Renaissance Capital

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Fondul Proprietatea
A great value play on Romania: **BUY**

- **Initiating coverage of Romania: Fondul Proprietatea, BUY, target price RON0.92.** In line with our ever-expanding frontiers footprint, we initiate coverage of one of Romania's benchmark and most liquid stocks.
- **What is Fondul Proprietatea?** FP is the largest listed closed-ended fund globally and is a top-three listed firm on the Romanian stock exchange (after Petrom/Romgaz) with a market cap of $3.4bn. The Romanian state seeded the fund with stakes in state-owned and formerly state-owned companies. Despite having 58 holdings today, the top-three holdings make up close to 65% of the NAV (with all others holding less than 4% apiece) – two of which are listed, which aids valuation and transparency. The portfolio is heavily skewed to the energy sector. We believe FP stands out, due to the following:
  1) A strong activist shareholder base, including Elliot Associates, Morgan Stanley and City of London Investment Management.
  2) Franklin Templeton (FTIM) managing the fund, whose activist approach has, in our view, transformed the value of the portfolio's underlying assets.
  3) A proven track record of returning cash to shareholders through a solid dividend policy (close to 6.5%).
  4) A stock that is a valuation play, has catalysts aplenty and a track record of delivering value for minorities (see share price chart).
- **Catalysts abound:** The key issue with many listed holding companies is waiting on inherent value to be realised. We are cognisant that cheap assets can remain cheap without a catalyst; but for FP we see a number of clear catalysts:
  1) A strong IPO pipeline of key assets – Hidroelectrica planned for 1H15.
  2) The disposal of listed/unlisted holdings – Romgaz/Petrom in focus.
  3) A dual listing in London – targeted by YE14.
  4) A strong and regular share buyback programme.
  5) A reforming energy market in Romania.
- **Valuation.** We value FP based on a SoTP methodology. Focusing on key assets, which make up the majority of NAV, we derive a fair valuation for FP, as any swing in these firms would impact the NAV significantly. For the remainder of the portfolio, we mark to market for the listed assets, with a 10-25% discount based on the free float and liquidity of the stock; and for the unlisted assets, we take FP's audited valuation and place a 40% illiquidity discount. We derive a 'fair' NAV of RON1.12/share through this methodology (FP audited NAV currently at RON1.18), to which we apply a listed holding company discount of 18% (average of EMEA listed holding companies), which translates into our target price of RON0.92 per share. At current market price, Fondul trades at a 32%/36% discount to our/company audited NAV.
- **Risks:** The key risks to the fund are predominantly macro and political, which could affect the realisation of value in the funds component parts. However, with FTIM at the helm, and given the track record of disposals to date, we have a lot more comfort than if we were at FP's inception.

Report date:	**7 May 2014**
Rating	BUY
Target price comm	RON0.92
Current price comm	RON0.76
MktCap, $bn	3.4
Average daily volume, $mn	4.5
Free float	100%
Reuters/Bloomberg	FPEUR.DEp/FP RO

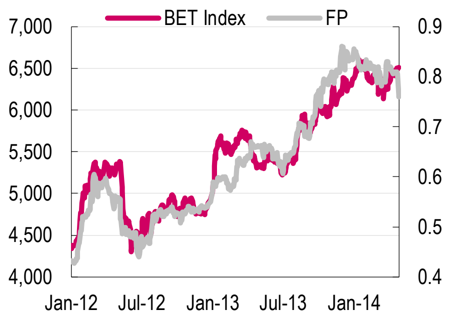
Pricing data in this report are as of 2 May 2014.

Valuation summary, FP vs RenCap estimates

	RenCap	FP
NAV, RONmn	13,512.67	14,250.00
NAV/share, RON	1.12	1.18
Listed % of portfolio	58%	53%
Unlisted % of portfolio	39%	44%
Cash % of portfolio	3%	3%

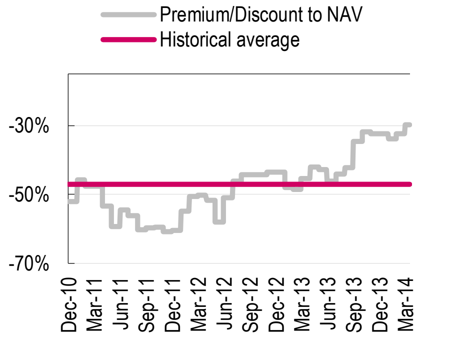
Source: Company data, Renaissance Capital estimates,

Price performance – BET (LHS) vs FP (RHS; RON)



Source: Bloomberg

FP – historical premium/discount to NAV



Source: Bloomberg

Content

History and background

The largest closed-ended, listed fund globally

FP is the largest closed-ended listed fund globally. Fondul Proprietatea (which means *property fund* in Romanian) is technically a 'restitution fund', created in 2005 as a means to compensate Romanian citizens who had been relieved of their property during the communist era. The Romanian state seeded the fund with stakes in state-owned and formerly state-owned companies, and distributed the shares to citizens. However, over time the state's stake in the fund has decreased substantially. There are other SIFs in Romania, but we believe FP is the only one managed with a focus on creating shareholder value through an activist approach. A number of other SIFs have investment restrictions on foreigners, which is not the case for FP.

FTIM won an international tender to act as investment manager for the fund

In 2009, The Romanian state put out an international tender for firms to compete to run FP. FTIM, won the international tender and was appointed sole director, sole administrator and investment manager in September 2010. The fund is run by Grzegorz Konieczny from Bucharest, with an investment team comprising six individuals. Dr. Mark Mobius, CIO of Franklin Templeton, also overlooks the fund and sits on the boards of numerous underlying assets within the portfolio.

