.8 | 4,834 |
| Opex | -2,057 | -1,129 | -3,186 | 67.4 | -4,730 |
| EBIT | -157 | 55 | -102 | n.m. | 104 |
| Net financial gain/(loss) | -36 | -17 | -53 | 78.5 | -68 |
| Pre-tax profit | -194 | 38 | -155 | n.m. | 37 |

***Source: CE Oltenia, IPOPEMA Research***

**Table 39: 1H14 results vs. budgeted figures**

| | 1Q14B | 2Q14B | 3Q14B | 4Q14B | 1H14 as % 2014B |
|---|---|---|---|---|---|
| EBITDA (RON mn) | 180.1 | 141.4 | 182.4 | 110.1 | 21.4 |
| EBIT (RON mn) | 30.4 | -8.3 | 55.0 | 27.3 | n.m. |
| Cost (RON/MWh) | 199.4 | 199.3 | 195.8 | 194.1 | 107.9 |
| Cost (RON/ton of coal) | 59.6 | 59.1 | 58.7 | 57.5 | 116.5 |

***Source: CE Oltenia, IPOPEMA Research***

**In the balance sheet, we would note mainly the significant deterioration of the bank debt related ratios**. Net debt to EBITDA is close to 6x (using 1H14 net debt and 12TM EBITDA) up from 2x in 2012 and way above the figures for the other gencos 0.3x at Hidroelectrica and 1x at Nuclearelectrica). Gearing ratio (net debt to equity) of ca. 43% in

1H14 is also above that of its domestic peers (28% at Hidroelelectrica and 34% at SNN).

## Other developments

### An IPO initially scheduled for 4Q14 is more likely in 1H15 the earliest

The consortium of BRD Groupe SG and Swiss Capital is to handle the IPO (the intermediation contract was signed in April last year). A 15.3% rights issue is planed with a 12% state's stake to be sold on the BVB and 3.29% allocated to FP in order not to be diluted. Should FP decide not to subscribe in the IPO, its stake is to decline to 19.2%, while state's stake to 69%. The coal reserves' audit is to be completed by YE the latest. We view the delay in the IPO (compared to the initial deadline of 4Q14) as an opportunity for the company to have more time to advance with its operational restructuring (support activities to be concentrated at the HQ), to clarify its strategic plans and thus show a better/clearer picture to investors. Other corporate actions/restructuring plans in early stage are the setup of a trading company for export activities, the transfer of UMC Berbesti mine to CET Govora (as a way to settle the overdue receivables issue) and the spin-off of UMC Husnicioara mine.

**Changes in the management:** A new board was appointed on 28 June 2013 according to corporate governance legislation for SOEs and following a selection process conducted by a consortium of executive search companies. However, of the 7 members, 6 were recommended by the Ministry of Economy (2 are employees from this ministry, 1 is a former member of a government party, 1 is employed by Transelectrica and 1 comes from a well-known law firm). The executive search firm considered as most appropriate CEO the former CEO of one of the companies prior to the merger. The members of the Directorate are also in the process of being elected these months based on the requirements of the above mentioned ordinance (interviews with the short listed candidates were scheduled for 15-26 September 2014).

**Dividend payout**: In theory, CE Oltenia is also subject to the regulation stating that minimum 50% of the net profit (after the retention of a 5% legal reserve and employees' participation to profit) has to be distributed as dividends. However, prior to the merger, only two out of four components (Rovinari and Craiova) distributed dividends, the former 82% of its 2011 profit and the latter 13% and 8% of the 2010 and 2011 net profits, as Turceni had losses in 2011 due to FX losses from its JPY loan. In 2012, 48.3% of the newly formed CE Oltenia's net profit was distributed as dividends (RON 12.3mn cashed by FP), while no dividend was distributed in 2013, as CE Oltenia closed in the red and this may be the case also in 2014 (budgeted figure is very low at ca. RON 16mn)

**Operational restructuring still far from completion**: CE Oltenia's operational restructuring is ongoing in the context of difficult market conditions for the electricity producers in general and thermal power plants in particular. Ca. 90 types of bonuses (for special working conditions, seniority etc.) were cut out of the 119 in 2013. The personnel expenses were reduced by 7.5% yoy (salaries cut by 15%). Around 200 administrative staff was laid off in 2013 to 2,300 and a further reduction to 1,700 is to follow in 2014. Starting 19 February 2014, 802 administrative staff were routed to production units, while legal, financial, human resources and trading activities were centralized. As a result, 79 mid management positions disappeared. Cost savings from restructuring were used to increase salaries in the production area starting April 2014. In 2009-2012 ca. 1,150 staff from Turceni and Rovinari was laid off and ca. RON 28.5mn were paid as severance costs. In terms of staff layoffs, the plan is to make 3,138 persons redundant during 2014-2018 (600 in 2014, mostly via natural attrition). The plan to externalize two mines that have clients with overdue receivables would also lead to reduction in the personnel of a still overstaffed mining division (3 mines are to reach this year their useful lives and in some production might be halted), but visibility remains limited as to the exact timing.

In 2013 and 1H14 CE Oltenia's activity was negatively impacted by the overall decline in the energy consumption that was even more pronounced in the case of thermal power producers due to increased competition from the renewable energy producers (wind and solar units) receiving generous subsidies via green certificates. CE Oltenia's significant decline in the

2013 market share (by ca. 6pp yoy) was thus caused by increased production at Hidroelectrica due to a better hydrological year, increased capacity in wind farms (up 220 MW) and solar plants (up 250 MW) and ANRE's regulations allowing the prioritized functioning of the renewable energy producers, which has caused several costly production interruptions for the thermal producers. The government and ANRE have partly compensated CE Oltenia via a guaranteed supply of technological system services to Transelectrica for 600MW starting April 2013 until July 2015.

## Risks

**Weak corporate governance**: as the state is to remain the main shareholder with a ca. 69% stake even after the IPO, we expect further interference in the company's activity (as to capex and dividend policy mostly). Some decisions might not be taken in the best interest of the minority shareholders and social consideration may prevail. However we see the company's IPO as a mitigating factor and we expect transparency and corporate governance to gradually improve. FP has a representative in CE Oltenia's Supervisory Board and so far has been actively pushing for improvements on this front.

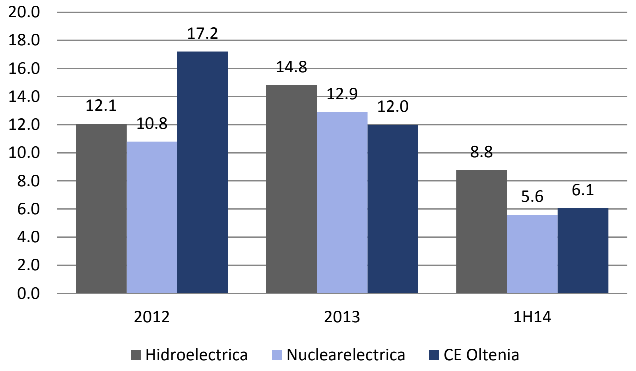
**Regulatory risk fading:** starting 2014 CE Oltenia is no longer supplying electricity to the regulated market. As regulated prices were often below the ones on the competitive marjet (and also production costs), this was creating a regulatory risk. These days, regulatory risks manifests in the case of CE Oltenia mostly via the impact on its financials of various support schemes for renewables. The introduction of new taxes (such as the 1.5% special construction tax) or obliging CE Oltenia to support various investments in the sector (Tarnita, the Romania-Turkey submarine cable) remains a risk. Moreover, recovery of such taxes/costs via price increases is uncertain with a negative impact on CE Oltenia's financials.

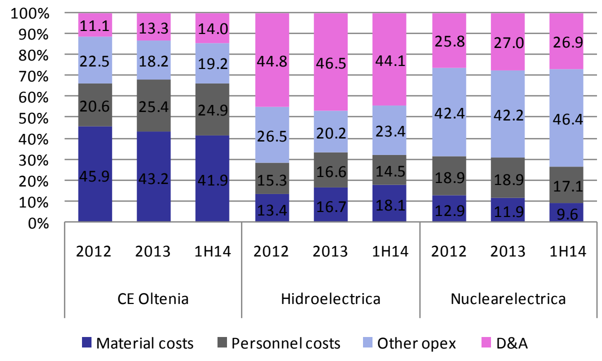
**FX risk:** a significant portion of CE Oltenia's loans are in FX (mostly JPY and EUR), which creates a significant pressure to its bottom line via high net FX losses in the case RON depreciates against these currencies. The company has no hedging in place nor made publicly available its plans to reduce FX exposure via issuing more RON denominated debt.

**High overdue receivables**: at the end of June 2014, CE Oltenia had ca. RON 916mn overdue receivables, of which 78% are overdue by more than 180 days. Most of these receivables (71%) are in relation to coal sales to several state owned companies, while 28% are from district heating companies (the largest from the municipality of Craiova) in relation to CE Oltenia's sales of heat. Of the total receivables figure, actually RON 218mn represent penalties. The highest amount is due by an insolvent company RAAN Drobeta Turnu Severin (RON 305mn, of which RON 33.7mn are the penalties alone), followed by RON 257.4mn by Termo Craiova. According to media sources, there have been some contracts signed with the former that should result in the settlement of ca. 70% of the amounts due in the near future.

## Comparisons between Romanian gencos

### Chart 13: Production of electricity (TWh) (left chart); breakdown of operating expenses (right chart) (%)

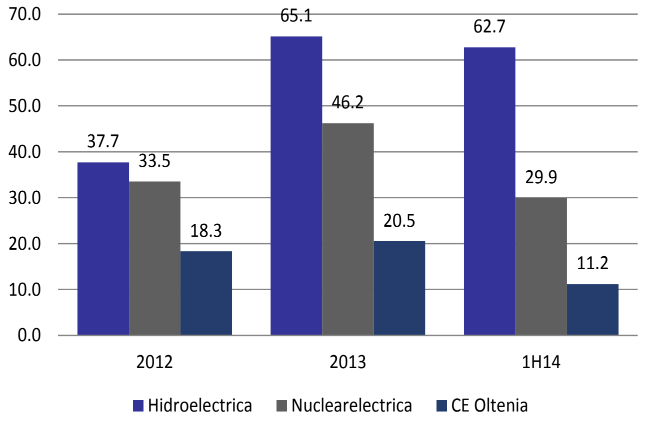


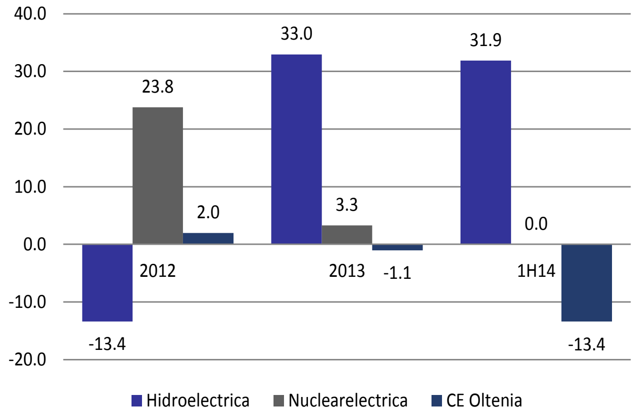




*Source: Company data, IPOPEMA Research*

*Source: Company data, IPOPEMA Research*

### Chart 14: EBITDA margin (left chart); EBIT margin (right chart) (%)

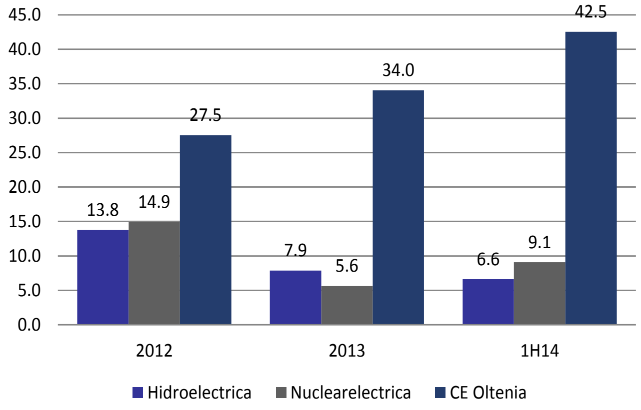


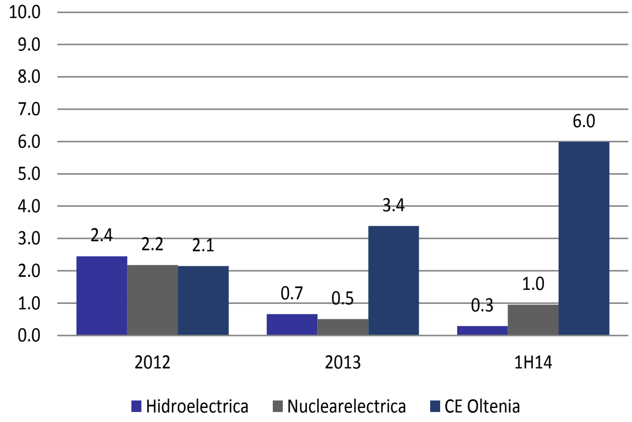




*Source: Company data, IPOPEMA Research*

*Source: Company data, IPOPEMA Research*

### Chart 15: Net debt/equity (%) (left chart); Net debt/EBITDA(x) (right chart)




*Source: Company data, IPOPEMA Research*

*Source: Company data, IPOPEMA Research*

# ELECTRICITY DISTRIBUTION & SUPPLY

## A very mixed bag

28 October 2014

FP holds stakes in 7 out of the 8 electricity distribution companies and in 3 electricity supply companies. Of the distribution companies, three are majority owned by Enel (covering the regions of Muntenia South, Banat and Dobrogea), one by E.ON (Moldova) and three by the state through Electrica (Transilvania Sud, Transilvania Nord and Muntenia Nord). Of the supply companies, 2 are majority owned by Enel and 1 by Electrica.

**On FP's sale list:** The cumulated official value of FP's holdings in the electricity distribution companies amounts to RON 2,466mn (as of June 2014) or RON 2,342mn using our fair values. If supply companies are added, the values are RON 2,693mn (18% of 1H14 official NAV) and RON 2,569mn respectively. Currently, FP is assisted by Citigroup Global Markets in their sale. FP might monetize its stake in Electrica subsidiaries as Electrica might use part of the IPO proceeds for this purpose. FP has tag along rights on EDM (can sell its stakes at the same price as Enel). Enel itself seeks to exit Romania by YE.

**Except some of Enel's subsidiaries, the privatized discos were not dividend payers.** FP cashed dividends of RON 23mn in 1H14 for 2013, of RON 16.2mn in 2013 and RON 1.8mn in 2012 from EDMN. In 2011 FP cashed RON 20.2mn from EDB and RON 13.5mn from EDD. Dividends of RON 11.7mn from EDTN and RON 12.7mn from EDTS were also cashed for FY 2013. While discos are usually stable and consistent dividend plays, the privatized discos were not (except for some Enel's subsidiaries), despite their high profitability and net cash, which is not consistent with their defensive profile.

**Main triggers:** a) an increase in the asset base (through capex) would set the grounds for higher tariffs and, in the long run, would reduce maintenance costs; b) for the state-owned discos, more stringent cost control and improvement in corporate governance. Both should boost disco's profitability.

**Main risks:** a) evolution of the electricity consumption; b) regulatory and fiscal changes (some new taxes not recognized in the cost base and not transferred in the final prices, such as the special construction tax and the RON 0.85/MWh monopoly tax on volumes); c) litigations (of the Romanian state with the privatized disco's majority shareholders, the most important being with Enel; the Romanian State is claiming as high as EUR 1bn as damages for not meeting investment obligations assumed in the privatization contracts); d) for the state owned discos, corporate governance related (the state is the majority shareholder, thus decision making tends to be more bureaucratic, although after the IPO, the appointment of a new board of professionals in the holding company Electrica is a mitigating factor).

**ELECTRICITY DISTRIBUTION COMPANIES– Summary Financial Data**

| 2014B data in RON mn | Sales | EBITDA | EBIT | Net profit | Net debt | Book value |
|---|---|---|---|---|---|---|
| Enel Distributie Muntenia | 833 | 477 | 288 | 254 | -882 | 2,582 |
| Enel Distributie Banat | 572 | 307 | 191 | 176 | -1,026 | 1,922 |
| Enel Distributie Dobrogea | 464 | 254 | 155 | 131 | -453 | 1,296 |
| E.ON Distributie Moldova | 679 | 226 | 85 | 71 | n.a. | n.a. |
| Electrica Distributie Transilvania Nord | 677 | 202 | 100 | 79 | n.a. | n.a. |
| Electrica Distributie Transilvania Sud | 733 | 216 | 108 | 89 | n.a. | n.a. |
| Electrica Distributie Muntenia Nord | 776 | 175 | 90 | 75 | n.a. | n.a. |