The fund has $4.56bn in AuM and is the second-largest listed firm listed on the Romanian stock exchange, with a market cap of $3.45bn. The stock trades approximately $4mn daily.

Portfolio and fund objectives

The main goals of the fund are to: 1) continue to engage with portfolio companies and create value by introducing proper corporate governance, increasing efficiency and improving transparency; 2) dispose of assets; 3) work with the government for the privatisation of state-owned companies; and 4) return cash to shareholders.

FP will become a diversified play on the Romanian stock market

The fund's investment guidelines, which apply to new investments rather than the legacy portfolio, stipulate that it must have a minimum of 70% in Romanian listed shares, a maximum of 20% in unlisted shares, and no more than 10% in any one issuer; however, this does not apply to legacy holdings. FTIM has gone further, stating that its long-term objective is to increase the fund's exposure to listed Romania-linked companies to 100%. Thus, the fund should logically evolve into a diversified proxy on listed Romanian equities.

FTIM has been reappointed, with the key goal of narrow FP's discount to NAV

Furthermore, the goal of FTIM is to narrow FP's discount to NAV. FP has traded at a deep discount to NAV since inception, due to the substantial unlisted portion of the portfolio. Also, due to significant government involvement in the underlying assets, we believe investors may be sceptical about security for minority shareholders. Accordingly, this has become a key focus for FTIM since 2013, and shareholders have approved it as one of the criteria for the reappointment of FTIM to continue running FP. Clearly, long-term capital appreciation is the main focus of the fund.

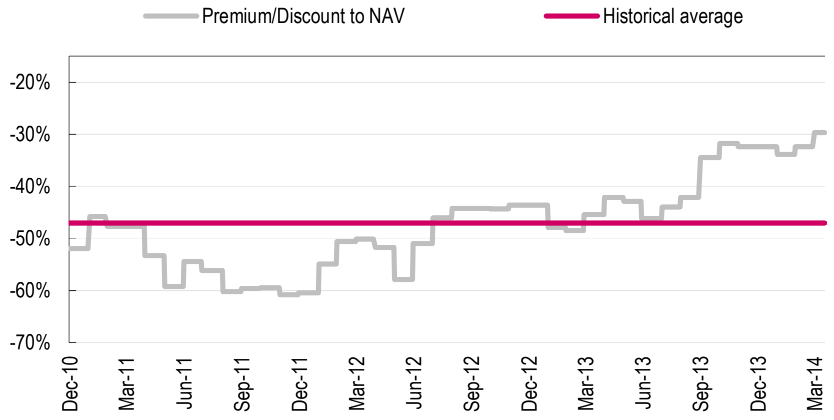
On this basis, the performance criteria approved by shareholders are as follows:

If performance criteria are not met, FTIM will lose its investment management agreement: fund manager and shareholder incentives are aligned

- NAV/share on 13 June 2015, adjusted for returns of capital, must be greater than the NAV/share as of 30 September 2013.
- The discount to NAV must be at least 15% for two-thirds of the trading days between 1 October 2014 and 30 June 2015.

If these criteria are not met, FTIM's contract can be terminated and a new international tender placed. This, we believe, has helped align the incentives of FTIM with the goals of minority shareholders. As a result, share buybacks and efficient disposal of assets have become prevalent, which has allowed for a contraction in FP's discount to NAV. The goal of the fund is to monetise its underlying assets and distribute cash to shareholders, but to eventually have the portfolio reflect the Romanian economy. The fund has made no new investments for close to three years, and FTIM is looking to shrink the size of the fund.

Figure 1: FP – historical premium/discount to NAV



Source: Bloomberg

A narrowing of the discount is finally taking place

The fund's dividend policy is to pay out dividends received plus interest income, less operational expenses and taxes, less legal reserves. Majority state-owned companies in Romania are required to maintain at least a 50% payout ratio, and for the past three years have been required to pay out 85% of their net profits. The average dividend yield for FP has been 6% since inception.

Management background and shareholder structure

Strong management, with a consistent track record of returning cash to shareholders

With closed-ended funds, we believe it is important to understand the management of the fund (FTIM, in this case), to get comfortable with its ability to return shareholder capital. Franklin Templeton is clearly a well-known, major global asset manager; however, what we think has been impressive in FP's case is the consistent improvement in underlying assets; strong track record of privatisation; close work with the government on improving the country's economic position; and the overall fund performance since FTIM's appointment.

FTIM has incorporated a strict corporate governance code at the majority of FP's underlying assets, which meet the standards of the Organisation for Economic Co-operation and Development (OECD). Further, as an activist manager, FTIM sits on the boards of approximately 90% of the companies FP is invested in. FTIM has also worked with the Romanian government and the IMF to push for the deregulation of the country's energy market – an initiative that has helped, and will in our view continue to help, the profitability of the majority of FP's investments.

Activist-style fund management…instrumental in relationship between IMF and Romanian government

The alignment of FTIM's and shareholders' objectives is exemplified by FTIM's successful lobbying to allow for the distribution of dividends by FP. Under Romanian Companies Law, companies are not allowed to distribute dividends if shareholders' equity is less than the share capital of the fund, which applies to FP. However, FTIM has approached Romania's Ministry of Public Finance and convinced it to change its valuation methodology for FP, since it is a fund.