*Source: Company data, IPOPEMA Research*

**Note**

EDMN = Electrica Distributie Muntenia Nord

EDTN = Electrica Distributie Transilvania Nord

EDTS = Electrica Distributie Transilvania Sud

EDM = Enel Distributie Muntenia

EDB = Enel Distributie Banat

EDD = Enel Distributie Dobrogea

EMD = E.ON Moldova Distributie

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| P&L (RON m) | EDMN 2013 | EDMN 1H14 | EDMN 12TM | EDTN 2013 | EDTN 1H14 | EDTN 12TM | EDTS 2013 | EDTS 1H14 | EDTS 12TM | EDM 2012 | EDM 2013 | EDM 2014B | EDB 2012 | EDB 2013 | EDB 2014B | EDD 2012 | EDD 2013 | EDD 2014B | EMD 2012 | EMD 2013 | EMD 2014B |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Revenues** | **773** | **381** | **768** | **652** | **331** | **661** | **706** | **362** | **720** | **967** | **998** | **933** | **637** | **659** | **572** | **509** | **544** | **498** | **689** | **766** | **n.a.** |
| *yoy change* | *5%* | *-1%* | *-1%* | *8%* | *3%* | *1%* | *6%* | *4%* | *2%* | *19%* | *3%* | *-6%* | *2%* | *4%* | *-13%* | *4%* | *7%* | *-8%* | *4%* | *11%* | *n.a.* |
| **Sales** | **756** | **371** | **749** | **616** | **312** | **623** | **672** | **342** | **682** | **870** | **892** | **833** | **603** | **625** | **n.a.** | **480** | **509** | **464** | **666** | **702** | **679** |
| *yoy change* | 4.9% | -1.8% | -0.9% | 7.8% | 2.3% | 1.2% | 6.3% | 2.8% | 1.4% | 23.2% | 2.5% | -4.2% | 3.0% | 3.6% | n.a. | 4.6% | 6.0% | -9.0% | 4.6% | 5.5% | -3.3% |
| **EBIT** | **133** | **78** | **133** | **88** | **70** | **98** | **90** | **76** | **121** | **172** | **221** | **288** | **181** | **203** | **191** | **103** | **149** | **155** | **84** | **107** | **85** |
| *yoy change* | *34%* | *0%* | *0%* | *28%* | *16%* | *11%* | *46%* | *67%* | *34%* | *234%* | *28%* | *30%* | *-24%* | *12%* | *-6%* | *-18%* | *45%* | *4%* | *281%* | *27%* | *-20%* |
| Depreciation costs | -88 | -44 | -89 | -118 | -61 | -121 | -122 | -64 | -127 | -185 | -203 | -189 | -111 | -132 | -116 | -87 | -99 | -99 | -129 | -148 | -141 |
| **EBITDA** | **220** | **122** | **222** | **206** | **131** | **219** | **212** | **141** | **248** | **358** | **424** | **477** | **292** | **335** | **307** | **190** | **248** | **254** | **213** | **255** | **226** |
| *yoy change* | *21%* | *1%* | *81%* | *14%* | *11%* | *67%* | *20%* | *34%* | *76%* | *69%* | *18%* | *12%* | *-7%* | *15%* | *-8%* | *2%* | *31%* | *2%* | *12%* | *20%* | *-11%* |
| Financial Income/(Cost) | 13 | 7 | 13 | -1 | 1 | 1 | -2 | 3 | 3 | 63 | 98 | 20 | 21 | 28 | 27 | 8 | 12 | 11 | 4 | 6 | 0 |
| **Pretax profit** | **145** | **85** | **146** | **87** | **72** | **99** | **88** | **80** | **123** | **236** | **319** | **307** | **203** | **232** | **218** | **111** | **161** | **166** | **87** | **112** | **87** |
| *yoy change* | *37%* | *0%* | *71%* | *31%* | *-18%* | *38%* | *52%* | *81%* | *55%* | *205%* | *36%* | *-4%* | *-21%* | *14%* | *-6%* | *-15%* | *45%* | *3%* | *231%* | *29%* | *-23%* |
| Income tax | -19 | -9 | -18 | -23 | -11 | -25 | -18 | -13 | -21 | -29 | -52 | -53 | -35 | -41 | -42 | -16 | -28 | -35 | -15 | -25 | -14 |
| **Net income** | **127** | **76** | **127** | **64** | **61** | **74** | **69** | **67** | **102** | **206** | **267** | **254** | **167** | **191** | **176** | **94** | **134** | **131** | **71** | **87** | **71** |

*Source: Company data, IPOPEMA Research*

| Profitability Ratios | EDMN 2013 | EDMN 1H14 | EDMN 12TM | EDTN 2013 | EDTN 1H14 | EDTN 12TM | EDTS 2013 | EDTS 1H14 | EDTS 12TM | EDM 2012 | EDM 2013 | EDM 2014B | EDB 2012 | EDB 2013 | EDB 2014B | EDD 2012 | EDD 2013 | EDD 2014B | EMD 2012 | EMD 2013 | EMD 2014B |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| EBITDA Margin | 29% | 33% | 30% | 33% | 42% | 35% | 32% | 41% | 36% | 41% | 48% | 57% | 48% | 54% | 54% | 39% | 49% | 55% | 32% | 36% | 33% |
| EBIT Margin | 18% | 21% | 18% | 14% | 23% | 16% | 13% | 22% | 18% | 20% | 25% | 35% | 30% | 33% | 33% | 21% | 29% | 33% | 13% | 15% | 13% |
| Net Margin | 17% | 20% | 17% | 10% | 20% | 12% | 10% | 19% | 15% | 24% | 30% | 31% | 28% | 31% | 31% | 20% | 26% | 28% | 11% | 12% | 10% |
| ROE | 9% | 11% | 19% | 7% | 12% | 15% | 7% | 13% | 20% | 6% | 7% | n.a. | 8% | 9% | n.a. | 7% | 9% | n.a. | 4% | 5% | n.a. |

*Source: Company data, IPOPEMA Research*

| Balance Sheet (RON m) | EDMN 2012 | EDMN 2013 | EDMN 1H14 | EDTN 2012 | EDTN 2013 | EDTN 1H14 | EDTS 2012 | EDTS 2013 | EDTS 1H14 | EDM 2012 | EDM 2013 | EDM 2014B | EDB 2012 | EDB 2013 | EDB 2014B | EDD 2012 | EDD 2013 | EDD 2014B | EMD 2012 | EMD 2013 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Total Fixed Assets** | **1,649** | **1,730** | **1,744** | **1,493** | **1,556** | **1,555** | **1,601** | **1,657** | **1,672** | **3,532** | **3,523** | **0** | **1,801** | **1,795** | **0** | **1,613** | **1,636** | **1,356** | **2,116** | **1,910** |
| Tangible Assets | 1,623 | 1,697 | 1,715 | 1,484 | 1,545 | 1,544 | 1,598 | 1,644 | 1,661 | 3,507 | 3,503 | 2,926 | 1,767 | 1,763 | 1,343 | 1,579 | 1,604 | 1,341 | 2,104 | 1,893 |
| Other Fixed Assets | 26 | 33 | 29 | 9 | 12 | 11 | 3 | 13 | 11 | 25 | 20 | 21 | 34 | 32 | 15 | 34 | 33 | 15 | 12 | 16 |
| **Total Current Assets** | **463** | **507** | **482** | **152** | **167** | **184** | **162** | **207** | **229** | **1,597** | **1,942** | **0** | **806** | **1,041** | **1,149** | **440** | **543** | **563** | **337** | **498** |
| Cash and Equivalents | 301 | 332 | 304 | 23 | 32 | 43 | 17 | 47 | 76 | 1,210 | 1,516 | 1,366 | 611 | 810 | 1,026 | 299 | 351 | 453 | 100 | 213 |
| Other Current Assets | 161 | 174 | 178 | 128 | 135 | 141 | 144 | 159 | 152 | 387 | 426 | 195 | 195 | 231 | 123 | 141 | 192 | 110 | 236 | 280 |
| **Total Assets** | **2,112** | **2,237** | **2,226** | **1,645** | **1,723** | **1,739** | **1,763** | **1,864** | **1,901** | **5,130** | **5,465** | **4,519** | **2,606** | **2,836** | **2,506** | **2,053** | **2,180** | **3,838** | **2,452** | **2,408** |
| **Stockholders` Equity** | **1,337** | **1,390** | **1,360** | **912** | **976** | **984** | **967** | **1,036** | **1,045** | **3,618** | **3,885** | **2,582** | **2,013** | **2,204** | **1,922** | **1,346** | **1,479** | **1,296** | **1,894** | **1,763** |
| **Long Term Liabilities** | **625** | **691** | **688** | **549** | **572** | **576** | **570** | **609** | **638** | **1,073** | **1,103** | **0** | **376** | **399** | **0** | **372** | **485** | **0** | **450** | **473** |
| Long -Term Debt | 30 | 31 | 0 | 40 | 29 | 0 | 38 | 44 | 1 | 0 | 0 | 484 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Long - Term liabilities | 595 | 660 | 688 | 509 | 543 | 576 | 531 | 564 | 637 | 1,073 | 1,103 | 329 | 376 | 75 | 166 | 372 | 485 | 74 | 450 | 473 |
| **Short Term Liabilities** | **150** | **157** | **178** | **184** | **175** | **179** | **227** | **219** | **218** | **438** | **477** | **0** | **217** | **233** | **0** | **336** | **215** | **0** | **109** | **139** |
| Short -Term Debt | 6 | 15 | 0 | 36 | 28 | 42 | 52 | 71 | 18 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Short Term Liabilities | 144 | 142 | 178 | 148 | 147 | 137 | 175 | 148 | 200 | 438 | 477 | 120 | 217 | 233 | 0 | 336 | 215 | 65 | 109 | 139 |
| **Total Equity & Liabilities** | **2,112** | **2,237** | **2,226** | **1,645** | **1,723** | **1,739** | **1,763** | **1,864** | **1,901** | **5,130** | **5,465** | **4,519** | **2,606** | **2,836** | **2,506** | **2,053** | **2,180** | **3,838** | **2,452** | **2,408** |

*Source: Company data, IPOPEMA Research*

| Balance Sheet Ratios | EDMN 2012 | EDMN 2013 | EDMN 1H14 | EDTN 2012 | EDTN 2013 | EDTN 1H14 | EDTS 2012 | EDTS 2013 | EDTS 1H14 | EDM 2012 | EDM 2013 | EDM 2014B | EDB 2012 | EDB 2013 | EDB 2014B | EDD 2012 | EDD 2013 | EDD 2014B | EMD 2012 | EMD 2013 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Current Ratio | 3.1 | 3.2 | 2.7 | 0.8 | 1.0 | 1.0 | 0.7 | 0.9 | 1.0 | 3.6 | 4.1 | n.a. | 3.7 | 4.5 | n.a. | 1.3 | 2.5 | n.a. | 3.1 | 3.6 |
| Quick Ratio | 3.0 | 3.1 | 2.5 | 0.8 | 0.9 | 0.9 | 0.7 | 0.9 | 1.0 | 3.6 | 4.1 | n.a. | 3.7 | 4.5 | n.a. | 1.3 | 2.5 | n.a. | 2.9 | 3.5 |
| Bank Debt/Assets | 1.7% | 2.1% | 0.0 | 4.6% | 3.3% | 2.4% | 5.1% | 6.2% | 1.0% | 0.0% | 0.0% | n.a. | 0.0% | 0.0% | n.a. | 0.0% | 0.0% | n.a. | 0.0% | 0.0% |
| **Bank Debt/Equity** | **2.7%** | **3.3%** | **0.0** | **8.4%** | **5.8%** | **4.3%** | **9.4%** | **11.2%** | **1.8%** | **0.0%** | **0.0%** | n.a. | **0.0%** | **0.0%** | n.a. | **0.0%** | **0.0%** | n.a. | **0.0%** | **0.0%** |

*Source: Company data, IPOPEMA Research*

| Cash Flow (RON mn) | EDMN 2011 | EDMN 2012 | EDMN 2013 | EDTN 2011 | EDTN 2012 | EDTN 2013 | EDTS 2011 | EDTS 2012 | EDTS 2013 | EDM 2011 | EDM 2012 | EDM 2013 | EDB 2011 | EDB 2012 | EDB 2013 | EDD 2011 | EDD 2012 | EDD 2013 | EMD 2011 | EMD 2012 | EMD 2013 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Net Profit | 67 | 87 | 127 | 29 | 53 | 64 | 20 | 46 | 69 | 50 | 206 | 267 | 220 | 167 | 191 | 109 | 94 | 134 | 7 | 71 | 87 |
| Depreciation and Amortisation | 79 | 83 | 88 | 101 | 111 | 118 | 112 | 114 | 122 | 160 | 185 | 203 | 75 | 111 | 132 | 59 | 87 | 99 | 167 | 129 | 148 |
| Other (incl. WC change) | -26 | -17 | -16 | -35 | -16 | -8 | -38 | -13 | -42 | -122 | -182 | -1 | -67 | 15 | -21 | -68 | 88 | -172 | -61 | -63 | -14 |
| **Operating Cash Flows** | **120** | **153** | **198** | **95** | **149** | **173** | **93** | **147** | **149** | **88** | **210** | **470** | **229** | **294** | **302** | **101** | **269** | **61** | **113** | **137** | **221** |
| Capital Expenditures (Net) | -160 | -55 | -74 | -98 | -66 | -61 | -143 | -90 | -46 | -481 | -688 | 4 | -477 | -21 | 4 | -433 | -66 | -25 | -801 | -29 | 210 |
| Other | 3 | -5 | -7 | 3 | 2 | -3 | 4 | -1 | -11 | -12 | -8 | 6 | -8 | -6 | 2 | -8 | -6 | 2 | 5 | -1 | -4 |
| **Cash Flows from Investing Activities** | **-157** | **-60** | **-81** | **-95** | **-63** | **-63** | **-138** | **-91** | **-56** | **-493** | **-696** | **10** | **-485** | **-27** | **6** | **-441** | **-72** | **-24** | **-796** | **-30** | **206** |
| Change in Debt | 11 | 16 | 10 | 16 | 11 | -19 | 61 | 10 | 25 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Issuance of Shares | | | | | | | | | | | | | | | | | | | | | |
| Other | 90 | -5 | -96 | -27 | -90 | -82 | -25 | -63 | -88 | -141 | 382 | -174 | 224 | -85 | -109 | 222 | -46 | 15 | 665 | -93 | -315 |
| **Cash Flows from Financing Activities** | **101** | **11** | **-85** | **-12** | **-79** | **-102** | **36** | **-53** | **-63** | **-141** | **382** | **-174** | **224** | **-85** | **-109** | **222** | **-46** | **15** | **665** | **-93** | **-315** |
| Beginning Cash | 134 | 198 | 301 | 30 | 18 | 23 | 23 | 14 | 17 | 1,859 | 1,314 | 1,210 | 462 | 430 | 611 | 266 | 148 | 299 | 102 | 85 | 100 |
| Increase/(Decrease in cash | 64 | 103 | 31 | -12 | 6 | 8 | -9 | 3 | 30 | -545 | -104 | 305 | -32 | 181 | 199 | -118 | 151 | 52 | -17 | 15 | 113 |
| **Ending cash** | **198** | **301** | **332** | **18** | **23** | **32** | **14** | **17** | **47** | **1,314** | **1,210** | **1,516** | **430** | **611** | **810** | **148** | **299** | **351** | **85** | **100** | **213** |

*Source: Company data, IPOPEMA Research*

## Electricity distribution and supply companies' Valuation

### FP holds stakes in seven electricity distribution companies and in four electricity supply companies

We have performed separate valuations only for FP's stakes in the electricity distribution companies (7 out of the total 8), while the stakes in the 4 electricity supply companies, we value at their official valuation as at June 2014. FP's exposure to electricity distribution companies amounts to RON 2,466mn or 16.6% of FP's June 2014 official NAV (or RON 2,342mn our fair value), while the exposure in the supply companies to RON 227mn (1.5% of the 1H14 official NAV), which is also our fair value.

The fair values of FP stakes in the distribution companies were determined as a simple average of the fair values based EV/EBITDA and EV/Customer. We used a reference 2014E EV/EBITDA median of peers of 8x as per Bloomberg consensus, to which we applied different discounts (the lowest of 5% for Enel subsidiaries and the highest of 20% for Electrica subsidiaries (and 10% for the E.ON unit). Enel subsidiaries have significant levels of cash, which would allow them to invest in the grid and, in time, increase their RAB and reduce maintenance & repair costs, while the majority state-owned companies (Electrica subsidiaries) deserve higher discounts than the privatized ones as they have less cash for investments (especially if they would use part of the IPO proceeds to buy out FP), and also the decision-making process is slower and more bureaucratic, in our view.

In the case of the privatized discos we used the 2014 budgeted P&L and net debt for the Enel subsidiaries and 2014 budgeted P&L and 2013 net debt for E.ON, while for Electrica's subsidiaries 1H14 TTM P&L data and 1H14 net debt (for all RAS financials). 1H14 results (both in RAS and IFRS) are available only for the state-owned discos. For EDMN, the 1H14 RAS net earnings (RON 75.8mn) already exceed company's guidance for FY 2014 (RON 75.3mn). Ffor EDTN, 1H14 RAS net earnings (RON 61mn) represents ca. 78% of the FY budgeted figure of RON 78.5mn. For EDTS, the 1H14 RAS net profit was RON 66.5mn, and represented ca. 75% of the FY budgeted figure of RON 88.5mn.

**Table 41: Key financial data used in the valuation of FP's electricity distributions**

| RON m | Sales | EBITDA | EBIT | Net profit | Net debt | Book | Period | No. of customers (mn) |
|---|---|---|---|---|---|---|---|---|
| Enel Distributie Muntenia | 833 | 477 | 288 | 254 | -882 | 2,582 | 2014B | 1.18 |
| Enel Distributie Banat | 572 | 307 | 191 | 176 | -1,026 | 1,922 | 2014B | 0.89 |
| Enel Distributie Dobrogea | 464 | 254 | 155 | 131 | -453 | 1,296 | 2014B | 0.63 |
| E.ON Distributie Moldova | 679 | 226 | 85 | 71 | -213 | 1,763 | 2014B | 1.30 |
| Electrica Distributie Transilvania Nord | 623 | 219 | 98 | 74 | -1 | 984 | 1H14 | 1.20 |
| Electrica Distributie Transilvania Sud | 682 | 248 | 121 | 102 | -58 | 1,045 | 1H14 | 1.10 |
| Electrica Distributie Muntenia Nord | 749 | 222 | 133 | 127 | -304 | 1,360 | 1H14 | 1.30 |

*Source: Company data, IPOPEMA Research*

For the EV/customer multiple we used as reference the EV/Customer of EUR 118 (RON 521) paid by E.ON to Electrica for a 17% stake in E.ON Distributie Moldova and a 2.4% in E.ON Energie Romania (the transaction price appeared in the Bursa daily in March 2014). The price was way below the EUR 558 paid by CEZ for 100% of CEZ Distributie to FP and Electrica in September 2009 (when a majority stake was sold).

**Table 42: Fair values for electricity distribution companies in FP's portfolio**

| | | Value of FP stake based on | | | | |
|---|---|---|---|---|---|---|
| RON m | FP stake (%) | P/E | EV/EBITDA | EV/customer | Average | Official valuation |
| Enel Distributie Muntenia | 12.0 | 375 | 541 | 176 | 358 | 473 |
| Enel Distributie Banat | 24.1 | 523 | 810 | 353 | 582 | 573 |
| Enel Distributie Dobrogea | 24.1 | 387 | 574 | 185 | 379 | 379 |
| E.ON Distributie Moldova | 22.0 | 182 | 405 | 181 | 293 | 345 |
| Electrica Distributie Transilvania Nord | 22.0 | 169 | 309 | 110 | 209 | 207 |
| Electrica Distributie Transilvania Sud | 22.0 | 233 | 362 | 114 | 238 | 192 |
| Electrica Distributie Muntenia Nord | 22.0 | 291 | 379 | 187 | 283 | 296 |
| **Total electricity distribution** | | | | | **2,342** | **2,466** |

*Source: Company data, IPOPEMA Research*

**Table 43: Fair values of Electrica's subsidiaries derived from Electrica's market cap**

| RON m | EDTS | EDTN | EDMN | Electrica Serv | Electrica Furnizare | Total |
|---|---|---|---|---|---|---|
| 1H14 EBITDA as % in total | 26.0% | 24.3% | 20.7% | 1.7% | 27.3% | |
| Electrica's market capitalization | | | | | | **4,321** |
| Market capitalization of the units | 1,125 | 1,049 | 894 | 74 | 1,180 | 4,321 |
| Values of FP stakes | 247 | 231 | 197 | 16 | 260 | 951 |
| Official values | 192 | 207 | 296 | n.a. | 88 | 783 |
| **IPOPEMA fair values based on multiples** | **238** | **209** | **283** | **n.a.** | **88** | **818** |

*Source: Company data, IPOPEMA Research*

**Table 44: Electricity distributors vs. peers (multiples)**

| | Price (EUR) | Mcap (EUR m) | P/E (x) | | | EV/EBITDA (x) | | | EV/sales (x) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | 2013 | 2014 | 2015E | 2013 | 2014E | 2015 | 2013 | 2014E | 2015E |
| EDF (France) | 22.4 | 53,238 | 10.4 | 9.0 | 8.7 | 4.4 | 4.5 | 4.6 | 1.0 | 1.0 | 1.0 |
| EDP (Portugal) | 3.3 | 11,840 | 9.3 | 10.0 | 9.7 | 8.3 | 8.4 | 7.9 | 1.9 | 1.8 | 1.6 |
| Endesa (Spain) | 30.3 | 25,474 | 10.3 | 12.2 | 14.5 | 4.0 | 5.2 | 6.8 | 0.9 | 1.0 | 1.1 |
| Iberdrola (Spain) | 5.5 | 30,867 | 10.2 | 11.7 | 11.3 | 7.4 | 7.7 | 7.4 | 1.6 | 1.6 | 1.5 |
| Energa (Poland) | 5.8 | 1,115 | 5.7 | 4.8 | 5.1 | 5.0 | 3.5 | 3.7 | 0.9 | 0.7 | 0.7 |
| Enea (Poland) | 3.8 | 1,550 | 9.2 | 9.8 | 12.3 | 3.7 | 4.5 | 6.1 | 0.6 | 0.8 | 1.2 |
| Electrica (Romania) | 2.8 | 977 | | 18.3 | 13.6 | 0.0 | 2.5 | 3.1 | 0.0 | 0.4 | 0.7 |
| Transelectrica (Romania) | 6.1 | 448 | 5.4 | 7.2 | 7.2 | 2.8 | 3.8 | 3.9 | 0.7 | 1.0 | 1.0 |
| Enagas (Spain) | 25.4 | 6,055 | 10.9 | 15.1 | 15.0 | 8.0 | 10.3 | 10.6 | 6.3 | 8.1 | 8.1 |
| United Utilities (UK) | 10.6 | 7,257 | 17.0 | 20.2 | 18.4 | 10.6 | 11.7 | 11.4 | 6.4 | 6.8 | 6.8 |
| Severn Trent (UK) | 25.3 | 6,060 | 19.4 | 23.8 | 22.5 | 10.1 | 11.5 | 11.0 | 4.6 | 5.0 | 5.1 |
| National Grid (UK) | 11.3 | 42,707 | 14.4 | 18.2 | 16.3 | 9.9 | 10.9 | 10.7 | 3.5 | 3.9 | 3.7 |
| SNAM (Italy) | 4.2 | 14,169 | 13.6 | 13.8 | 13.3 | 9.3 | 9.9 | 9.8 | 7.4 | 7.8 | 8.0 |
| Terna (Italy) | 3.9 | 7,879 | 13.5 | 15.4 | 14.7 | 9.1 | 10.2 | 9.9 | 7.1 | 7.8 | 7.7 |
| **Median CEE** | | | **6.8** | **10.0** | **9.5** | **3.8** | **3.6** | **4.2** | **0.7** | **0.7** | **0.9** |
| **Median all** | | | **10.4** | **13.0** | **13.5** | **8.0** | **8.0** | **7.7** | **1.9** | **1.7** | **1.6** |
| Enel Distributie Muntenia | | | 11.2 | 11.8 | | 5.0 | 4.4 | | 2.4 | 2.5 | |
| ENEL Distributie Banat | | | 12.6 | 13.7 | | 4.1 | 4.5 | | 2.1 | 2.4 | |
| ENEL Distributie Dobrogea | | | 11.8 | 12.1 | | 4.5 | 4.4 | | 2.2 | 2.4 | |
| E.ON Distributie Moldova | | | 15.3 | 18.8 | | 4.4 | 5.0 | | 1.6 | 1.6 | |
| Electrica Distributie Transilvania Nord | | | 14.9 | 12.9 | | 4.7 | 4.3 | | 1.5 | 1.4 | |
| Electrica Distributie Transilvania Sud | | | 15.6 | 10.6 | | 4.7 | 4.1 | | 1.4 | 1.4 | |
| Electrica Distributie Muntenia Nord | | | 10.2 | 10.1 | | 4.5 | 4.4 | | 1.3 | 1.3 | |

*Source: Company data, Bloomberg, IPOPEMA Research*

**Table 45: Electricity distributors vs. peers (profit margins)**

| | EBITDA margin (%) | | | Net margin (%) | | |
|---|---|---|---|---|---|---|
| | 2013 | 2014E | 2015E | 2013 | 2014E | 2015E |
| EDF (France) | 22.8 | 22.9 | 23.0 | 4.7 | 5.5 | 5.5 |
| EDP (Portugal) | 22.2 | 21.8 | 21.9 | 6.1 | 5.7 | 5.7 |
| Endesa (Spain) | 21.5 | 18.6 | 17.8 | 6.0 | 5.1 | 5.4 |
| Iberdrola (Spain) | 21.7 | 21.2 | 21.2 | 7.7 | 7.0 | 7.1 |
| Energa (Poland) | 17.2 | 19.4 | 18.8 | 6.7 | 7.8 | 7.1 |
| Enea (Poland) | 17.3 | 18.7 | 19.0 | 7.5 | 7.3 | 6.1 |
| Electrica (Romania) | 14.5 | 16.4 | 18.2 | 4.7 | 4.8 | 6.5 |
| Transelectrica (Romania) | 24.4 | 26.0 | 26.0 | 7.7 | 10.4 | 10.2 |
| Enagas (Spain) | 78.3 | 78.4 | 78.4 | 31.1 | 32.3 | 34.0 |
| United Utilities (UK) | 60.2 | 57.8 | 58.2 | 17.3 | 17.2 | 17.9 |
| Severn Trent (UK) | 46.0 | 43.8 | 45.7 | 11.7 | 11.1 | 11.3 |
| National Grid (UK) | 34.8 | 36.1 | 35.7 | 13.7 | 13.3 | 13.8 |
| SNAM (Italy) | 79.5 | 78.3 | 78.4 | 26.1 | 28.7 | 28.9 |
| Terna (Italy) | 77.8 | 76.4 | 76.5 | 26.6 | 26.6 | 26.6 |
| **Median CEE** | **18.3** | **20.1** | **20.5** | **6.6** | **7.6** | **7.5** |
| **Median all** | **23.6** | **24.4** | **24.5** | **7.7** | **9.1** | **8.7** |
| Enel Distributie Muntenia | 47.5 | 57.2 | | 30.0 | 30.5 | |
| ENEL Distributie Banat | 53.6 | 53.7 | | 30.5 | 30.8 | |
| ENEL Distributie Dobrogea | 48.7 | 54.7 | | 26.2 | 28.2 | |
| E.ON Distributie Moldova | 36.3 | 33.3 | | 12.4 | 10.5 | |
| Electrica Distributie Transilvania Nord | 32.9 | 35.1 | | 10.3 | 11.9 | |
| Electrica Distributie Transilvania Sud | 32.2 | 36.3 | | 10.3 | 15.0 | |
| Electrica Distributie Muntenia Nord | 29.1 | 29.6 | | 16.7 | 17.0 | |

*Source: Company data, Bloomberg, IPOPEMA Research*

**Table 46: Fair (and official) values for electricity supply companies in FP's portfolio**

| | FP stake (%) | Value (RON mn) | % in 1H14 FP's NAV |
|---|---|---|---|
| Enel Energie Muntenia | 12.0% | 65 | 0.4% |
| ENEL Energie | 12.0% | 74 | 0.5% |
| Electrica Furnizare | 22.0% | 88 | 0.6% |
| **Sub-total electricity supply companies** | | **227** | **1.5%** |

*Source: FP, IPOPEMA Research*

# Business overview

**FP is a minority shareholder in all companies from this sub sector:** FP owns 22% stakes in each of the 3 electricity distribution companies and in the electricity supply company of Electrica (in each of which Electrica has stakes of 78%) as well as in E.ON Moldova Distributie (E.ON has a 68% stake and after the transactions performed last year, 10% in the distribution company and 1.4% in the supply subsidiary are allocated to the former employees of Electrica, details of the transaction to be decided by YE). FP owns also ca. 24% stakes in each of EDD and EDB and 12% in EDM. In the two supply companies in which Enel is the majority shareholder, FP has 12% stakes in each.

**FP is seeking to sell the stakes in the electricity and gas distribution and supply companies**

In March 2012, Franklin Templeton announced that Citigroup Global Markets had been appointed as exclusive intermediary to facilitate the sale, transfer or disposal of FP's interests in these companies. Up until recently, no material progress in this direction has been announced, as investors were mostly waiting for: a) the communication of the main indicators of the new 4 year regulatory period (that started in 2014), b) the settlement of various litigations between the Romanian state and the majority shareholders of the privatized companies and c) Electrica's IPO. After the completion of Electrica's IPO this summer and the appointment of a new board at Electrica in September, FP is likely to resume soon the talks on the ways to monetize its stakes in Electrica (the latter is likely to use part of the IPO proceeds for this purpose, after the swap option was excluded). Several transactions in the sector (either ongoing or completed) also complicated/delayed FP's exit from the privatized entities.

**The most complex ongoing transaction is the one involving Enel assets in Romania**. Enel is seeking to sell 64% of EDM and Enel Energie Muntenia (EEM), 51% of EDB, EDD and Enel Energie (EE), as well as 100% of services company Enel Romania (held via Enel Investment Holding BV), for which it would like to receive (ideally by YE) EUR 1.8bn vs. ca. EUR 1.2bn valuation of the stake in FP's June 2014 official NAV (FP does not have a stake in the services company). According to Ziarul Financiar daily, quoting undisclosed sources, Enel might not do the sale if the price would be lower. Potential interested buyers are E.ON, EDF and State Grid Corporation of China, as well as Nuclearlectrica and initially also Electrica. In Electrica's case, a transaction might not be possible for competition related reasons, and SAPE could be an alternative (the company was spun off from Electrica and includes Electrica's minority stakes in the privatized electricity distribution companies). Enel would like to sell as a package all the assets, while most bidders are interested only in some of them. A sale as a package would be challenging given the different clauses in the initial privatization contracts (for example in the case of Enel Muntenia and Enel Distributie Muntenia, there is a tag along clause stating that FP can sell its stake at the same price as Enel, which means that FP could cash RON 538mn, if it were to sell at the valuation from its June 2014 NAV). On the other hand, the transaction via which Electrica (now SAPE) exercised its put option in case of Enel Muntenia companies and asked for EUR 521mn for its 13.6% stake (more than 5x the book value of the two companies) is yet to be finalized. Als Enel won the litigations in case of EDD and EDB (Electrica was challenging in court the fact that Enel's post privatization investments in Romania were not financed from capital increases at their privatization but rather from companies' retained earnings).

Moreover, in mid- September, the Energy Minister Mr. Razvan Nicolaescu also indicated that EDD is considered a strategic asset for the Romanian state in the geopolitical context of Ukrainian conflict, thus he advised interested investors not to submit offers for this subsidiary.

# Electricity Distribution and Supply Market Overview

**Electricity distribution** in Romania is currently controlled by 8 licensed electricity distribution companies (FP has stakes in 7 out of the 8), each responsible for the exclusive distribution of electricity within its region, based on a concession agreement with the Romanian state via the Ministry of Economy.

## Electricity Distribution Tariffs and Regulatory Changes

Electricity distribution tariffs are set by the energy market regulator, ANRE, using a "tariff basket price cap" methodology which reduces revenues fluctuations and end-user price variation. There are individual tariffs for each electricity distributor and each voltage level, intended to cover the justified cost (controllable costs such as raw materials and consumables, maintenance and repair costs, rents, R&D expenses, personnel expenses and expenses with third party services+ uncontrollable costs) plus a justified return on capital. Revenues are set in real terms and adjusted annually for inflation, an efficiency factor (applicable to controllable operating and maintenance costs), differences in the previous year between estimated and actual (realized) distributed volumes, grid losses (price and quantity), uncontrollable costs and realized capex.

The third regulatory period started in 2014 and will end in 2018. The pre-tax regulated return on RAB was set at 8.52% in real terms for all discos while the after-tax return is 7.16%. The return is the same as in 2013 which was a transition year and compares to 10% for the privatized discos and 7% for the Electrica subsidiaries in the second regulatory period (2008-2012) (12% and 7% respectively in the first regulatory period 2005-2007). The new efficiency factor 1.5% per year (up from 1%) capped at 80% of the average efficiencies realized in the second regulatory period. The energy market regulator also implemented some changes to the tariff methodology, which now allows for an additional 0.5pp increase in return on RAB at the end of the regulatory period, for investments in smart metering solutions that lead to a further 1% reduction of technological losses below the limit agreed with the regulator.

ANRE also sets an annual regulated target for grid losses, (as percentage of volumes) and if any efficiency gains are achieved, 25% are left with the disco for high and medium voltage lines and 50% for the low voltage network. The maximum power price for grid losses allowed by ANRE is the 80/20 weighted average between the average price on the bilateral contracts market and the average price on the day-ahead market.

Unitary tariffs are set based on allowed revenues divided by volume estimates. Allowed revenues are computed as the sum of controllable opex, non-controllable opex (which are in theory pass through), grid losses, working capital, regulated depreciation expenses, return on RAB, and less reactive energy revenues (which is remunerated separately). Depreciation expense is computed on a straight line basis (useful life of 25 years) of 2005 RAB assets while the useful life is used for new assets included in RAB. The RAB is computed each year as the RAB from the previous period plus investments commissioned minus assets sold or decommissioned, less depreciation. The RAB is adjusted for inflation.

As for volumes, the YE actual volume is usually different from the estimate made by ANRE. ANRE sets via the tariffs' adjusting mechanism, the criteria for the recognition of the surpluses or deficits of a period for the next periods.

The key risks posed by the tariff basket cap methodology are:

a) a failure to improve efficiency – should distributors fail to increase efficiency in line with the expected efficiency factor, this could have a material impact on their financial standing;

b) relatively weak cost control – at the beginning of each regulatory period, distributors report to ANRE the value of opex related to the regulated activity; the difference between reported costs and those that are deemed acceptable by ANRE is borne by the distributors, putting pressure on profitability.

**Table 47: Electricity distribution tariffs (Electrica's discos and E.ON)**

| | EMD | | | | EDMN | | | | EDTN | | | | EDTS | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **RON/MWh** | **2011** | **2012*** | **2013** | **2014** | **2011** | **2012*** | **2013** | **2014** | **2011** | **2012*** | **2013** | **2014** | **2011** | **2012*** | **2013** | **2014** |
| High Voltage | 21 | 21 | 22 | 21 | 15 | 18 | 19 | 19 | 21 | 21 | 22 | 21 | 21 | 21 | 22 | 24 |
| Medium Voltage | 63 | 63 | 66 | 67 | 54 | 60 | 63 | 63 | 63 | 63 | 66 | 63 | 60 | 63 | 66 | 71 |
| Low Voltage | 196 | 202 | 212 | 215 | 190 | 199 | 209 | 206 | 152 | 164 | 179 | 179 | 174 | 186 | 196 | 195 |
| Average tariff | | | | | 96 | 102 | 111 | 112 | 106 | 110 | 119 | 124 | 106 | 108 | 116 | 120 |

*Source: Company data, FP, IPOPEMA Research*

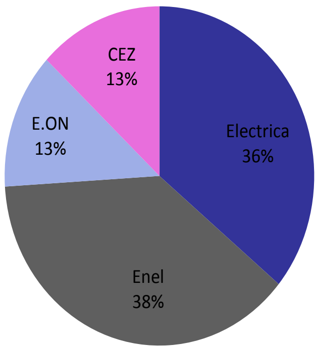
**Table 48: Electricity distribution tariffs (ENEL's discos)**

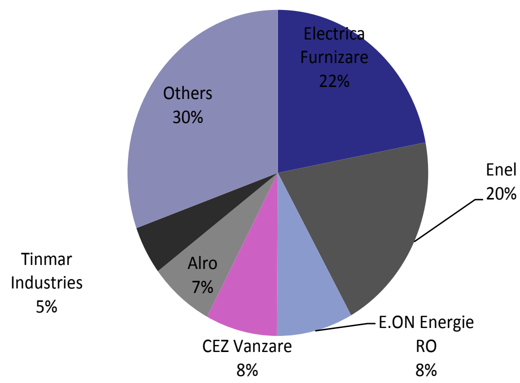
| | EDB | | | | EDB | | | | EDM | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **RON/Mwh** | **2011** | **2012*** | **2013** | **2014** | **2011** | **2012*** | **2013** | **2014** | **2011** | **2012*** | **2013** | **2014** |
| High Voltage | 21 | 21 | 22 | 23 | 21 | 21 | 22 | 22 | 9 | 11 | 11 | 12 |
| Medium Voltage | 63 | 63 | 66 | 69 | 63 | 63 | 66 | 66 | 35 | 35 | 39 | 48 |
| Low Voltage | 193 | 202 | 212 | 206 | 187 | 202 | 212 | 212 | 151 | 172 | 183 | 183 |

*Source: Company data, FP, IPOPEMA Research*

**Electricity Supply:** There are two main markets: regulated and competitive. In the former (for residential and SME consumers), the prices are approved by ANRE. The percentage of energy to be purchased on this market is set to gradually decline by 10pp/year to zero by Jan 2018 (from 70% in July 2014-the process started in July 2013). The tariffs incorporate costs (including the acquisition of electricity), transport and distribution, technological system services and a regulated 2.5% mark-up on the electricity purchased. The regulated segment comprises 5 companies integrated with the same group as the corresponding distribution operators.