Incentivised by market capitalisation, not NAV of fund

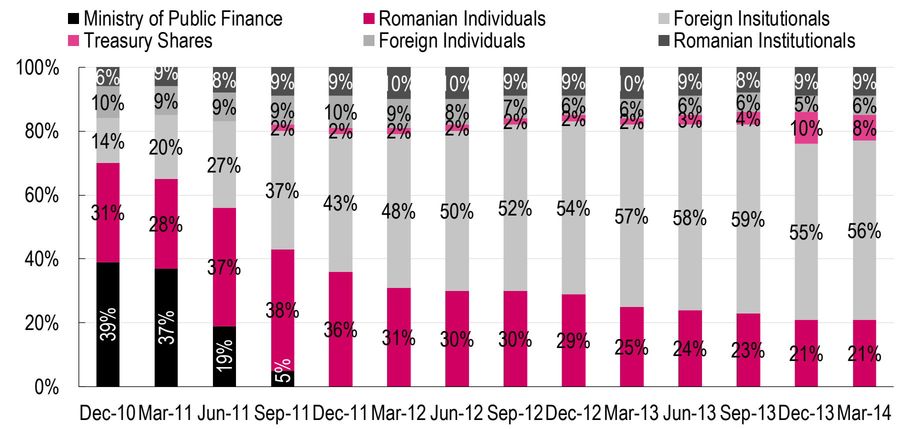
The new mandate of the fund manager runs for two years, starting on 30 September 2014. The total fee payable to FTIM is linked to FP's market capitalisation, with an additional, variable fee linked to the amount of exceptional distributions to shareholders in the relevant period. The fee structure is as follows:

- A base fee of 0.60% on the average quarterly market cap of the fund.
- A distribution of 2.00% of total non-dividend distributions until 31 October 2015.
- 1.00% of total non-dividend distributions, starting 1 November 2015.

FP's shareholder structure has evolved significantly over the past few years, and with respected shareholders such as Elliot Associates, Morgan Stanley and City of London Investment Management, the unlocking of value in FP has been very positive, in our view. The largest shareholder in the fund is US activist hedge fund manager, Elliott Associates, at around 16%. Other significant shareholders are City of London Investment Management (just under 5%), and Georgia Palade van Dusen, the granddaughter of Romanian industrialist Nicholae Malaxa (c. 4%) It was Elliot Associates who pushed for the new performance criteria for FTIM, which we believe gives further comfort to investors that minority shareholders' interests are being protected.

A strong shareholder base that has evolved significantly over time

Figure 2: FP – shareholder breakdown



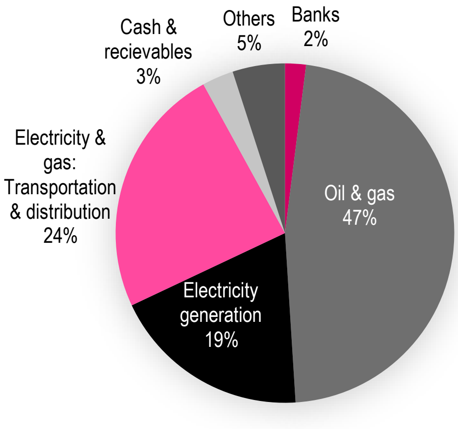
Source: Company data

Portfolio summary

The fund currently has 58 underlying assets (20 listed and 38 unlisted), with the top 20 making up 90% of NAV. The portfolio is heavily skewed to the energy sector, due to legacy issues, and therefore has stakes in numerous state enterprises. Excluding FP from the exchange, its portfolio is not truly representative of the market (see Figure 3); however, we do not regard this as negative, given the likely transformation of Romania's energy sector over the next few years (see below for further detail): 99% of the assets are in Romania and 1% in Austria.

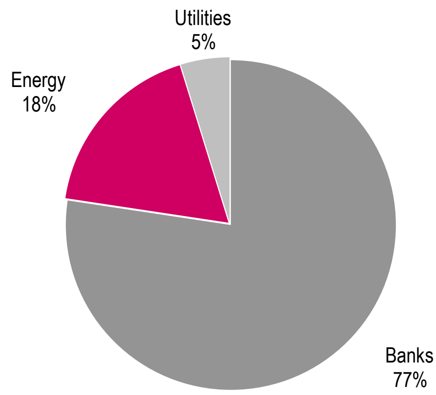
FP is not a play on the BSE, but a play on Romania's transforming energy sector

Figure 3: FP – portfolio split by sector



Source: Company data

Figure 4: Bucharest Stock Exchange – split by sector*



*Excluding FP from stock list

Source: Bloomberg

The listed portfolio is primarily made up of oil & gas company, OMV Petrom (not covered), which accounts for around 19% of FP's NAV. In the unlisted portfolio, Hidroelectrica SA (not listed) is the largest asset, making up around 14% of NAV. Oil & gas is the largest sector in the portfolio, followed by power generation and power & gas distribution.