**Chart 15: 2013 Market Shares: Distribution (left chart) and Supply (right chart)**

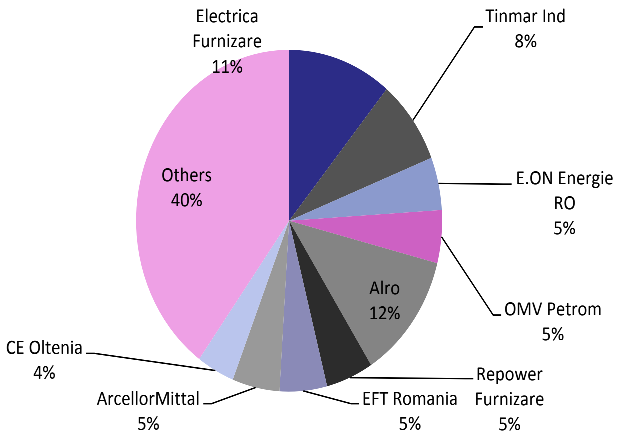


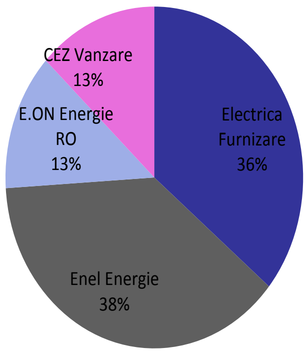




***Source: Electrica, IPOPEMA Research***

***Source: Electrica, IPOPEMA Research***

**Chart 16: 2013 Market shares of Electrica Furnizare: Competitive Market (left chart) and Regulated Market (right chart)**




***Source: Electrica, IPOPEMA Research***

***Source: Electrica, IPOPEMA Research***

The competitive market has 62 players, 54% of which with market shares below 4%. It has retail and wholesale components. In retail, the prices are negotiated freely by the parties, mostly large industrial consumers. On the wholesale market, the participants trade the electricity based on agreements concluded on segments of the centralized market (OPCOM) while supply companies are allowed to trade only if they participate in the balancing of the National Power System (NPS).

## Financial performance review (RAS data) of discos

The three majority state-owned discos continued to have margins lower than those of their privatized peers (average net margin was 12.5% in 2013 vs. 29% at Enel's subsidiaries and 12.4% at E.ON subsidiary). The figure improved by 3.1pp, more than the 1.7pp increase at E.ON but less than the 5.2pp average increase for Enel's subsidiaries. Further improvements in profitability were noticeable in the 1H14 results of Electrica's distribution subsidiaries vs. 2013, while yoy trends are more mixed. Lower effective tax rate and switch from net FX loss in 1H13 to net FX gains in 1H14, coupled with declines in opex (or their growth below sales') explain the improved margins at EDTN and EDTS, with at EDMN opex decline was below that of sales.

We would note that EBITDA margins of Electrica subsidiaries improved steadily starting 2009 (with the exception of 2010 for EDTN and EDTS). In 2013 improvement in margins was a result of opex growth (or declines in the case of EDM and EDD by ca. 2%-3%) below that of revenues (the exception was E.ON, where margins also improved but marginally, despite the significant opex growth). In 2013, all 7 discos showed growth in net sales, at rates varying from 2.5% (EDM) to 7.8% (EDTN), while opex growth ranged from 0.1% at EDB to 9% at EMD. In 1H14, sales increased yoy at the state owned discos (except for EDMN, where the decline was mainly a result of lower volumes for non-households).

Margins at Electrica subsidiaries could witness a further improvement in the long term if they were to undergo their planned investments in the electricity network, which would be the basis for higher tariffs set by ANRE (via higher RAB) and would reduce maintenance costs.

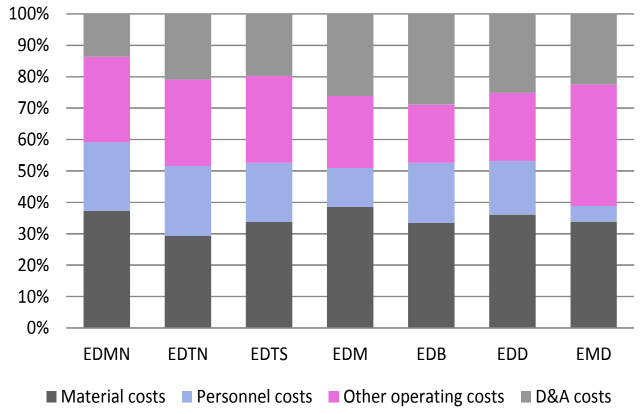
**Table 49: Profit and loss account of electricity distribution companies in FP's portfolio**

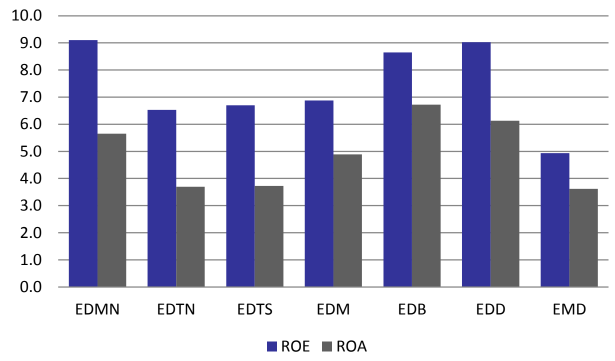
| | EDMN | EDMN | EDTN | EDTN | EDTS | EDTS | EDM | EDM | EDB | EDB | EDD | EDD | EMD | EMD |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **RON m** | **2013** | **2014B** | **2013** | **2014B** | **2013** | **2014B** | **2013** | **2014B** | **2013** | **2014B** | **2013** | **2014B** | **2013** | **2014B** |
| Total operating revenues | 773 | 817 | 652 | 677 | 706 | 733 | 998 | 933 | 659 | 572 | 544 | 498 | 766 | n.a. |
| *yoy change* | 5.1% | 5.6% | 7.8% | 3.9% | 6.5% | 3.8% | 3.2% | -6.5% | 3.6% | -13.3% | 6.9% | -8.5% | 11.3% | n.a. |
| **Net sales** | **756** | **776** | **616** | **n.a.** | **672** | **n.a.** | **892** | **n.a.** | **625** | **n.a.** | **509** | **464** | **702** | **679** |
| *yoy change* | 4.9% | 2.7% | 7.8% | n.a. | 6.3% | n.a. | 2.5% | n.a. | 3.6% | n.a. | 6.0% | -9.0% | 5.5% | -3.3% |
| Other operating income | 16 | 39 | 33 | 0 | 32 | 0 | 84 | 71 | 21 | 0 | 21 | 17 | 64 | 60 |
| Change in inventories | 2 | 2 | 3 | 0 | 2 | 0 | 22 | 30 | 13 | 0 | 14 | 18 | 0 | 0 |
| Material costs | -240 | -269 | -166 | 0 | -208 | 0 | -300 | -225 | -152 | 0 | -143 | -112 | -224 | -190 |
| Personnel costs | -139 | -144 | -125 | 0 | -116 | 0 | -96 | -81 | -88 | 0 | -68 | -49 | -33 | -40 |
| Other operating costs | -174 | -229 | -155 | 0 | -170 | 0 | -177 | -150 | -84 | 0 | -86 | -84 | -255 | -283 |
| **EBITDA** | **220** | **175** | **206** | **202** | **212** | **216** | **424** | **477** | **335** | **307** | **248** | **254** | **255** | **226** |
| **EBIT** | **133** | **90** | **88** | **100** | **90** | **108** | **221** | **288** | **203** | **191** | **149** | **155** | **107** | **85** |
| Net interest | 14 | 5 | 0 | 0 | 0 | 0 | 39 | 0 | 29 | 0 | 12 | 0 | 6 | 1 |
| Interest income | 14 | 6 | 1 | 0 | 0 | 0 | 39 | 0 | 29 | 0 | 12 | 0 | 6 | 1 |
| Interest expense | 0 | -1 | -1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other fin. Net | -1 | -5 | -1 | 0 | -2 | 0 | 60 | 0 | 0 | 0 | 0 | 0 | 1 | 0 |
| Financial result | 13 | 0 | -1 | 0 | -2 | 0 | 98 | 20 | 28 | 27 | 12 | 11 | 6 | 0 |
| Pre-tax profit | 145 | 90 | 87 | 0 | 88 | 0 | 319 | 307 | 232 | 218 | 161 | 166 | 112 | 87 |
| Taxes | -19 | -14 | -23 | 0 | -18 | 0 | -52 | -53 | -41 | -42 | -28 | -35 | -25 | -14 |
| **Net profit** | **127** | **75** | **64** | **79** | **69** | **89** | **267** | **254** | **191** | **176** | **134** | **131** | **87** | **71** |

*Source: Company data (in RAS), IPOPEMA Research*

With regards to opex breakdown, we would outline that among Electrica's subsidiaries, EDMN had the highest material costs as percentage of opex and was the only disco witnessing a deterioration of this indicator in 2013. While in 1H14, the value of this indicator improved for all 3 Electrica's subsidiaries, EDMN's indicator remained the highest. As to personnel expenses, EDTS stands out with the lowest figure among the Electrica subsidiaries (19% in 2013 up to 20% in 1H14), while among all discos, we would outline the EMD performance with the highest adjustment (11pp down yoy) to the lowest figure (5%). On the counterpart, the same EMD had the highest other opex (of 38.6% of total, by 12.4pp up yoy) mainly on the back of a significant increase in the third party costs but also due to a switch from a RON 6.5mn provision income in 2012 to a RON 3.3mn provision expense. EDMN also had the lowest D&A costs as percentage of revenues (13.7% in 2013, 14.6% in 1H14), while EDB had the highest value of this indicator (29% in 2013 up 4.5pp yoy).

**Chart 17: 2013 Opex breakdown (left chart); ROE/ROA (right chart) %**

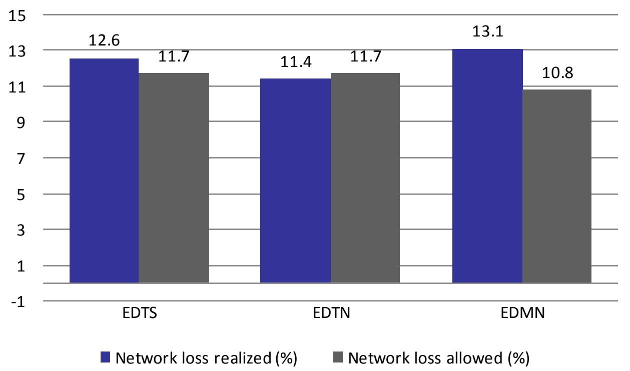


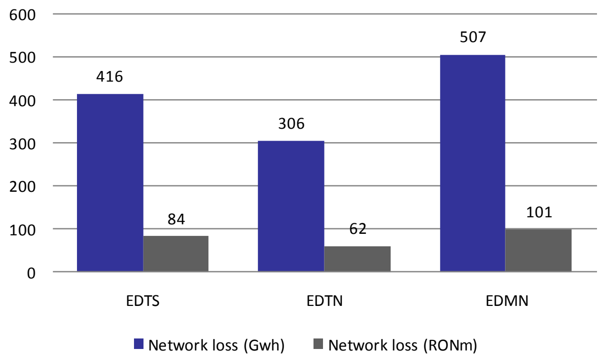




*Source: Company data, IPOPEMA Research*

*Source: Company data, IPOPEMA Research*

**Chart 18: 1H14 Network losses (Electrica's distribution subsidiaries)**




*Source: Electrica, IPOPEMA Research*

*Source: Electrica, IPOPEMA Research*

In 1H14, all three Electrica subsidiaries had net cash positions (vs. only EDMN in 2013). For the Enel subsidiaries and E.ON we lack 1H14 data but usually, these companies are holders of significant net cash. The indebtedness level was low for the two Electrica's subsidiaries with net debt in 2013 (given that 2013 net debt to equity ratios stood at 6.5% for EDTN and 6.7% in EDTS, while the net debt to EBITDA ratios were 0.1x and 0.3x respectively).

We would also outline that in 2013, EDMN posted the highest ROE, ROCE and ROA ratios of 9.1%, 9.4% and 5.7% respectively and it was also the electricity distribution company where these indicators improved most on a yoy basis (and further improved in 1H14). On average the ROCE of Electrica's distribution subsidiaries stood at 7.1% in 2013, vs. the 9.6% average of Enel's subsidiaries and 6.6% at EON.

**Comparison between RAS and IFRS key financials of Electrica's discos (left); Key data for Electrica's discos (right table)**

| | IFRS | | | RAS | | |
|---|---|---|---|---|---|---|
| Data for 1H14 (RON m) | EDTS | EDTN | EDMN | EDTS | EDTN | EDMN |
| Sales | 346.6 | 314.2 | 362.8 | 341.7 | 312.3 | 370.5 |
| EBITDA | 139.5 | 130.1 | 110.8 | 140.7 | 131.4 | 122.3 |
| Net profit | 54.8 | 50.9 | 56.4 | 66.5 | 61.1 | 75.8 |
| Net debt | 49.2 | -3.4 | -211.3 | -57.7 | -0.5 | -304.1 |

| | EDTS | EDTN | EDMN |
|---|---|---|---|
| Volumes (TWh) | 2.7 | 2.3 | 3 |
| Capex (RON mn) | 88 | 68 | 70 |
| Users (m) | 1.1 | 1.2 | 1.3 |
| Market share (%) | 13 | 11 | 15 |
| Area covered km2 | 34,071 | 34,160 | 29765 |
| Lengt of lines (km) | 53,951 | 67,328 | 67,788 |
| RAB | 1,332 | 1,298 | 1,446 |

*Source: Electrica, IPOPEMA Research*

*Source: Electrica, IPOPEMA Research*

# NATGAS SUPPLY & DISTRIBUTION

## Gas price liberalisation-main theme

FP owns stakes in 3 gas distribution and supply companies E.ON Gaz Distributie (E.ON GD) obtains the bulk of its revenues from gas distribution (89% in 2013), while GDF Suez Energy Romania (GDF) and E.ON Energie Romania (E.ON ER) from gas supply (84% and 64% respectively). GDF also has some gas distribution (7%) and both have electricity supply businesses (5% and 36% respectively of 2013 revenues). FP owns 12% in each of GDF and E.ON GD and 13.4% in E.ON ER. We see regulatory risk as the most important for these companies. We believe the supply business may benefit from higher end-user prices following wellhead price liberalization; however this process has also caused a decline in domestic demand.

**Valuation**: The cumulated official value of FP's holdings in this sub-sector amounts to RON 701mn (as of June 2014, or 4.7% of NAV) or RON 640mn using our fair values. We determined the fair values as weighted averages of fair values based on EV/EBITDA (80% weight) and P/E multiples (20%) using the 2014 median multiples of a selection of peers, based on Bloomberg consensus, to which we applied discounts ranging from 20% (E.ON GD), 25% (GDF) and 40% (E.ON ER).

**Dividend contributors:** FP cashed some RON 22.8mn in 2012 and RON 33.6mn in 2013 as dividends from GDF and RON 30mn in 2013 from E.ON GD (as part of a settlement mechanism between E.ON and the Romanian state allowing E.ON ER to recover some overdue receivables from the state owned railways operator). The stakes are also on sale and Citigroup Global Markets is FP's consultant.

**Main risks** derive from taxes impacting the companies' profitability such as the last year's monopoly tax of RON 0.75/MWh distributed and this year's special construction tax (RON 37mn for GDF), the latter not included in the tariffs. The wellhead gas liberalisation prices is expected to have a mixed impact on the companies from this sub-sector thus can be view as both **trigger and risk factor**. On one hand, the increase in end user gas prices could help suppliers, although to date, volumes were adversely impacted, while it also increases their gas acquisition costs. Gas acquisition price increases have been lately partly mitigated by a lower gas import prices, lower weight of imports in the basket and the likelihood of freezing the gas prices for households since April until next year and of the postponement by 2.5 years to July 2021 of their deregulation.

**GAS DISTRIBUTION AND SUPPLY COMPANIES – Summary Financial Data**

| | GDF Suez Energy Romania | | | E.ON Gaz Distributie | | | E.ON Energie Romania | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014B | 2012 | 2013 | 2014B | 2012 | 2013 | 2014B |
| Sales (RONm) | 4,047 | 4,127 | 4,449 | 744 | 727 | 748 | 5,257 | 4,559 | 5,219 |
| EBITDA (RONm) | 583 | 730 | 644 | 205 | 216 | 201 | -13 | 229 | 161 |
| EBIT (RONm) | 423 | 519 | 453 | 83 | 74 | 50 | -16 | 227 | 159 |
| Net profit (RONm) | 360 | 447 | 352 | 73 | 68 | 37 | -33 | 224 | 131 |
| EPS (RON) | 18.1 | 22.5 | 17.7 | 0.6 | 0.6 | 0.3 | -0.4 | 3.0 | 1.8 |
| DPS (RON) | 10 | 2 | n.a. | 2.2 | n.a. | n.a. | 0.0 | 0.0 | n.a. |
| EV/EBITDA (x)* | 5.9 | 4.9 | 5.5 | 4.6 | 4.8 | 5.2 | -82.0 | 3.4 | 4.8 |
| P/E (x)* | 9.7 | 7.8 | 9.9 | 12.1 | 13.1 | 23.9 | -26.3 | 3.8 | 6.5 |

*Source: Company data, IPOPEMA Research*

28 October 2014

### GDF SUEZ ENERGY ROMANIA
*NOT LISTED*

| Key Ratios | 2012 | 2013 |
|---|---|---|
| EBITDA Margin | 14.4% | 17.7% |
| EBIT Margin | 10.5% | 12.6% |
| ROE | 11.1% | 12.6% |
| Bank debt/ Assets | 7.8% | 6.9% |

| Shareholders | Stake |
|---|---|
| Romania Gas Holding | 51.0% |
| Ministry of Economy | 37.0% |
| Fondul Proprietatea | 12.0% |

### E.ON GAS DISTRIBUTIE
*NOT LISTED*

| Key Ratios | 2012 | 2013 |
|---|---|---|
| EBITDA Margin | 27.5% | 29.8% |
| EBIT Margin | 11.1% | 10.2% |
| ROE | 5.0% | 5.2% |
| Bank debt/ Assets | 3.2% | 8.2% |

| Shareholders | Stake |
|---|---|
| E.ON Romania SRL | 51.0% |
| Ministry of Economy | 37.0% |
| Fondul Proprietatea | 12.0% |

### E.ON ENERGIE ROMANIA
*NOT LISTED*

| Key Ratios | 2012 | 2013 |
|---|---|---|
| EBITDA Margin | -0.3% | 5.0% |
| EBIT Margin | 0.3% | -5.0% |
| ROE | -6.7% | 31.6% |
| Bank debt/ Assets | 13.5% | 0.0% |

| Shareholders | Stake |
|---|---|
| E.ON Romania SRL | 53.4% |
| Ministry of Economy | 31.8% |
| Fondul Proprietatea | 13.4% |
| Electrica | 1.4% |

**Valuation multiples using IPOPEMA fair values*

Analyst

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| | GDF Suez Energy Romania | | | | | E.ON Gaz Distributie | | | | | E.ON Energie Romania | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **P&L (RON m)** | **2010** | **2011** | **2012** | **2013** | **2014B** | **2010** | **2011** | **2012** | **2013** | **2014B** | **2010** | **2011** | **2012** | **2013** |
| **Revenues** | **3,593** | **3,886** | **4,073** | **4,161** | **4,449** | **816** | **819** | **775** | **796** | **748** | **2,496** | **4,288** | **5,369** | **4,767** |
| *yoy change* | | *8%* | *5%* | *2%* | *7%* | | *0%* | *-5%* | *3%* | *-6%* | | *72%* | *25%* | *-11%* |
| **Sales** | **3,542** | **3,859** | **4,047** | **4,127** | **4,449** | **794** | **800** | **744** | **727** | **748** | **2,468** | **4,261** | **5,257** | **4,559** |
| yoy change | | *9%* | *5%* | *2%* | *8%* | | *1%* | *-7%* | *-2%* | *3%* | | *73%* | *23%* | *-13%* |
| **EBIT** | **322** | **286** | **423** | **519** | **453** | **196** | **265** | **83** | **74** | **50** | **-129** | **-198** | **-16** | **227** |
| *yoy change* | | *-11%* | *48%* | *23%* | *-13%* | | *35%* | *-69%* | *-11%* | *-32%* | | *53%* | *-92%* | *n.m.* |
| Depreciation costs | -122 | -128 | -159 | -212 | -191 | -115 | -90 | -122 | -142 | -151 | -1 | -2 | -3 | -2 |
| **EBITDA** | **444** | **414** | **583** | **730** | **644** | **311** | **354** | **205** | **216** | **201** | **-129** | **-196** | **-13** | **229** |
| *yoy change* | | *-7%* | *41%* | *25%* | *-12%* | | *14%* | *-42%* | *6%* | *-7%* | | *52%* | *-93%* | *n.m.* |
| Financial Income/(Cost) | 11 | 9 | 12 | 2 | -29 | -1 | 0 | 1 | 2 | -5 | 34 | 6 | -17 | -2 |
| **Pretax profit** | **332** | **295** | **436** | **521** | **424** | **195** | **265** | **84** | **76** | **45** | **-95** | **-192** | **-33** | **224** |
| *yoy change* | | *-11%* | *48%* | *20%* | *-19%* | | *36%* | *-68%* | *-10%* | *-40%* | | *101%* | *-83%* | *n.m.* |
| Income tax | -61 | -54 | -76 | -74 | -72 | -35 | -35 | -11 | -8 | -8 | 0 | 0 | 0 | 0 |
| **Net income** | **271** | **240** | **360** | **447** | **352** | **160** | **230** | **73** | **68** | **37** | **-95** | **-192** | **-33** | **224** |

*Source: Company data, IPOPEMA Research*

| | GDF Suez Energy Romania | | | | | E.ON Gaz Distributie | | | | | E.ON Energie Romania | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Profitability Ratios** | **2010** | **2011** | **2012** | **2013** | **2014B** | **2010** | **2011** | **2012** | **2013** | **2014B** | **2010** | **2011** | **2012** | **2013** |
| EBITDA Margin | 12.5% | 10.7% | 14.4% | 17.7% | 14.5% | 39.2% | 44.3% | 27.5% | 29.8% | 26.9% | -5.2% | -4.6% | -0.3% | 5.0% |
| EBIT Margin | 9.1% | 7.4% | 10.5% | 12.6% | 10.2% | 24.7% | 33.1% | 11.1% | 10.2% | 6.7% | 5.2% | 4.7% | 0.3% | -5.0% |
| Net Margin | 7.7% | 6.2% | 8.9% | 10.8% | 7.9% | 20.1% | 28.8% | 9.4% | 8.5% | 4.7% | -3.9% | -4.5% | -0.6% | 4.9% |
| ROE | 10.0% | 8.4% | 11.1% | 12.6% | n.a. | 16.6% | 19.3% | 5.0% | 5.2% | n.a. | -14% | -38% | -7% | 32% |

*Source: Company data, IPOPEMA Research*

| | GDF Suez Energy Romania | | | | E.ON Gaz Distributie | | | | E.ON Energie Romania | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance Sheet (RON m)** | **2010** | **2011** | **2012** | **2013** | **2010** | **2011** | **2012** | **2013** | **2010** | **2011** | **2012** | **2013** |
| **Total Fixed Assets** | **2,651** | **2,657** | **2,963** | **3,246** | **1,210** | **1,326** | **1,637** | **1,679** | **18** | **19** | **27** | **31** |
| Tangible Assets | 2,508 | 2,490 | 2,761 | 3,087 | 1,183 | 1,290 | 1,597 | 1,641 | 15 | 14 | 21 | 22 |
| Other Fixed Assets | 144 | 168 | 202 | 158 | 26 | 36 | 40 | 38 | 3 | 5 | 6 | 9 |
| **Total Current Assets** | **1,566** | **1,381** | **1,815** | **1,735** | **187** | **251** | **275** | **209** | **1,775** | **2,081** | **1,934** | **1,894** |
| Cash and Equivalents | 387 | 82 | 433 | 277 | 5 | 1 | 1 | 0 | 158 | 96 | 42 | 89 |
| Other Current Assets | 1,321 | 1,299 | 1,383 | 1,458 | 182 | 250 | 274 | 209 | 1,616 | 1,985 | 1,892 | 1,805 |
| **Total Assets** | **4,217** | **4,038** | **4,779** | **4,980** | **1,396** | **1,577** | **1,913** | **1,888** | **1,793** | **2,100** | **1,961** | **1,926** |
| **Stockholders` Equity** | **2,715** | **2,873** | **3,245** | **3,546** | **963** | **1,194** | **1,472** | **1,298** | **704** | **511** | **486** | **711** |
| **Long Term Liabilities** | **481** | **376** | **518** | **493** | **236** | **214** | **222** | **194** | **10** | **11** | **9** | **4** |
| Long -Term Debt | 123 | 113 | 250 | 250 | 5 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Long - Term liabilities | 358 | 263 | 268 | 243 | 231 | 214 | 222 | 194 | 10 | 11 | 9 | 4 |
| **Short Term Liabilities** | **1,022** | **789** | **1,015** | **941** | **197** | **169** | **218** | **395** | **1,078** | **1,578** | **1,467** | **1,211** |
| Short -Term Debt | 309 | 26 | 120 | 94 | 6 | 22 | 62 | 154 | 0 | 465 | 265 | 0 |
| Other Short Term Liabilities | 713 | 763 | 895 | 847 | 191 | 147 | 156 | 241 | 1,078 | 1,114 | 1,202 | 1,211 |
| **Total Equity & Liabilities** | **4,217** | **4,038** | **4,779** | **4,980** | **1,396** | **1,577** | **1,913** | **1,888** | **1,793** | **2,100** | **1,961** | **1,926** |

*Source: Company data, IPOPEMA Research*

| | GDF Suez Energy Romania | | | | E.ON Gaz Distributie | | | | E.ON Energie Romania | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance Sheet Ratios** | **2010** | **2011** | **2012** | **2013** | **2010** | **2011** | **2012** | **2013** | **2010** | **2011** | **2012** | **2013** |
| Current Ratio | 1.5 | 1.7 | 1.8 | 1.8 | 0.9 | 1.5 | 1.3 | 0.5 | 1.6 | 1.3 | 1.3 | 1.6 |
| Quick Ratio | 1.3 | 1.4 | 1.5 | 1.5 | 0.9 | 1.4 | 1.2 | 0.5 | 1.5 | 0.9 | 1.0 | 1.3 |
| Bank Debt/Assets | 10% | 3% | 8% | 7% | 1% | 1% | 3% | 8% | 0% | 22% | 13% | 0% |
| **Bank Debt/Equity** | **16%** | **5%** | **11%** | **10%** | **1%** | **2%** | **4%** | **12%** | **0%** | **91%** | **54%** | **0%** |

*Source: Company data, IPOPEMA Research*

| | GDF Suez Energy Romania | | | E.ON Gaz Distributie | | | E.ON Energie Romania | | |
|---|---|---|---|---|---|---|---|---|---|
| **Cash Flow (RON mn)** | **2011** | **2012** | **2013** | **2011** | **2012** | **2013** | **2011** | **2012** | **2013** |
| Net Profit | 240 | 360 | 447 | 230 | 73 | 68 | -95 | -192 | -33 |
| Depreciation and Amortisation | 128 | 159 | 212 | 90 | 122 | 142 | 1 | 2 | 3 |
| Other (incl. WC change) | 73 | 48 | -122 | -113 | -15 | 150 | -333 | 181 | 96 |
| **Operating Cash Flows** | **441** | **568** | **536** | **207** | **180** | **360** | **-428** | **-8** | **66** |
| Capital Expenditures (Net) | 18 | -271 | -326 | -107 | -307 | -44 | 1 | -7 | -1 |
| Other | -24 | -35 | 44 | -10 | -4 | 2 | -2 | -1 | -4 |
| **Cash Flows from Investing Activities** | **-6** | **-306** | **-282** | **-116** | **-311** | **-42** | **-1** | **-8** | **-4** |
| Change in Debt | -292 | 231 | -27 | 12 | 39 | 93 | 465 | -200 | -265 |
| Issuance of Shares | 0 | 21.2 | 0 | 0 | 0 | 8.3 | 0.0 | 0.0 | 0.0 |
| Other | 161 | -864 | -72 | -99 | 92 | -419 | 27 | 271 | 156 |
| **Cash Flows from Financing Activities** | **-131** | **-612** | **-99** | **-88** | **132** | **-318** | **491** | **70** | **-109** |
| Beginning Cash | 387 | 82 | 433 | 5 | 1 | 1 | 158 | 96 | 42 |
| Increase/(Decrease) in cash | 305 | -351 | 155 | 4 | 0 | 1 | 62 | 54 | -47 |
| **Ending cash** | **82** | **433** | **277** | **1** | **1** | **0** | **96** | **42** | **89** |

*Source: Company data, IPOPEMA Research*

## Gas supply and distribution companies' valuation

FP has stakes of 12% in each of GDF Suez Energy Romania (GDF) and E.ON Gaz Distributie (EON GD) and a 13.4% stake in E.ON Energie Romania (E.ON ER) (both a gas and electricity supplier). The three utilities had values of RON 404mn, RON 165mn and RON 131mn respectively in FP's June 2014 official NAV (4.7%) while our fair values are RON 419mn, RON 106mn and RON 115mn respectively. We valued the gas utilities using a combination of financial multiples: we calculated weighted averages of fair values based on P/E (weight of 20%) and EV/EBITDA (weight of 80%). We assigned various discounts to the median peers' multiples as the companies we selected as peers are generally more diversified (they have also other business lines such as electricity, water management or district heating), the sector environment is riskier (declining domestic demand and hence of the gas volumes supplied and distributed) which was partly caused by the liberalization of domestic wellhead prices) and to account also for the unlisted status of the Romanian companies. The discounts range from 20% at E.ON GD (lowest due to its highest margins), 25% at GDF and 40% at E.ON ER (highest given high earnings volatility and low earnings visibility).

**Table 51: Key data used in the valuation of gas supply and distribution companies**

| RON mn | Sales | EBITDA | EBIT | Net profit | Net debt | Book value | No. of clients | Period |
|---|---|---|---|---|---|---|---|---|
| GdF Suez Energy Romania | 4,448.5 | 644.3 | 453.3 | 352.2 | 66.7 | 3,546.0 | 1.4 | 2014B P&L 2013 BS |
| E.ON Gaz Distributie | 748.0 | 201.0 | 50.0 | 37.0 | 154.5 | 1,298.1 | 2.8 | 2014B P&L 2013 BS |
| E.ON Energie Romania | 5,219.5 | 161.3 | 159.0 | 131.0 | -89.0 | 710.6 | 2.8 | 2014B P&L 2013 BS |

*Source: Company data, IPOPEMA Research*

As to the reference multiples used in the valuation, we used as key inputs the 2014 median multiples of a selection of peers, based on Bloomberg consensus (14.7x for P/E and 7.2x for EV/EBITDA).

**Table 52: Our fair values for the gas supply and distribution companies**

| | Fair value of equity based on | | | | Value of FP stake based on | | | |
|---|---|---|---|---|---|---|---|---|
| RON mn | P/E | EV/EBITDA | Average | FP stake (%) | P/E | EV/EBITDA | Average | Official valuation |
| GdF Suez Energy Romania | 3,875.5 | 3,397.1 | 3,492.8 | 12.0 | 465.1 | 407.7 | 419.1 | 404.4 |
| E.ON Gaz Distributie | 434.3 | 998.2 | 885.4 | 12.0 | 52.1 | 119.8 | 106.2 | 165.2 |
| E.ON Energie Romania | 1,153.2 | 782.7 | 856.8 | 13.4 | 138.4 | 104.9 | 114.8 | 130.9 |
| **Sub-total** | | | | | | | **640.2** | **700.5** |

*Source: Company data, Bloomberg, IPOPEMA Research*

While both GDF and EON GD have higher profit margins than the peers' median, we believe that the implied discounts in 2014E EV/EBITDA terms of 23% and 28% respectively using our fair values are warranted by market and sector specific risks. E.ON ER margins are below peers' median.

**Table 53: Comparison with peers (financial multiples)**

| | | | P/E (x) | | | EV/EBITDA (x) | | | EV/Sales (x) | | | P/BV (x) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Price (EUR) | Mcap (EUR m) | 2013 | 2014E | 2015E | 2013 | 2014E | 2015E | 2013 | 2014E | 2015E | 2013 | 2014E | 2015E |
| Gas Natural SDG SA (Spain) | 22.04 | 22,050 | 15.3 | 15.6 | 14.7 | 7.8 | 7.6 | 7.2 | 1.5 | 1.5 | 1.4 | 1.6 | 1.5 | 1.5 |
| Iren (Italy) | 0.96 | 1,129 | 8.9 | 11.1 | 9.8 | 6.0 | 5.6 | 5.4 | 1.1 | 1.1 | 1.0 | 0.8 | 0.7 | 0.6 |
| Hera (Italy) | 1.98 | 2,954 | 18.7 | 19.8 | 17.9 | 6.9 | 6.7 | 6.4 | 1.2 | 1.2 | 1.2 | 1.3 | 1.3 | 1.3 |
| SNAM SpA (Italy) | 4.19 | 14,169 | 15.5 | 13.7 | 13.5 | 9.8 | 9.9 | 9.8 | 7.4 | 7.8 | 7.7 | 2.3 | 2.2 | 2.2 |
| **Median** | | | **15.4** | **14.7** | **14.1** | **7.4** | **7.2** | **6.8** | **1.4** | **1.4** | **1.3** | **1.4** | **1.4** | **1.4** |
| GDF Suez Energy (Romania) | | | 7.8 | 9.9 | | 4.9 | 5.5 | | 0.9 | 0.8 | | 1.0 | | |
| E.ON Gaz Distributie (Romania) | | | 13.1 | 23.9 | | 4.8 | 5.2 | | 1.4 | 1.4 | | 0.7 | | |
| E.ON Energie (Romania) | | | 3.8 | 6.5 | | 3.4 | 4.8 | | 0.2 | 0.1 | | 1.2 | | |
| **Discounts vs. median %)** | | | | | | | | | | | | | | |
| GDF Suez Energy (Romania) | | | -49.3 | -32.4 | | -33.8 | -22.9 | | -37.6 | -41.9 | | -32.0 | | |
| E.ON Gaz Distributie (Romania) | | | -15.3 | 63.1 | | -34.7 | -27.8 | | 3.6 | 1.0 | | -52.9 | | |
| E.ON Energie (Romania) | | | -75.2 | -55.4 | | -54.4 | -33.6 | | -87.8 | -89.3 | | -16.8 | | |

*Source: Company data, Bloomberg, IPOPEMA Research*

**Table 54: Comparison with peers (financial ratios)**

| | EBITDA margin (%) | | | Net margin (%) | | | ROE (%) | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2013 | 2014E | 2015E | 2013 | 2014E | 2015E | 2013 | 2014E | 2015E |
| Gas Natural SDG SA (Spain) | 11.9 | 12.3 | 11.9 | 6.7 | 6.0 | 5.9 | 10.1 | 10.4 | 10.3 |
| Iren (Italy) | 9.9 | 9.9 | 9.7 | 3.7 | 3.2 | 3.6 | 7.5 | 5.7 | 6.3 |
| Hera (Italy) | 9.3 | 9.3 | 9.5 | 3.2 | 3.2 | 3.5 | 9.8 | 6.8 | 7.6 |
| SNAM SpA (Italy) | 54.5 | 56.3 | 56.1 | 24.6 | 28.7 | 28.9 | 15.3 | 16.2 | 16.1 |
| **Median** | **10.9** | **11.1** | **10.8** | **5.2** | **4.6** | **4.7** | **9.9** | **8.6** | **9.0** |
| GDF Suez Energy (Romania) | 17.7 | 14.5 | | 10.8 | 7.9 | | 12.6 | | |
| E.ON Gaz Distributie (Romania) | 29.8 | 26.9 | | 9.3 | 4.9 | | 5.2 | | |
| E.ON Gaz Distributie (Romania) | 5.0 | 3.1 | | 4.9 | 2.5 | | 31.6 | | |
| E.ON Energie (Romania) | | | | | | | | | |
| **Discounts vs. median (pp)** | | | | | | | | | |
| GDF Suez Energy (Romania) | 6.8 | 3.4 | | 5.7 | 3.3 | | 2.7 | | |
| E.ON Gaz Distributie (Romania) | 18.9 | 15.8 | | 4.2 | 0.3 | | -4.7 | | |
| E.ON Energie (Romania) | -5.9 | -8.0 | | -0.3 | -2.1 | | 21.7 | | |

*Source: Company data, Bloomberg, IPOPEMA Research*

# Business overview

In this section we present some sector data and a short profile of GDF Suez Energy Romania only (given that it is among FP's top 10 holdings and there is more data available for this company). **GDF Suez Energy Romania** is the main natgas supplier on the domestic regulated segment. It also provides natgas distribution through its subsidiary, Distrigaz Sud Retele, and covers the southern part of Romania. On the supply side, it had a 51.8% market share in May 2014 on the regulated segment and was followed by **E. ON Energie Romania with 36.9%** (the rest is supplied by 18 players with market shares below 3% each). It also supplies natgas on the free market to eligible consumers, where it had a 12.5% market share in May 2014 (OMV Petrom Gas had 33.2%, Romgaz 14.95%, Interagro (fertilizers producer) 21% and **E.ON Energie Romania 6.8%**). In addition, GDF is a small electricity supplier as it has two wind farms with an installed capacity of 98 MW. GDF finalized in July 2014 the acquisition of a 57.2% stake in the regional gas distributor Congaz Constanta from E.On Ruhrgas and Petrom (it owns an 85.8% stake).