FP's top-20 assets make up 90% of NAV…and its top-10 assets account for 80%

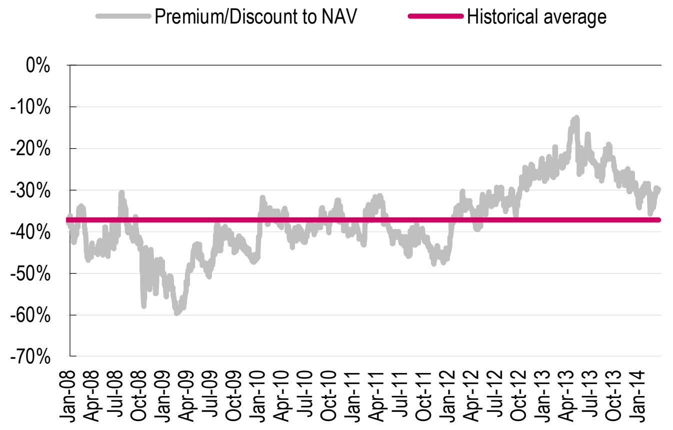
Figure 5: FP – list of assets

	Listed/unlisted	FP stake value %	% of NAV
OMV Petrom	Listed	18.99%	37.40%
Romgaz	Listed	14.99%	15.20%
Hidroelectrica	Unlisted	19.94%	9.90%
ENEL Distribute Muntenia	Unlisted	12.00%	3.10%
ENEL Distribute Banat	Unlisted	24.12%	3.10%
Aeroprturi Bucuresti	Unlisted	20.00%	2.40%
E ON Moldova Distributie	Unlisted	22.00%	2.30%
ENEL Distributie Dobrogea	Unlisted	24.00%	2.30%
Nuclearelectrica	Listed	9.72%	2.00%
CE Oltenia	Unlisted	21.50%	1.90%
BRD - Group Societe Generale	Listed	3.64%	1.80%
Electrica Distributie Muntenia Nord	Unlisted	12.00%	1.80%
GDF Suez Energy Romania	Unlisted	12.00%	1.60%
Electrica Distributie Transilvania Nord	Unlisted	22.00%	1.30%
Electrica Distributie Transilvania Sud	Unlisted	21.99%	1.30%
Societatea Nationala	Unlisted	48.99%	1.30%
Transelectrica	Listed	13.49%	1.20%
Posta Romana	Unlisted	96.00%	1.10%
Conpet	Listed	29.70%	0.90%
Banca Transilvania	Listed	2.93%	0.90%

Source: Company data

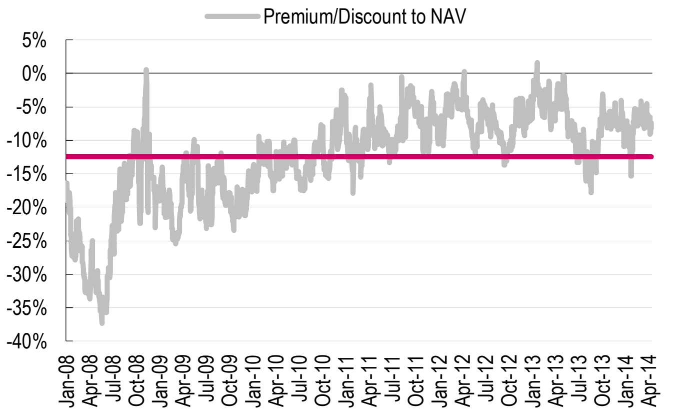
The majority of assets are listed; however, a significant proportion remains unlisted, which has resulted in a valuation anomaly for the fund. We believe this should be regarded as an opportunity, however, as many of the larger unlisted assets have strong underlying fundamentals, which will allow for significant value unlocking to come to fruition. Compared with other listed funds, we conclude that FP carries an unjustified discount to NAV: Figures 6 and 7 illustrate the comparative premia/discounts for Turkish entities Sabanci Holding (**HOLD**, TP TRY10.85, current price TRY9.26) and Koc Holding (**BUY**, TP TRY11.80, current price TRY9.38).

Figure 6: Sabanci Holding – NAV premium/discount over time



Source: Bloomberg, Renaissance Capital

Figure 7: Koc Holding – NAV premium/discount over time



Source: Bloomberg, Renaissance capital

Figure 8: FP – NAV/current share price

Total NAV, RONmn	14,250		
Listed portfolio NAV (10% discount)	8,377		
		Number of shares, mn	13,538
Current share price, RON	0.808		
Listed assets NAV/share, RON	0.51		
Cash holdings shares, RON	0.02		
Unlisted assets NAV/share, RON	0.27		
Unlisted assets % of share price	33.42%		

Source: Company data, Bloomberg, Renaissance Capital

Market is placing an unjustified discount on unlisted assets

After speaking with investors, a simple calculation leads us to conclude that the unlisted assets of the portfolio are a clear obstacle, but also an opportunity. Taking the NAV as stated from FP's 2013 annual statement, and segmenting into the listed, unlisted and cash holdings as a percentage of the current share price, we see a steep discount for the unlisted assets. As 53% of the portfolio is in the listed arena, even taking a 10% discount on the resulting NAV for the listed assets [*(marked to market) x 90%*], and dividing that by the shares outstanding to derive the NAV/share, it is evident that there is an unjustified discount still attached to the unlisted portfolio. We know that approximately 44% of the NAV is unlisted according to FP's valuation; however the market is placing a value of only 33.4% here.

FTIM is conservative in its valuation methodology, in our view. For example, it values poorly performing assets at zero in the NAV. Its general valuation methodology to calculate an end NAV for FP is as set out in Figure 9.

Conservative valuation methodology

Figure 9: FTIM – NAV calculation methodology for FP

Security type	Valuation methodology
Listed	Marked to market, and valued at closing market prices
Unlisted or illiquid listed	Valued as per latest issued annual financial statements (proportionally with stake held) or using fair valuation methodologies

Source: Company data

As mentioned earlier, the majority of the underlying assets are large dividend-distributors – hence, a large proportion of cash that is redistributed to shareholders comes from a stable source.

A strong dividend yield (over 6%)

Figure 10: FP – top-20 holdings

	Dividend payout, %		FP net dividend, RONmn		
	2012	2011	2013	2012	2011
OMV Petrom	40.0	47.0	319.0	353.1	201.6
Hidroelectrica	-	-	-	-	52.5
Romgaz	85.0	91.0	158.9	140.6	106.0
ENEL Distributie Banat	-	-	-	-	20.2
ENEL Distribute Muntenia	-	-	-	-	-
GDF Suez Energy Romania	50.0	-	22.8	-	9.6
ENEL Distributie Dobrogea	-	-	-	-	13.5
E ON Moldova Distributie	-	-	-	-	-
CE Oltenia	-	-	10.3	-	-
Nuclearelectrica	83.0		2.3	-	-
Electrica Distributie Muntenia Nord	84.0	12.0	16.2	1.8	-
CN Aeroporturi Bucuresti SA	85.0	89.0	9.1	9.4	9.9
BRD Groupe Societe Generale	-	25.0	-	3.6	2.1
Electrica Distributie Transilvania Nord	-	-	-	-	-
Electrica Distributie Transilvania Sud	-	-	-	-	-
E.ON Gaz Distributie SA	-	-	29.9	-	-
Transelectrica	86.0	89.0	4.0	10.9	1.2
Conpet	92.0	90.0	8.4	6.6	7.0
Banca Transilvania	-	-	-	-	-
SN a Sarii Salrom SA	92.0	90.0	9.3	0.1	0.8
Total, RONmn			**590.2**	**526.1**	**424.4**
Total dividends from listed companies			373.9	450.1	304
Total dividends from unlisted companies			275.8	168.9	215.1
Total dividend income			649.7	619	519.1
Dividend per share, RON				0.04089	0.03854
Share price				0.66	0.555
Dividend yield				6.20%	6.94%

Source: Company data

The Romanian energy market

Given FP's large exposure to the energy market, we think it is important to understand the transformation of the sector – a factor that underpins our positive view on FP's underlying assets.

Overview and outlook

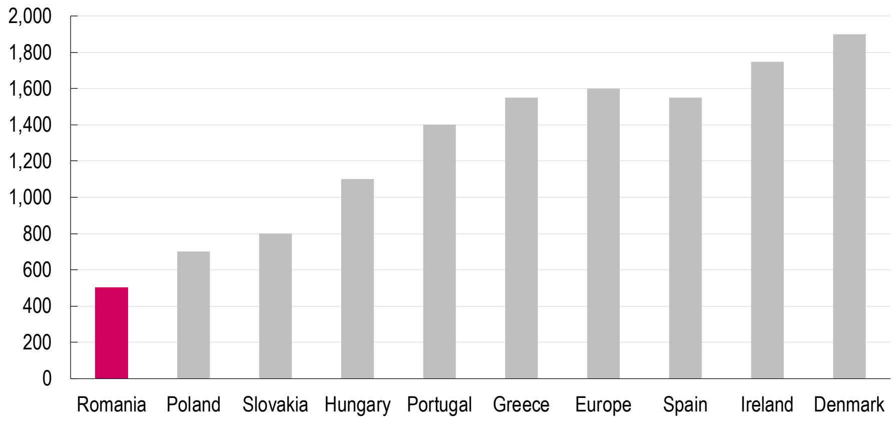
Romania has only a 20% energy-dependency ratio – among the lowest in Europe

Romania has one of the lowest energy-dependency ratios of any European country, with close to 80% of its energy consumption produced domestically. The country has a diversified energy base as well, coming from natural gas, oil, hydro, nuclear and wind. Romania is the largest natural gas producer in CEE, and close to 80% of its output is covered by domestic demand. Historically, the largest issue for firms operating in this sector has been government price controls. Due to the instability of the country post democratisation, socialist policies remained so as to ease the economic burden on Romanians.

A very low base for electricity consumption: the only way is up

The electricity sector faced similar issues, therefore pricing both for consumers and the industrial sector remained at loss-making levels. Romania has one of the lowest per-capita retail-consumption rates for electricity in the EU. Retail consumption is about 0.5 MWh per capita, vs the European average of 1.5 MWh per capita. In a recent study the European Commission found that almost all countries in Europe had household retail prices higher than industrial prices, by a factor of approximately 30%. Romania, however, was at 90% of industrial pricing. This, we conclude, provides scope for substantial improvement.

Figure 11: Electricity consumption per capita (current), KWh per year



Source: European Commission

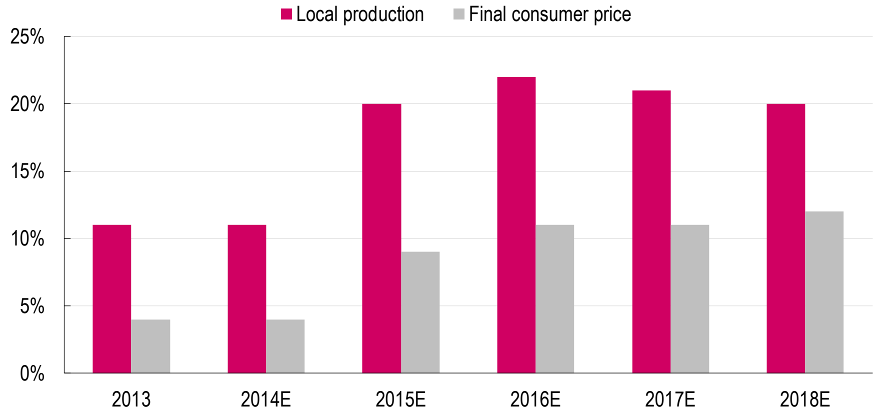
As a result of this, there has been little incentive for Romanian firms to spend on increasing their efficiency. Energy distribution to rural areas remains very low, with many households still using boilers. Furthermore, in the past few years due to the economic downturn in Europe, industrial consumption numbers have declined significantly. The government has also been over-subsidising the renewable energy sector, which has stifled growth in the traditional energy market.