**E.ON Gaz Distributie** provides natgas distribution services in the northern part of Romania. E.ON has a separate entity covering gas supply, i.e. E.ON Energie Romania which was set up through the absorption of E.ON Moldova Furnizare (electricity supply) by E. ON Gaz Romania (gas supply) in December 2011. In July 2014, E.ON announced the intention to merge its electricity distributing company E.ON Moldova Distributie (absorbed company) with the gas distributor (E.ON Gaz Distributie). The merger project was endorsed by the boards of the two companies, but still needs the shareholders' approval of the 2 companies. FP stake in the combined company would be around 18.3% based on the merger valuation report (vs. the current stakes of 22%in EMD and 12% in E.ON GD). The management intends the effective date of the merger to be 31 December 2014.

**Table 55: 2013 Sales breakdown for the three gas distribution and supply companies**

| E.ON GD | | E.ON ER | | GDF | |
|---|---|---|---|---|---|
| Gas distribution | 89.3% | Gas supply | 64.1% | Gas supply | 83.7% |
| Merchandise sales | 0.0% | Electricity supply | 35.8% | Gas distribution | 7.3% |
| Waste sales | 0.1% | Rents and others | 0.2% | Electricity supply | 5.1% |
| Other revenues | 10.6% | | | Green certificates | 1.0% |
| | | | | Other | 2.9% |
| **Total** | **100.0%** | **Total** | **100.0%** | | **100.0%** |

*Source: Company data, IPOPEMA Research*

### Market liberalization

Supply on the regulated market (for consumers which have not actively chosen their supplier) is done through framework contracts at final prices regulated by ANRE. ANRE uses a reference price for the domestic producer price and an import price estimate and also sets other components of the end-user price (transportation, underground storage, distribution tariffs, suppliers' margin), as well as the weights of domestic and import prices in the basket. The basket differs for households and district heating producers versus industrial consumers. The return on RAB for regulated supply was set at 8.43% (pre-tax) for 2013-2017, same as for distributors. As for the unregulated segment (clients which actively choose their supplier and are therefore considered eligible), natgas producers can theoretically negotiate their sale prices but in practice prices on this segment have been similar to those on the regulated segment.

Domestic wellhead prices have been increasing since Feb 2013 according to an official liberalization calendar agreed with the IMF and the European Commission, and once the deregulation process ends, they will eventually align with European market prices. The de-regulation is done through quarterly upward adjustments which should end this year for industrial consumers and by July 2021 for households (Romania obtained the EC approval for a 2.5Y postponement from the initial end 2018 deadline). With this change, the gas basket is to be maintained and ANRE has to draft a new road map as to the frequency of price increases going forward and the final price (vs. the RON 119/MWh, the price set for the initial Dec 2018 deadline). Last year, end-user prices increased by 5% in Feb 2013 for non-households, afterwards by ca. 8% for households and 3% for industrial consumers in July 2013, and by 1.5% and 1.8% respectively in October 2013. Another increase was implemented in January 2014, which resulted in a 1.6% hike for households and 4% for industrial consumers. The wellhead prices for regulated non-households increased on 1 April to RON 89.4/MWh but remained flat both on 1 July and 1 Oct, while it should have reached RON 119/MWh according to the official schedule (instead a regulation was adopted this summer according to which prices for this type of customers should be aligned to the European hubs gas prices); we outline also that import prices have been on a downward trend most of the year, but the picture may change in the case (to which we assign a low probability so far) of major disruption in the gas supplies in Europe as a result of Russia-Ukraine tensions.

The revenues of natgas suppliers should increase due to the deregulation of wellhead prices which leads to increased end-user prices, however the liberalization process had also led to a decline in demand from industrial consumers and hence in volumes distributed and sold.

### Natgas distribution tariffs

Gas distribution is regulated by the energy market regulator ANRE which sets distribution tariffs using a revenue cap methodology; tariffs are revised each year. The regulated return on RAB for the third regulatory period (2013-2017) was set at 8.43% (pre-tax) versus 8.63% for 2008-2012. A 1.4% incentive above the 8.43% return may be granted for several categories of long term assets. Gas distributors received nearly 5% increase in tariffs in July 2013, based on the 2012 inflation rate.

### Latest financials review and outlook

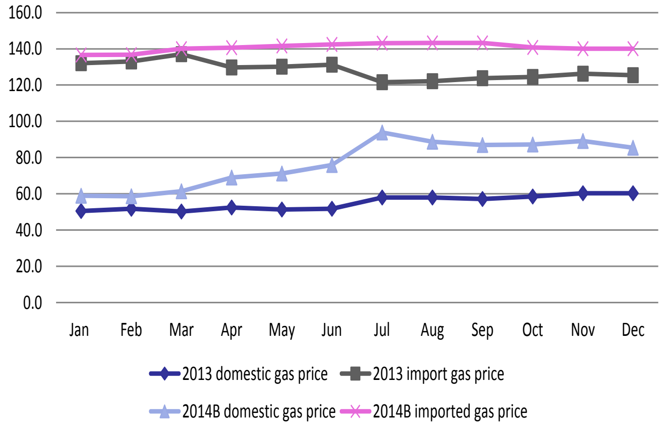
**GDF's** 2013 sales increased yoy by 2% on the back of flat sales in gas supply, 6.2% decline in gas distribution segment sales and 13.2% increase in the electricity distribution segment, the latter due to the commissioning of 2 new wind farms. The gross margin in gas (supply and distribution) increased to 32.2%, helped by end user price increases (by 8% in July and 1% in Oct for households and 5% in February, 3% in July and 2% in October for non-households), a decline in import gas prices and a lower average gas basket as positives, partly offset by some negatives (5% yoy declines in supplied gas volumes to 30.7TWh and by 2.5TWh of the distributed gas), higher transportation and warehousing tariffs, and higher acquisition costs for the domestic gas (overall gas acquisition costs were actually 13.4% down yoy). The gross margin for electricity became negative. Decline in COGS offset the double digit yoy advances in other opex, thus operating profits and margins advanced nicely. Decline in the tax rate helped net profit to increase. GDF switched from RON 62mn net cash position in 2012 to RON 67mn net debt in 2013.

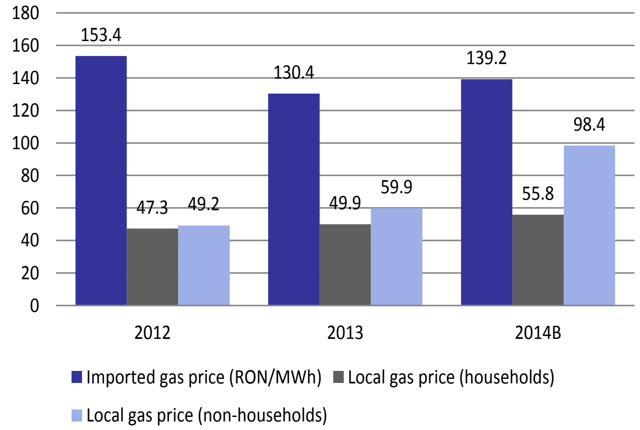
**Table 56: 2013 Sales and gross margins of GDF Suez Energy Romania**

| RON m | 2012 | 2013 | yoy (%) | 2014B | yoy (%) |
|---|---|---|---|---|---|
| Gas supply | 3,448 | 3,455 | 0.2 | 3,749 | 0.1 |
| Gas distribution | 322 | 302 | -6.2 | 329 | 0.1 |
| Electricity supply | 185 | 210 | 13.2 | 163 | -0.2 |
| Green certificates | 0 | 42 | n.m. | 45 | 0.1 |
| Other | 93 | 119 | 28.5 | 162 | 0.4 |
| **Total sales** | **4,047** | **4,127** | **2.0** | **4,449** | **0.1** |
| Gross margin gas | 1,015 | 1,209 | 0.2 | 784.9 | -0.4 |
| Gross margin electricity | 2.0 | -39.2 | n.m. | 36.7 | n.m. |
| Gas margin | 26.9% | 32.2% | 5.3 | 20.9% | -11.3 |

*Source: Company data, IPOPEMA Research*

**Chart 19: Domestic vs. import gas prices (RON/MWh): monthly evolutions (left chart); by type of customer (right chart)**

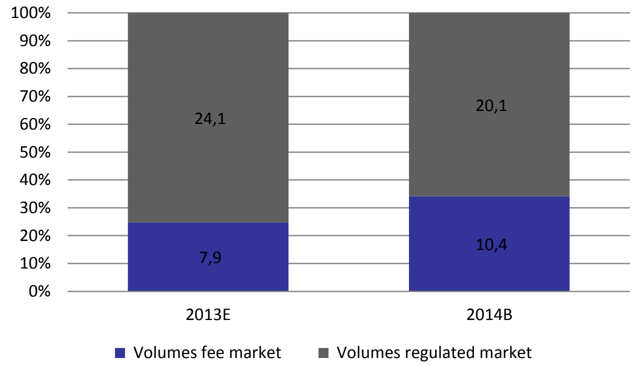


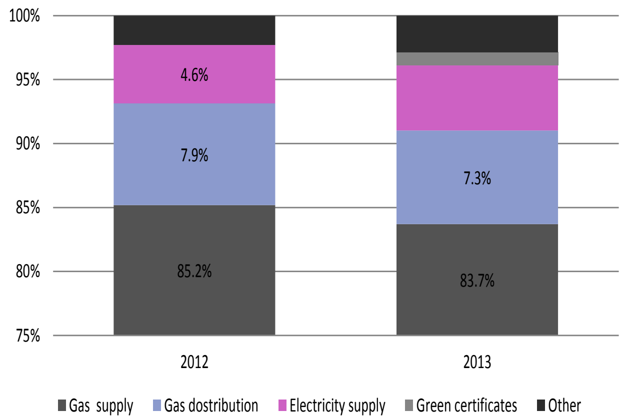




*Source: GDF Suez Energy, IPOPEMA Research*

*Source: GDF Suez Energy, IPOPEMA Research*

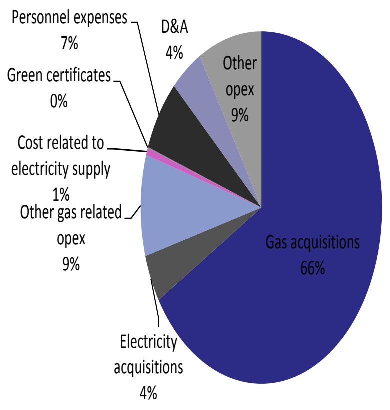
**Chart 20: Gas sales volumes (TWh) (left chart); Breakdown of sales (right chart)**

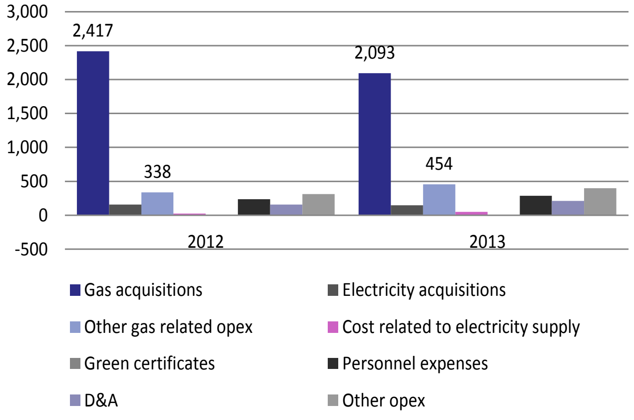



*Source: GDF Suez Energy, IPOPEMA Research*

**Chart: 2021 opex breakdown (left chart); Opex evolution in RON mn (right chart)**




*Source: GDF Suez Energy, IPOPEMA Research*

*Source: GDF Suez Energy, IPOPEMA Research*

For 2014, GDF budgeted a 21% yoy decline in net profit on opex increasing at a higher pace than revenues. GDF expects lower gross gas margins (by 11pp yoy to 21%) on higher gas acquisition costs and lower volumes. Th e D&A costs are also seen higher yoy given commissioned investments (2013 capex was ca. RON 490mn, vs. RON 223mn planned for 2014) while maintenance cost increase expectations are due to the commissioning of Alizeu wind park. This coupled with the increase in personnel expenses as a result of salary adjustments and the introduction of a new cost item, the special construction tax (RON 37mn) is likely to put pressure on margins (EBITDA margin to decline by 3pp to 14.5%). The increases in distribution tariffs (by 15% in April) was coupled with reduction on the end prices by 3.8% on average for industrial clients and 5.7% for households.

The 2014 budget of **E.ON Gaz Distributie** is based on the assumption of improved gross margin in the gas distribution segment (the main activity), which in turn would result from a combination of higher tariffs by ca 30% starting April and lower distributed volumes

**Chart 22: E.ON GD breakdown of gas sales volumes by customers (left chart); gross margins (right chart)**

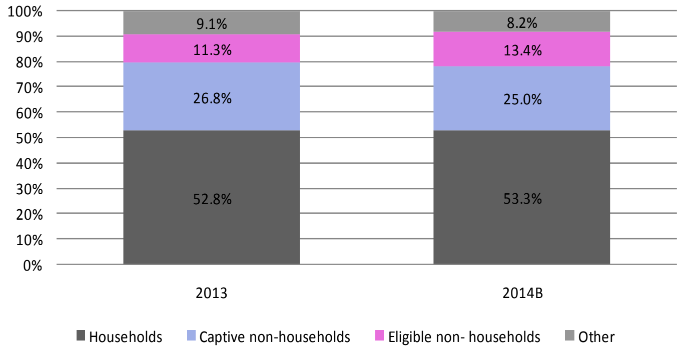
| GWh | 2013 | 2014B | yoy |
|---|---|---|---|
| Households | 13,099 | 12,505 | -4.5% |
| Capitive non-households | 6,644 | 5,878 | -11.5% |
| Eligible non- households | 2,797 | 3,155 | 12.8% |
| Other | 2,250 | 1,936 | -14.0% |
| **Total** | **24,790** | **23,474** | **-5.3%** |

| | 2013 | 2014B | yoy |
|---|---|---|---|
| Gross margin (RON mn) | 561 | 657 | 17.1% |
| Gross margin % | 86.6% | 87.8% | 1.3pp |

*Source: E.ON Gaz Distributie, IPOPEMA Research*

*Source: E.ON Gaz Distributie,, IPOPEMA Research*

**Chart 23: E.ON GD Capex breakdown (RON mn) (left chart); breakdown of gas sales volumes by customers (right chart)**


*Source: E.ON Gaz Distributie, IPOPEMA Research*

*Source: E.ON Gaz Distributie,, IPOPEMA Research*

# BUCHAREST AIRPORTS

## The largest airport operator

28 October 2014

**BUCHAREST AIRPORTS**
*NOT LISTED*

FP owns 20% stakes in each of Bucharest Airports (CNAB-Compania Nationala Aeroporturi Bucuresti), Traian Vuia Timisoara aiport and Mihail Kogalniceanu Constanta airport. CNAB was formed in 2010 by the merger of the international airports Henri Coanda (AIHCB) and Aurel Vlaicu (AIBB-AV). It is Romania's main aviation hub that accommodates over 70% of Romania's air traffic passengers, cargo and mail transportation. The 3 airports are valued in FP's June 2014 official NAV at RON 292mn (2% of NAV), while our cumulative fair value is RON 340mn. We calculated the fair values of FP stakes in the airports as weighted average fair values based P/Sales (30% weight), EV/EBITDA (50%) and EV/Pax (20%) (2014 Bloomberg estimates, median values of a peers selection) to which we applied discounts ranging from 30%-60% to account for differences in size, business models and unlisted status. As data for the smaller airports is scarce (and they have anyhow small weights in FP's NAV), we only provide a short profile for CNAB.

**Triggers:** The main growth triggers are: a) Romania's future accession to the Schengen area, b) increase in the passenger capacity following CNAB's significant capex that should led to the narrowing of the gap between Romania and EU-27 average in terms of pax/inhabitant; d) new direct routes to Asia and Latin America and new airlines to start using CNAB facilities; e) the potential 5%-15% IPO (possible in 2015 but with an unclear deadline).

**Risks:** a) Passenger traffic can significantly decline due to the recession and unemployment, as lower-cost transportation means can become a cost effective alternative b) CNAB is a state-owned company and there have been many changes in the Ministry of Transportation that led to no progress in the IPO and the board and CEO reshuffle in May (a new selection process to end on 30 Oct); c) the development of competing airports in the south of Bucharest and/or in Brasov/ Sibiu; d) weather conditions, especially during winter, that can cause disruptions of the airport traffic.

**Latest financials**: In 1H14 CNAB registered net sales of RON 294mn, up 10% yoy (44% of the FY budgeted figure) and a net profit of RON 53mn, up 93% yoy and 264% of the FY budgeted figure. In 1H14, the 2 airports were transited by 3.75mn passengers bringing the 12TM figure close to the FY targeted figure of 8mn (the 8M14 figure was 5.5mn, 7.5% up yoy).

**Outlook**: The 2014-2015 budgets look over conservative given that 12TM EBIT and net profit figures are significantly ahead of the budget, while CNAB was expecting the profitability to significantly deteriorate, mainly due to increasing costs for operating the new facilities and higher depreciation costs as a result of capex (over RON 250mn/year planned for 2014-2015).