FTIM pushed through deregulation of energy prices

This landscape is changing for the better, in our view. FTIM has been working closely with the IMF and the Romanian government, and deregulation of the energy market has been on course for the past year with the ultimate goal of full deregulation by 2018. The EC and IMF have issued favourable reports on Romania's progress in this regard. We note that 75% of Industrial consumers have already been moved over to the deregulated market, with a view that this should be 100% by the end of 2014. Household consumers are also on track to be liberalised, with gas prices having increased by approximately 10% over the past year. In order to ease the pinch on the consumer, this will be fully liberalised by 2018.

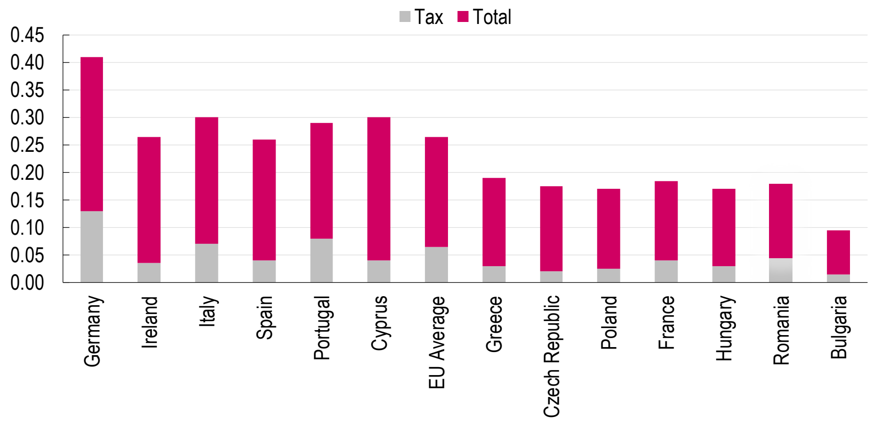
Romanian energy prices are set to be on a par with the EU average by 2018

Figure 12: Romania – annual increase in gas prices (current), household consumers



Source: ANRE

Figure 13: Europe – household electricity prices (current), EUR/kWh



Source: ANRE

Potential catalysts

We acknowledge that valuation anomalies can remain in place for long periods without sufficient catalysts to dislodge them. In FP's case, we believe this has been a problem for some time; however since FTIM has come into the picture, along with activist shareholders, we see a number of potential catalysts to narrow its discount to NAV.

Catalysts abound: we see a discount to NAV contraction as highly probable

A strong IPO pipeline

As mentioned, we believe the largest factor in FP's discount to NAV has been the transparency of valuations of a few of the larger assets in its portfolio. Over the course of the next year, there is an approved roadmap for this issue to be addressed as some assets come to the public market, as well as other key assets having transaction points that will confirm their valuations.

A strong IPO pipeline

Figure 14: FP – Offering pipeline

Company	Transaction	Seller	Offering stake	Market value, RONmn	Date
Transelectrica	SPO	Romanian state	15.00%	167	Mar-12
Transgaz	SPO	Romanian state	15.00%	320	Apr-13
Nuclearelectrica	IPO	New shares	10.00%	653	Sep-13
Romgaz	IPO	Romanian state	15.00%	1,703	Nov-13
CE Oltenia	IPO	New shares	12-15%	494/614*	Jun-14
Posta Romana	IPO	New shares	>50%	-	Jun-14
Electrica SA	IPO	Romanian state	51.00%	1,614*	Jul-14
Hidroelectrica	IPO	New shares	15.00%	1011.00*	1Q15

*Estimated by FP

Source: Company data

As can be seen, there has been a successful track record of listing assets in the past. Apart from Transelectrica (not covered), which came right after the Fukushima disaster, all other IPOs have been well subscribed and been at a higher valuation than was in the books. CE Oltenia is on track and will be going public by June, and the largest anomaly, Hidroelectrica is intended to go public at the beginning of 2015. As will be exemplified below, Hidroelectrica has made a positive turnaround thanks to FP; therefore – all else remaining equal – we would expect an IPO to proceed as planned.

Disposal of assets

With the goal to create a diversified fund, there will be a gradual disposal of underlying assets, which will also validate FP's NAV. One of the largest sectors FP is exposed to is energy distribution, making up approximately 22% of the NAV. With the listing of Electrica SA, there is the plan for the firm to take FP's stakes in the distribution firms. The valuations on these underlying assets are currently being negotiated between FP and Electrica SA. The rationale behind this is elaborated the in the next section.

Figure 15: FP – energy distribution firms in the portfolio

Company	FP stake	% NAV
Enel Distributie Banat	24.00%	3.80%
Enel Distributie Muntenia	12.00%	3.20%
GDF Suez Energy Romania	12.00%	2.70%
Enel Distributie Dobrogea	24.00%	2.50%
E.ON Moldova Distributie	22.00%	2.20%
Electrica Distributie Muntenia Nord	22.00%	2.00%
Electrica Distributie Transilvania Nord	22.00%	1.40%
Electrica Distributie Transilvania Sud	22.00%	1.30%
E.ON Gaz Distributie	12.00%	1.10%
E.ON Energie Romania	13.00%	0.42%
Enel Energie	12.00%	0.36%
Enel Energie Muntenia	12.00%	0.30%

Source: Company data

Energy distribution makes up 22% of the NAV: soon to be disposed of

According to management, these talks have been going well and valuations will be finalised shortly. However, even if a transaction does not take place between FP and Electrica SA, the listing itself will allow for a cross-valuation point for the sector, which will help validate the sector's weighting in FP's NAV. After speaking with management, FP also plans to offload a further 5% of OMV Petrom.

London listing

The average discount on SFM is close to 5%. FP would be largest fund

Due to the size and liquidity constraints of the local market, of which FP makes up a very large proportion, management and shareholders believe investors are restrained from investing in FP. Furthermore, the process of setting up trading accounts in Romania can be lengthy, taking up to six months in some cases. We believe this barrier is another reason for the deep discount to NAV. To tackle this, FTIM has pushed for a dual listing – a move that has been approved by shareholders. Initially, this was due to happen in Warsaw; however, the Polish government did not approve the listing. Management is now in the process of obtaining regulatory approval for the listing to take place in London on the Special Fund Market (SFM) in 2H14. The SFM currently has 27 listed funds, with an average discount to NAV of 5%. FP would be the largest stock on the SFM if listed. We view this as a significant potential catalyst for the stock, which would help contract the NAV discount.

Share buybacks

Share-price support with a strong buyback policy

With the new performance criteria having been approved, FTIM will have to be more aggressive about narrowing the discount to NAV in order to maintain its contract. We see two ways to go about this: disposing of assets, and share buybacks. FP has already undertaken three rounds of share buybacks.

Figure 16: FP – share buyback programmes

Programme	Period	Status	No. of shares/% of fund's issued share capital	Avg. price, RON/sh
1	May-Sep 2011	Completed	240.3mn/1.74%	0.4994
2	Apr-Dec 2013	Completed	1.1bn/7.99%	0.8743
3	Mar-14	Ongoing	253mn/1.89%	0.82
4	2H14	-	991mn/7.32%	-

Source: FP

Since the beginning of the programme, the performance of the stock has been strong, and this has helped with the discount contraction. Management believes it will obtain approval for the next round.

Energy liberalisation and eurozone recovery

Energy sector to be the *beta* for Romania moving forward

We believe the ongoing process of moving to a more free market energy realm will help with the profitability profile of FP's underlying assets. This is the key reason why we believe that although FP's portfolio is not representative of the market, it is capturing the key sector that will be the *beta* play due to these energy reforms. Stronger balance sheets will allow for higher valuations when assets are disposed of at a later date – all to the betterment of FP's NAV.

Key assets & valuation methodology

We value FP based on a SoTP methodology. Focusing on key assets, which make up the majority of its NAV, we derive a fair valuation for FP, as any swing in these firms would impact the NAV significantly. We prefer not to use DCF, as cash flows have been hard to predict as a result of their volatility on the back of government legislation and changes in the regulatory environment. For the remainder of the portfolio, we mark to market for the listed assets, with a 10-25% discount based on the free float and liquidity of the stock; and for the unlisted assets, we take FP's valuation and place a 40% illiquidity discount. Through this methodology, we derive an NAV/share of RON1.12, and apply an 18% discount to derive our TP of RON0.92. We rate the stock **BUY**.

Figure 17: Discount to NAV, selected peers (as of 6 May 2014)

Holding Company	Discount
Koc Holding	-7%
Sabanci Holding	-26%
Sistema	-22%
Average	-18%

Source: Company data, Renaissance Capital

OMV Petrom

OMV Petrom trades at a significant discount to peers – 5x 2014E P/E on Bloomberg consensus, vs an industry average of 9x; and 2.6x EV/EBITDA 2014E vs an industry average of 4.3x

Originally known as National Oil Company Petrom SA Bucharest, which was later renamed when OMV bought a stake in the firm, OMV Petrom (Petrom) is the largest oil & gas firm in Romania. OMV owns a 51% stake in Petrom. The company focuses on three business segments; 1) exploration & production; 2) refining & marketing; and 3) gas & power. OMV Petrom is the largest asset in FP's portfolio. Petrom Group's proven oil & gas reserves amount to 775mn boe in Romania and Kazakhstan (750mn boe in Romania), with nominal annual refining capacity of 4.2mnt and a network of about 800 filling stations operated under two brands. Petrom operates in Romania, Moldova, Bulgaria and Serbia. Petrom also has an 860 MW gas power plant at Brazi and a 45 MW wind farm at Dorobantu.

Beyond Petrom being a well-run firm with a strong earnings profile, Bloomberg consensus estimates imply room for significant upside in the stock. The firm established exploration capabilities in the Black Sea in 2010. Initial estimates of gas production from Neptun Deep are reported at 630mcf/day. To put that into perspective, Petrom's total gas production in 2012 was 510mcf/day. A second test well is set to be completed by mid-2014. We note that Petrom is trading at significantly cheaper valuations than its peer group, and we believe FP's valuation may be understated due to its conservative valuation methodology. A large reason why Petrom is undervalued is due to its small free float, of around 9% when discounting FP's stake. FTIM and the government are working to increase this by selling their stakes, which will allow for the valuation gap to narrow.