**BUCHAREST AIRPORTS (CNAB) – Summary Financial Data**

| | 2011 | 2012 | 2013 | 1H14 | 12TM | 2013B | 2014B | 2015B |
|---|---|---|---|---|---|---|---|---|
| Revenues (RONm) | 474 | 556 | 583 | 305 | 633 | 644 | 668 | 694 |
| EBITDA (RONm) | 213 | 215 | 238 | 128 | 254 | 209 | 231 | 234 |
| EBIT (RONm) | 88 | 81 | 94 | 61 | 114 | 38 | 38 | 36 |
| Net profit (RONm) | 53 | 53 | 72 | 53 | 93 | 19 | 20 | 19 |
| EPS (RON) | 3.7 | 3.7 | 5.0 | 3.7 | 6.5 | 1.3 | 1.4 | 1.3 |
| DPS (RON) | 0.0 | 3.2 | 0.0 | n.a. | n.a. | 0.9 | 0.9 | 1.0 |
| EV/EBITDA (x)* | 8.3 | 8.7 | 7.6 | 6.6 | 6.7 | 8.6 | 7.8 | 7.2 |
| P/E (x)* | 30.4 | 30.1 | 22.2 | 15.2 | 17.1 | 83.9 | 80.2 | 83.5 |

*Source: CNAB, IPOPEMA Research*

| Key Ratios | 12TM | 2014B |
|---|---|---|
| EBITDA Margin | 41.8% | 36.3% |
| EBIT Margin | 18.8% | 5.9% |
| ROE | 15.4% | 3.1% |
| Bank debt/ Assets | n.a. | n.a. |

| Shareholders | Stake |
|---|---|
| Ministry of Transportation | 80.0% |
| Fondul Proprietatea | 20.0% |

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**Valuation multiples using IPOPEMA fair value*

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| P&L (RON m) | 2011 | 2012 | 2013 | 1H14 | 12TM | 2013B | 2014B | 2015B |
|---|---|---|---|---|---|---|---|---|
| **Revenues** | **501** | **581** | **610** | **305** | **633** | **644** | **668** | **694** |
| *- yoy change* | | *15.9%* | *5.0%* | *7.9%* | *3.7%* | *10.8%* | *3.8%* | *3.9%* |
| **Sales** | **474** | **556** | **583** | **294** | **608** | **615** | **635** | **660** |
| *- yoy change* | | *17.1%* | *4.9%* | *9.6%* | *4.4%* | *5.5%* | *3.2%* | *3.9%* |
| **EBIT** | **88.5** | **80.9** | **94.0** | **60.7** | **114.2** | **37.9** | **37.6** | **35.7** |
| *- yoy change* | | *-8.6%* | *16.2%* | *50.0%* | *21.6%* | *-59.7%* | *-0.9%* | *-5.0%* |
| Depreciation cost | -124.4 | -134.5 | -144.4 | -67.4 | -140.0 | -170.9 | -193.0 | -197.9 |
| **EBITDA** | **212.9** | **215.3** | **238.4** | **128.2** | **254.2** | **208.7** | **230.6** | **233.6** |
| *- yoy change* | | *1.2%* | *10.7%* | *14.1%* | *6.6%* | *-12.4%* | *10.5%* | *1.3%* |
| Financial Income / (Cost) | -20.8 | -12.9 | -9.6 | 2.7 | -3.9 | -15.2 | -13.8 | -12.5 |
| **Pretax Profit** | 67.7 | 67.9 | 84.3 | 63.5 | 110.3 | 22.7 | 23.7 | 23.2 |
| *- yoy change* | | *0.4%* | *24.2%* | *69.2%* | *30.8%* | *-73.1%* | *4.6%* | *-2.3%* |
| Income tax | -15.1 | -14.8 | -12.4 | -10.9 | -16.9 | -3.6 | -3.8 | -4.0 |
| **Net Income** | **52.6** | **53.1** | **72.0** | **52.6** | **93.4** | **19.1** | **19.9** | **19.1** |
| | | | | | | | | |
| **Profitability Ratios** | | | | | | | | |
| EBITDA Margin | 44.9% | 38.8% | 40.9% | 43.6% | 41.8% | 34.0% | 36.3% | 35.4% |
| EBIT Margin | 18.7% | 14.6% | 16.1% | 20.7% | 18.8% | 6.2% | 5.9% | 5.4% |
| Net Margin | 11.1% | 9.6% | 12.4% | 17.9% | 15.4% | 3.1% | 3.1% | 2.9% |
| ROE | 1.1% | 1.1% | 3.4% | 4.9% | 4.4% | n.a. | n.a. | n.a. |

| Balance Sheet (RON m) | 2010 | 2011 | 2012 | 2013 | 1H14 |
|---|---|---|---|---|---|
| **Total Fixed Assets** | **7,536** | **5,640** | **5,704** | **2,686** | **2,623** |
| Tangible Assets | 5,471 | 5,591 | 5,676 | 2,660 | 2,597 |
| Other Fixed Assets | 2,065 | 49 | 28 | 26 | 26 |
| **Total Current Assets** | **168** | **103** | **134** | **161** | **223** |
| Cash and Equivalents | 62 | 23 | 47 | 82 | 138 |
| Other Current Assets | 106 | 80 | 87 | 80 | 84 |
| **Total Assets** | **7,704** | **5,743** | **5,838** | **2,847** | **2,846** |
| **Stockholders` Equity** | **4,973** | **4,976** | **4,979** | **2,091** | **2,144** |
| **Long Term Liabilities** | **2,539** | **667** | **735** | **636** | **604** |
| Long -Term Debt | 0 | 185 | 281 | 244 | 228 |
| Other Long - Term liabilities | 2,539 | 481 | 454 | 392 | 376 |
| **Short Term Liabilities** | **192** | **100** | **124** | **120** | **98** |
| Short -Term Debt | 0 | 0 | 40 | 41 | 4 |
| Other Short Term Liabilities | 192 | 100 | 84 | 79 | 94 |
| **Total Equity & Liabilities** | **7,704** | **5,743** | **5,838** | **2,847** | **2,846** |

| Balance Sheet Ratios | 2010 | 2011 | 2012 | 2013 | 1H14 |
|---|---|---|---|---|---|
| Current Ratio | 0.87 | 1.03 | 1.08 | 1.35 | 2.27 |
| Quick Ratio | 0.81 | 0.90 | 0.97 | 1.24 | 2.16 |
| Bank Debt/Assets | 0.0% | 3.2% | 5.5% | 10.0% | 8.1% |
| **Bank Debt/Equity** | **0.0%** | **3.7%** | **6.4%** | **13.6%** | **10.8%** |

| Cash Flow (RON mn) | 2011 | 2012 | 2013 |
|---|---|---|---|
| Net Profit | 53 | 53 | 72 |
| Depreciation and Amortisation | 124 | 134 | 144 |
| Other (incl. WC change) | -66 | -24 | 3 |
| **Operating Cash Flows** | **111** | **163** | **219** |
| Capital Expenditures (Net) | 119 | 85 | -3,016 |
| Other | -2,016 | -21 | -2 |
| **Cash Flows from Investing Activities** | **-1,897** | **64** | **-3,018** |
| Change in Debt | 185 | 136 | -37 |
| Issuance of Shares | 0 | 0 | 0 |
| Other | 2,769 | -2,382 | -316 |
| **Cash Flows from Financing Activities** | **2,955** | **-2,247** | **-352** |
| Beginning Cash | 62 | 23 | 47 |
| Increase/(Decrease) in Cash | 39 | -23 | -35 |
| **Ending cash** | **23** | **47** | **82** |

*Source: CNAB, IPOPEMA Research*

## Romanian Airports Valuation

FP's holdings in the companies from the infrastructure sector account for 2.6% of FP's June 2014 official NAV (2.97% of our fair NAV). FP has holdings in three airports (Bucharest, Timisoara and Constanta), with 20% stakes in each and in several port companies. The stakes in the airports only (for which we perform separate valuations) amount to a cumulative RON 292mn (1H14 official value) or RON 340mn (our fair value).

Our fair values for FP's holdings in the three airports are based on a combination of financial multiples (EV/EBITDA, P/sales) and EV/passenger multiples (medians of the 2014 multiples of a selection of European peers, using data from Bloomberg). We use a weighted average of fair values based on P/sales (30% weight), EV/EBITDA (50%) and EV/passenger (20%). We have not used the P/E multiple as reference (as it would have yielded meaningless valuations in case of Timisoara and Constanta airports, with 2013 net losses and for which no financials for 1H14 nor 2014 budget was available). The valuation based on the EV/passenger multiple is the highest for all airports (vs. the one obtained using the financial multiples and vs. official valuations). However, as all Romanian airports have very low traffic data vs. peers, when calculating the airports' fair values, we applied hefty discounts to peers and assigned a low weight to this valuation method, thus we view our fair values as conservative.

**Table 57: Peers' median reference multiples used in the fair valuation of airports**

| | | | | | Weights in valuation (%) | | |
|---|---|---|---|---|---|---|---|
| | P/Sales (x) | EV/EBITDA (x) | EV/pax (EUR) | Discount (%) | P/Sales | EV/EBITDA | EV/pax |
| Bucharest airports | 2.4 | 9.9 | 99.3 | 30 | 30 | 50 | 20 |
| Timisoara airport | | | | 60 | 30 | 50 | 20 |
| Constanta airport | | | | 50 | 30 | 50 | 20 |

*Source: Company data, Bloomberg, IPOPEMA Research*

**Different discounts applied:** As the location of the airports has been a key factor in determining the traffic volumes, which in turn is a main differentiator of profitability and outlook, we applied different discounts for the three airports ranging from 30% for Bucharest Airport (CNAB), the largest and most profitable among the three, 50% for Constanta airport (the smallest) and 60% for Timisoara airport (with the highest loss). The 20% yoy decline in the number of passengers in 1H14 at Timisoara airport, Romania's 3rd largest airport was mainly a result of the entering in insolvency at the beginning of this year of its main client Carpatair (and occurred after yoy slumps in traffic also in 2012 and 213 of 14% and 28% respectively). At Constanta airport, after a 10.6% yoy increase in the passenger numbers in 2012, there was a 14% yoy decline in 2013.

The discount differential between Bucharest airport on one hand and the other two is also due to the scarcity of the financial data (for Constanta, no 2013 financials are available while for Timisoara only the sales, net profit and equity figures). Thus, while we used for CNAB 1H14 12TM data (P&L and traffic) and 1H14 net debt and 2015 budgeted numbers (over conservative in our view), for the other 2 airports we used 2013 budgeted data.

**Table 58: Key financial data of the Romanian airports**

| EUR mn | Sales | EBITDA | EBIT | Net profit | Net debt | Book | Pax mn |
|---|---|---|---|---|---|---|---|
| Bucharest airports | 136,6 | 57,1 | 25,6 | 21,0 | 21,0 | 481,4 | 7,9 |
| Timisoara airport | 6,3 | 2,0 | 0,2 | -4,9 | 1,0 | 7,8 | 0,8 |
| Constanta airport | 4,5 | 0,6 | 0,0 | 0,0 | -0,2 | 5,3 | 0,1 |

*Source: Company data, IPOPEMA Research*

Romania is not yet a Schengen member, thus the transit business is limited for all Romanian airports and the number of passengers is very low compared to the population of the respective cities (or differently said, Romania's indicator of number of passengers per 1,000 inhabitants is way below the EU average). All the above represent in our view reasons to apply relatively hefty discounts to peers. On the other hand, we outline that the comparison with peers has its limitations as peers are much larger and complex (in terms of revenue breakdown by key activities) and also have a liquidity advantage from being listed.

**Table 59: Fair values for airports**

| | Fair value of equity based on | | | | | Fair value of PF stake based on | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| RON m | P/sales | EV/EBITDA | EV/pax | average | FP stake (%) | P/sales | EV/EBIT | EV/pax | Average | Official values | Book | P/BV (x) |
| Bucharest airports | 1,009 | 1,659 | 2,332 | 1,598 | 20.0 | 201.8 | 331.7 | 466.3 | 319.7 | 287.7 | 428.8 | 0.75 |
| Timisoara airport | 27 | 30 | 325 | 88 | 20.0 | 5.3 | 6.0 | 65.0 | 17.6 | 1.7 | 1.7 | 10.63 |
| Constanta airport | 24 | 14 | 19 | 11 | **20.0** | 4.7 | **2.9** | **3.7** | **2.2** | **2.3** | **4.7** | 0.47 |
| **Total airports** | | | | | | | | | **339.5** | **291.6** | | |

*Source: Company data, Bloomberg, IPOPEMA Research*

9IPOPEMA fair value is lower than the official valuation in FP's NAV in the case of Constanta airport, marginally higher at CNAB and by ca. RON 16mn higher at Timisoara airport. Except for the latter, the implied P/BVs are below 1x (0.47x at Constanta airport and 0.75x at CNAB). In Dec 2013, FP revised up CNAB's official valuation from RON 272mn to RON 288mn, but both figures are way below CNAB's book (the fair valuation performed by FP's valuators considered overstated the value of some pieces of land owned by Baneasa airport (the city airport that merged with the larger international airport)). There could be some upside risk to CNAB's valuation in case some of this land is sold when the real estate market recovers and/or certain projects (real estate or air traffic related) would be developed in the near future. Thus we consider our CNAB's valuation reasonably conservative.

**CNAB vs. peers median multiples**: As visible from the table below, the fair value of CNAB as determined by us implies a stock cheap compared to the peers medians in EV/EBITDA and EV/Pax (less so in P/Sales terms). We consider CNAB 2015 multiples based on budgeted data as less relevant (too conservative).

**Table 60: Romanian airports vs. peers (multiples)**

| | | | P/E (x) | | | P/Sales (x) | | | EV/EBITDA (x) | | | EV/Pax | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Price | Mcap (EUR m) | 2013 | 2014E | 2015E | 2013 | 2014E | 2015E | 2013 | 2014E | 2015E | 2013 | 2014E |
| TAV Havalimanlari | 5.8 | 2,111 | 13.1 | 11.9 | 9.9 | 2.1 | 2.1 | 1.9 | 13.8 | 7.4 | 6.4 | 36.8 | 33.6 |
| **Western Europe** | | | | | | | | | | | | | |
| Aeroports de Paris | 86.4 | 8,551 | 23.3 | 21.9 | 19.1 | 3.1 | 3.0 | 2.9 | 9.4 | 10.1 | 9.3 | 112.3 | 124.2 |
| Fraport AG Frankfurt | 47.6 | 4,399 | 19.7 | 18.1 | 15.4 | 1.7 | 1.8 | 1.7 | 9.0 | 9.7 | 9.0 | 77.5 | 108.6 |
| Flughafen Zuerich | 472.1 | 2,899 | 15.9 | 18.0 | 16.9 | 3.6 | 3.7 | 3.6 | 7.2 | 8.5 | 8.0 | 124.6 | 139.6 |
| Flughafen Wien (AU) | 70.0 | 1,470 | 14.0 | 17.0 | 15.2 | 2.4 | 2.3 | 2.2 | n.a. | 7.9 | 7.2 | n.a. | 96.3 |
| Save Group (IT) | 12.8 | 708 | 20.6 | 24.2 | 21.9 | 4.0 | 4.7 | 4.4 | 12.2 | 14.4 | 13.5 | 63.3 | 82.8 |
| Aeroporto Toscano | 11.7 | 115 | 32.6 | 31.6 | 26.6 | 1.7 | 1.6 | 1.5 | 8.0 | n.a. | n.a. | 19.1 | n.a. |
| **Median all** | | | **19.7** | **18.1** | **16.9** | **2.4** | **2.3** | **2.2** | **9.2** | **9.7** | **9.0** | **70.4** | **96.3** |
| **Bucharest airports** | | | **22.2** | **17.1** | **83.5** | **2.9** | **2.8** | **2.6** | **7.1** | **6.7** | **7.2** | **48.8** | **47.2** |
| Timisoara airport | | | -4.0 | n.a. | n.a. | 3.1 | n.a. | n.a. | 9.7 | na. | na. | 25.5 | n.a. |
| Constanta airport | | | -52.2 | n.a. | n.a. | 0.5 | n.a. | n.a. | 5.4 | na. | na. | 41.7 | n.a. |

*Source: Company data, Bloomberg, IPOPEMA Research*

**Profit margins are usually lower than of peers:** As visible from the table below, CNAB's EBITDA margins in 2013-2014E are higher than the peers' median values, while for 2015, the margin is lower. However, we should stress that CNAB's 2014-2015 budget figures (for both EBIT and net profit) are quite linear (no growth expected, despite some growth in sales) and 12TM based on 1H14 EBIT and net profit are significantly ahead the budgeted figures. EBITDA margins of the other two airports are way below peers' medians (for Constanta airport, negative). The net profit margins are negative for the two smaller airports and fairly in line (marginally below) than the peers' medians for CNAB (2013-2014E).

**Table 61: Romanian airports vs. peers (margins and traffic data)**

| | EBITDA margin (%) | | | Net margin (%) | | | No. of passengers (m) | |
|---|---|---|---|---|---|---|---|---|
| | 2013 | 2014E | 2015E | 2013 | 2014E | 2015 | 2013 | 2014E |
| TAV Havalimanlari | 24.3 | 41.8 | 41.0 | 13.1 | 17.8 | 19.0 | 83.6 | 92.3 |
| **Western Europe** | | | | | | | | |
| Aeroports de Paris | 39.0 | 39.6 | 40.2 | 11.1 | 13.7 | 15.0 | 90.3 | 92.0 |
| Fraport AG Frankfurt | 34.7 | 32.0 | 32.8 | 8.9 | 9.8 | 11.1 | 103.5 | 5.9 |
| Flughafen Zuerich | 53.7 | 53.1 | 53.3 | 18.5 | 20.6 | 21.3 | 24.8 | 25.3 |
| Flughafen Wien (AU) | 38.8 | 39.6 | 40.0 | 11.8 | 13.5 | 14.6 | 22.0 | 10.5 |
| Save Group (IT) | 37.6 | 40.8 | 42.4 | 17.7 | 19.6 | 20.1 | 10.6 | 4.9 |
| Aeroporto Toscano | 19.2 | n.a. | n.a. | 4.3 | 5.1 | 5.8 | 4.5 | 0.0 |
| **Median all** | **37.6** | **40.2** | **40.6** | **12.5** | **15.7** | **15.0** | | |
| **Bucharest airports** | **40.9** | **41.8** | **35.4** | **12.4** | **15.4** | **2.9** | **7.6** | **7.9** |
| Timisoara airport | 3.0 | n.a. | n.a. | -77.3 | n.a. | n.a. | 0.8 | n.a. |
| Constanta airport | -0.2 | n.a. | n.a. | -1.0 | n.a. | n.a. | 0.1 | n.a. |

*Source: Company data, Bloomberg, IPOPEMA Research*

## Business overview Bucharest Airports (CNAB)

CNAB was formed in 2010 by the merger of the international airports Henri Coanda (AIHCB) and Aurel Vlaicu (AIBB-AV). It is Romania's main aviation hub that accommodates over 70% of Romania's air traffic of passengers, cargo and mail transportation. CNAB has 49 years concession agreements signed in 2001 (for AIHCB) and 2002 (for AIBB-AV) for the platforms, taxiways and the takeoff and landing runways, as well as for the 1.5mn square meters of land beneath them.

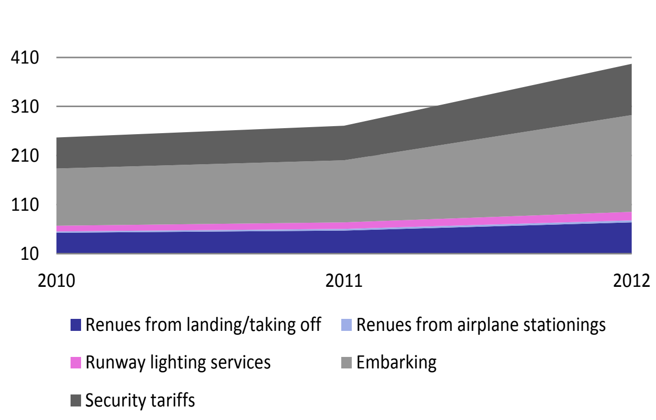
**AIHCB** (20 km from Bucharest) has two runways with a length of 3,500m and a width of 45m, parking lots with a capacity of 1,300 spots, two arrivals - departures terminals served by a Finger and 5 bottles for passengers processing. AIHCB is the largest Romanian airport, serving 67 external destinations and 9 domestic destinations. 37 airlines are currently operating here. Two new airlines started operating in 2013: easyJet and Air Serbia, while, starting with 2014, two more were added Ryanair and Air Baltic.

**AIBB-AV** (8.5 km from Bucharest) has one runway with a length of 3,500 m and a width of 45m, parking lots with a capacity of 250 spots and one arrivals - departures terminal. Opened in 1920, AIBB-AV airport was declared, in 2011, a monument of national importance, undergoing a process of rehabilitation and upgrading to the concept of City Airport, with a capacity of 30,000pax/year, at the highest comfort level according to IATA (International Air Transport Association) standards. The airport should provide services for business and general aviation traffic, for both Schengen and non-Schengen destinations. Pre-feasibility and feasibility studies are to be drafted in order to determine future development plans. Currently, AIBB-AV only operates flights for technical purposes, private or aviation school flights. The airport also hosts rescue, as well as ambulance and SMURD (Mobile Emergency Service for Resuscitation and Extrication) flights. All operations by low cost carriers from AIBB-AV were relocated to AHCB, generating a passenger increase of over 40% yoy in 2012 from 5 to 7mn (similar to the 2007 yoy increase (by 1.5mn) generated by Romania's entry into the EU in 2007).

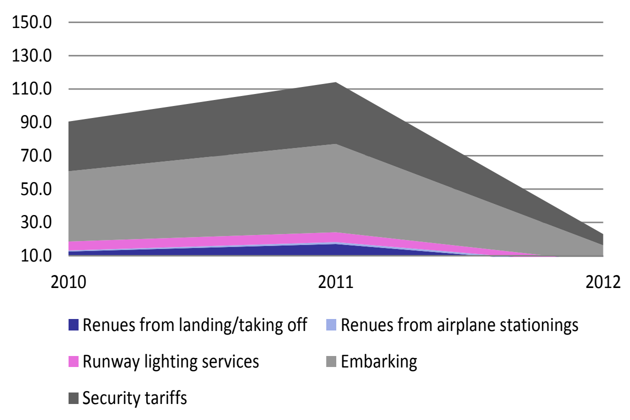
According to Ziarul Financiar daily quoting data from the General Transportation Master Plan of Romania 13 out of Romania's 16 airports would be modernized by 2020 based on a ca. EUR 600mn capex in order to allow for the expected doublings of the passengers' traffic from 10mn in 2012. The commissioning a new passengers terminal at AIHCB would require the largest capex of EUR 247mn. The project also aims for the extension of runaways, the rehabilitation of the existing parking space for aircrafts and the construction of 56 new places, new connections with the railways and metro systems as possibly a new cargo terminal. The prefeasibility study for AIBB-AV's conversion into a city airport is being prepared for more than 3 years now (this airport is not included in the Master Plan).

EUR 78mn are earmarked for the extension of the passengers' terminal by 2,900 sqm possibly of a new terminal cargo at Timisoara Airport. For Constanta, ca. EUR 5mn are to be spent for the revamping of the existing terminal.

**Chart 24: Revenues by activities: AIHCB (left chart); AIBB-AV (right chart) (RON mn)**

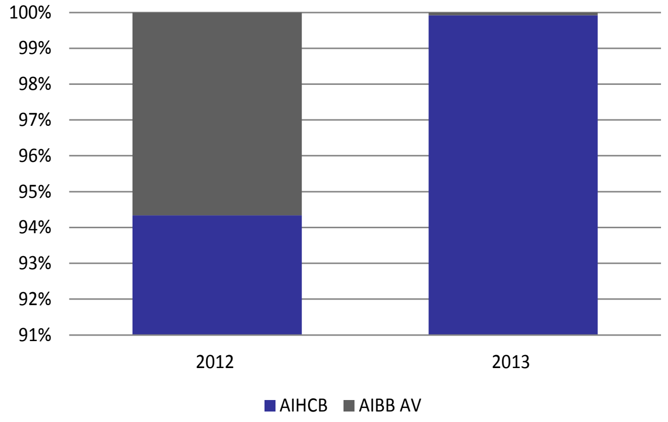


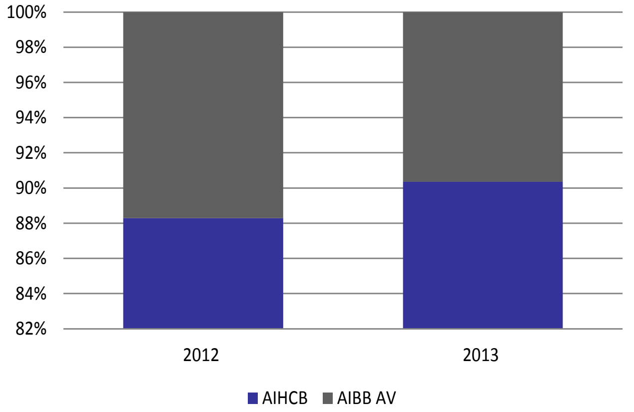

*Source: Company data, IPOPEMA Research*




*Source: Company data, IPOPEMA Research*

**Chart 25: Breakdown by airports: Passengers (left chart); Aircraft movements (right chart) % in total**

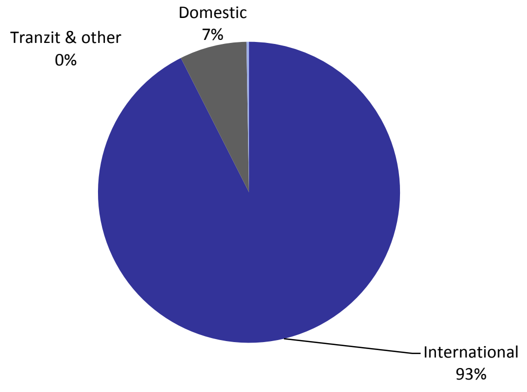


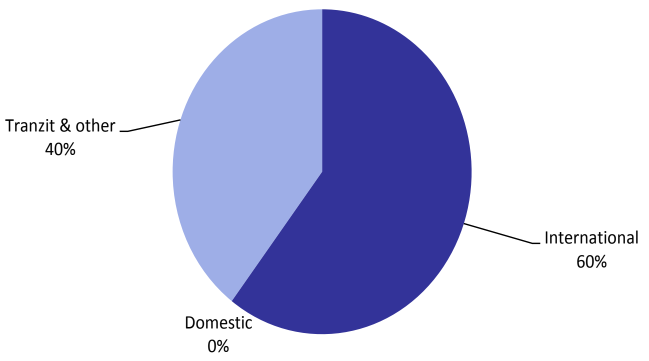




***Source: Company data, IPOPEMA Research***

***Source: Company data, IPOPEMA Research***

**Chart 26: Breakdown of passengers by type of traffic: AIHCB (left chart); AIBB-AV (right chart)**

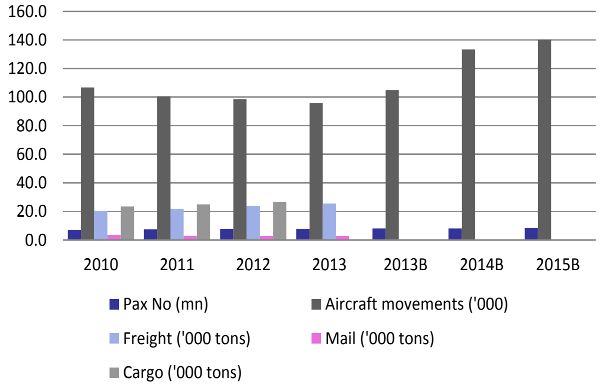


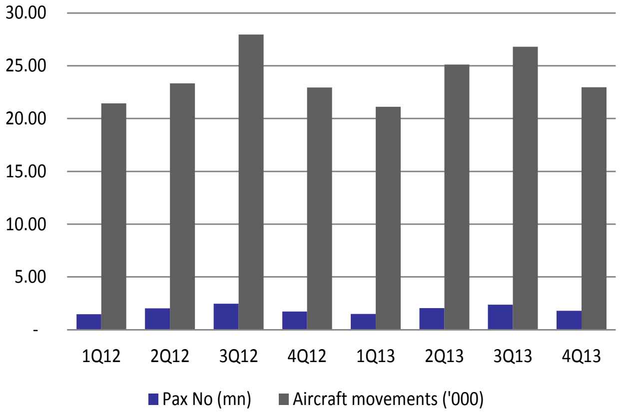




***Source: Company data, IPOPEMA Research***

***Source: Company data, IPOPEMA Research***

**Chart 27: Traffic data by activities- annual (left chart); quarterly (right chart)**




***Source: Company data, IPOPEMA Research***

***Source: Company data, IPOPEMA Research***

## Key financials of airport companies from FP's portfolio

| | Bucharest Airports | | | | | | | Constanta Airport | | | | Timisoara Airport | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **P&L (RON m)** | **2010** | **2011** | **2012** | **2013B** | **2013** | **1H14** | **12TM** | **2010** | **2011** | **2012** | **2013B** | **2010** | **2011** | **2012** | **2013B** | **2013** |
| **Revenues** | **431** | **501** | **581** | **610** | **610** | **305** | **633** | **16** | **17** | **17** | **20** | **45** | **47** | **48** | **44** | **28** |
| *-yoy change* | | *16%* | *16%* | *5%* | *5%* | *8%* | *4%* | | *7%* | *-1%* | *16%* | | *3%* | *4%* | *-9%* | |
| **Sales** | **397** | **474** | **556** | **583** | **583** | **294** | **608** | **14** | **15** | **15** | **20** | **43** | **43** | **44** | **44** | **28** |
| *-yoy change* | | *20%* | *17%* | *5%* | *5%* | *10%* | *4%* | | *10%* | *0%* | *31%* | | *1%* | *3%* | *0%* | |
| **EBIT** | **54** | **88** | **81** | **94** | **94** | **61** | **114** | **0** | **0** | **-1** | **0** | **16** | **11** | **6** | **1** | |
| *-yoy change* | | *63%* | *-9%* | *16%* | *16%* | *50%* | *22%* | | *n.m.* | *n.m.* | *n.m.* | | *-30%* | *-46%* | *-86%* | |
| Depreciation cost | -111 | -124 | -134 | -144 | -144 | -67 | -140 | -3 | -3 | -3 | -3 | -7 | -9 | -8 | -8 | |
| **EBITDA** | **165** | **213** | **215** | **238** | **238** | **128** | **254** | **3** | **3** | **2** | **3** | **23** | **20** | **14** | **9** | |
| *-yoy change* | | *29%* | *1%* | *11%* | *11%* | *14%* | *7%* | | *0%* | *-30%* | *n.m.* | | *-12%* | *-31%* | *-37%* | |
| Financial Income/(Cost) | 4 | -21 | -13 | -10 | -10 | 3 | -4 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | |
| **Pretax Profit** | **59** | **68** | **68** | **84** | **84** | **63** | **110** | **0** | **0** | **0** | **0** | **15** | **11** | **6** | **1** | |
| Income Tax | -16 | -15 | -15 | -12 | -12 | -11 | -17 | 0 | 0 | -1 | 0 | -3 | -2 | -2 | 0 | |
| **Net Income** | **43** | **53** | **53** | **72** | **72** | **53** | **93** | **0** | **0** | **0** | **0** | **13** | **9** | **4** | **1** | **-22** |

*Source: Company data, IPOPEMA Research*

| | Bucharest Airports | | | | | | | Constanta Airport | | | | Timisoara Airport | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **2010** | **2011** | **2012** | **2013B** | **2013** | **1H14** | **12TM** | **2010** | **2011** | **2012** | **2013B** | **2010** | **2011** | **2012** | **2013B** | **2013** |
| **Profitability Ratios** | | | | | | | | | | | | | | | | |
| EBITDA Margin | 41.5% | 44.9% | 38.8% | 40.9% | 40.9% | 43.6% | 41.8% | 19.6% | 17.7% | 12.3% | 14.0% | 53.4% | 46.5% | 31.3% | 19.8% | n.a. |
| EBIT Margin | 13.7% | 18.7% | 14.6% | 16.1% | 16.1% | 20.7% | 18.8% | 0.4% | 0.0% | -8.8% | -0.2% | 36.9% | 25.6% | 13.3% | 1.9% | n.a. |
| Net Margin | 10.7% | 11.1% | 9.6% | 12.4% | 12.4% | 17.9% | 15.4% | -0.3% | -0.8% | -0.4% | -1.0% | 29.4% | 20.4% | 9.5% | 1.3% | -77.3% |
| ROE | 0.9% | 1.1% | 1.1% | 3.4% | 3.4% | 4.9% | 4.4% | -0.3% | -0.5% | -0.3% | n.a. | 32.0% | 21.7% | 12.2% | n.a. | n.m. |

*Source: Company data, IPOPEMA Research*

| | Bucharest Airports | | | | | Constanta Airport | | | Timisoara Airport | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance sheet (RON** | **2010** | **2011** | **2012** | **2013** | **1H14** | **2010** | **2011** | **2012** | **2010** | **2011** | **2012** | **2013** |
| **Total Fixed Assets** | **7,536** | **5,640** | **5,704** | **2,686** | **2,623** | **107.8** | **118.7** | **38.1** | **94.0** | **61.9** | **54.2** | |
| Tangible Assets | 5,471 | 5,591 | 5,676 | 2,660 | 2,597 | 28.0 | 39.1 | 38.1 | 94.0 | 61.9 | 54.1 | |
| Other Fixed assets | 2,065 | 49 | 28 | 26 | 26 | 79.8 | 79.6 | 0.0 | 0.0 | 0.0 | 0.1 | |
| **Total Current Assets** | **168** | **103** | **134** | **161** | **223** | **2.6** | **3.0** | **3.1** | **31.0** | **34.3** | **32.0** | |
| Cash and Equivalents | 62 | 23 | 47 | 82 | 138 | 0.8 | 1.1 | 0.8 | 6.6 | 6.9 | 2.2 | 1.2 |
| Other Current Assets | 106 | 80 | 87 | 80 | 84 | 1.8 | 1.9 | 2.3 | 24.4 | 27.4 | 29.8 | |
| **Total Assets** | **7,704** | **5,743** | **5,838** | **2,847** | **2,846** | **110.4** | **121.7** | **41.2** | **125.0** | **96.2** | **86.2** | |
| **Shareholders' Equity** | **4,973** | **4,976** | **4,979** | **2,091** | **2,144** | **12.5** | **24.8** | **23.5** | **39.1** | **40.2** | **34.4** | 8.3 |
| **Long Term Liabilities** | **2,539** | **667** | **735** | **636** | **604** | **96.6** | **94.8** | **15.6** | **61.9** | **32.9** | **25.1** | |
| Long-Term Debt | 0 | 185 | 281 | 244 | 228 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Other Long-Term | 2,539 | 481 | 454 | 392 | 376 | 96.6 | 94.8 | 15.6 | 61.9 | 32.9 | 25.1 | |
| **Short-Term Liabilities** | **192** | **100** | **124** | **120** | **98** | **1.3** | **2.1** | **2.0** | **24.1** | **23.0** | **26.7** | |
| Short-Term Debt | 0 | 0 | 40 | 41 | 4 | 0.0 | 0.0 | 0.0 | 5.1 | 6.0 | 6.5 | |
| Other Short Term | 192 | 100 | 84 | 79 | 94 | 1.3 | 2.1 | 2.0 | 19.0 | 17.0 | 20.2 | |
| **Total Equity and** | **7,704** | **5,743** | **5,838** | **2,847** | **2,846** | **110.4** | **121.7** | **41.2** | **125.0** | **96.2** | **86.2** | |

*Source: Company data, IPOPEMA Research*

| | Bucharest Airports | | | | | Constanta Airport | | | Timisoara Airport | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance Sheet Ratios** | **2010** | **2011** | **2012** | **2013** | **1H14** | **2010** | **2011** | **2012** | **2010** | **2011** | **2012** | **2013** |
| Current Ratio | 0.9 | 1.0 | 1.1 | 1.3 | 2.3 | 2.0 | 1.4 | 1.6 | 1.3 | 1.5 | 1.2 | n.a. |
| Quick Ratio | 0.8 | 0.9 | 1.0 | 1.2 | 2.2 | 1.8 | 1.3 | 1.4 | 1.3 | 1.5 | 1.2 | n.a. |
| Bank Debt/Assets | 0.0% | 3.2% | 5.5% | 10.0% | 8.1% | 0.0% | 0.0% | 0.0% | 4.1% | 6.2% | 7.5% | n.a. |
| **Bank Debt/Equity** | **0.0%** | **3.7%** | **6.4%** | **13.6%** | **10.8%** | **0.0%** | **0.0%** | **0.0%** | **13.1%** | **14.9%** | **18.8%** | n.a. |

*Source: Company data, IPOPEMA Research*

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The date stated on the front page is the date of the publication of this document. The price used throughout the recommendation to calculate adequate ratios is the "last" price stated on the front page of this report.

The definitions of terms used in the recommendation include:

NII – Net interest income – interest income minus interest expense
Net F&C – Net fee and commission income – fee and commission income minus fee and commission expense
LLP – loan loss provisions – an expense set aside as an allowance for bad loans
NPL – non-performing loan – loans that are in default or close to be in default
Cost/Income – operating expenses divided by total banking revenue
ROE – return on equity – net income (or adjusted net income) divided by the average shareholders' equity
ROA – return on assets – net income (or adjusted net income) divided by the average assets
EBIT – interests before earnings and tax
EBITDA – interest before earnings, tax, depreciation and amortization
EPS – earnings per share – the net income (or adjusted net income divided by the number of shares outstanding
P/E – price to earnings ratio – price divided by earnings per share
PEG – P/E ratio divided by the annual EPS growth, usually over a certain period of time
CAGR –compound annual growth rate
BVPS – book value per share, the book value of the Company's equity divided by the number of shares outstanding
P/BV – price to book value - price divided by the BVPS
DPS – dividend per share – dividend of a given year divided by the number of shares outstanding
DY – dividend yield – dividend of a given year divided by the current price
DDM – dividend discount model – a fundamental method of valuation based on the assumption that the value of stock equals the sum of all discounted future dividends
TP – target price, calculated based on valuation methods outlined in the document

Our recommendations are:

Buy – expected 12 moths total return of 15% or more.
Hold – expected 12 months total return of 5%-15%.
Sell – expected 12 months total return of below 5%.
There are three risk ratings: High Risk, Medium Risk and Low Risk that take into account fundamental factors as well as liquidity and volatility of the stock. Please note that the risk rating may impact the level of total return that is required for specified recommendation.

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Rating History - Company Name

| Date | Recommendation | Target Price | Last Price (RON) |
|---|---|---|---|
| FONDUL PROPRIETATEA | | | |
| 28.10.2014 | BUY | 1.14 | 0.94 |

IPOPEMA Research - Distribution by rating category (Jul 1 - Sep 30, 2014)

| | Number | % |
|---|---|---|
| Buy | 19 | 36% |
| Hold | 14 | 26% |
| Sell | 20 | 38% |
| Total | 53 | 100% |