Figure 18: OMV – peer analysis (Bloomberg consensus estimates)

	P/E, x			EV/EBITDA, x			P/CF
	2012	2013	2014E	2012	2013	2014E	2013
OMV Petrom	**6.0**	**5.6**	**5.1**	**3.2**	**3.0**	**2.6**	**3.2**
Romgaz	11.8	12.5	9.4	5.5	4.5	4.4	5.2
OMV	7.1	8.8	8.1	3.5	3.1	3.5	2.7
MOL	6.6	9.2	9.4	4.4	4.4	4.5	1.9
Repsol YPF	12.0	11.1	13.8	5.7	4.6	5.5	6.2
ONGC	11.6	7.9	9.1	6.1	4.1	4.1	5.5
CNOOC	8.0	5.0	7.4	4.5	3.1	3.7	5.2
Petrobras	9.2	6.2	5.9	7.2	3.5	4.6	3.5
Group average	**9.5**	**8.7**	**9.0**	**5.3**	**3.9**	**4.3**	**4.3**

Source: Bloomberg

We arrive at a NAV contribution for Petrom using its listed market valuation, which is in line with FP. We do believe the asset is undervalued, and therefore apply no illiquidity discount to the final NAV. We therefore derive a NAV of RON5,054.41mn.

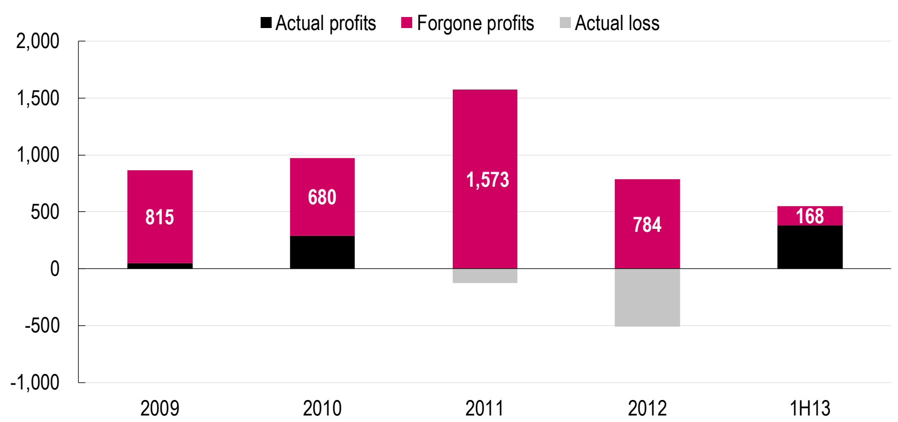
Hidroelectrica

Hidroelectrica is the largest domestic hydropower producer with 6,500 MW of capacity. The firm produced close to 23% of Romania's output in 2012 and has a 95%+ market share currently. At the end of 2013, the firm had 275 hydropower plants and pumping stations, with annual production of 17.5TWh. This is FP's second-largest asset.

A solid turnaround story that exemplifies FTIM's strong management capabilities

Hidroelectrica has been the most controversial asset in FP's portfolio. In mid-2012, the firm applied for insolvency. Though this looks negative, we believe it was actually a move in the right direction for the firm, and was strongly led by FP. Essentially, due to the poor conditions of the energy market, energy traders were taking advantage of state price controls and selling at significant premiums in the open market. These contracts made up close to 80% of the company's revenue. This, therefore, caused a significant amount of lost potential revenue for Hidroelectrica. FP, having got wind of this, pushed for insolvency, so the majority of these unfavourable bilateral contracts could be eliminated and renegotiated.

Figure 19: Hidroelectrica – foregone profits, RONmn



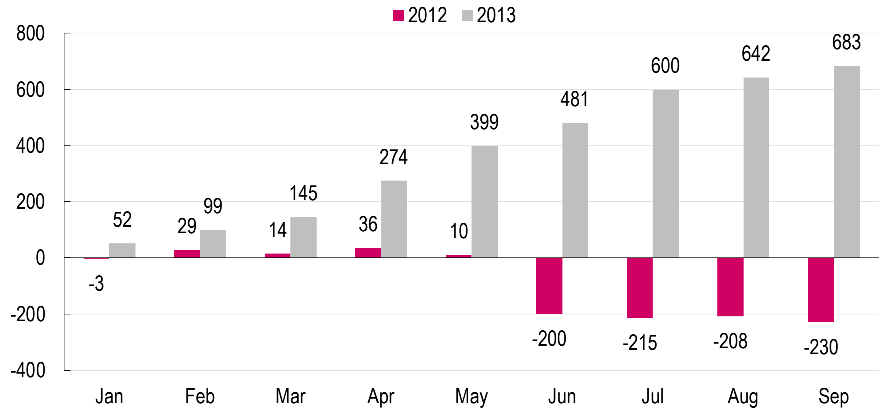
Source: FP

IPO delayed due to insolvency, but on track for early 2015

However, due to having entered insolvency twice, there has been an overhang on FP's stock performance. Management believes the associated court cases favour Hidroelectrica. Furthermore, Mr. Borza who initiated the significant restructuring seen during the first round of insolvency has been reappointed as judicial administrator – a big positive for shareholders, in our view. Fundamentally, we conclude the firm is doing far better as well, with latest filed earnings in 3Q13 having beaten guidance by over 20%. The bottom line was also almost 40% above company guidance. Hidroelectrica is now a much more profitable firm and is looking to undertake a 15% IPO by early 2015. The focus remains to cut costs in order to optimise returns on capex.

Figure 20: Hidroelectrica – pre-tax profit, RONmn

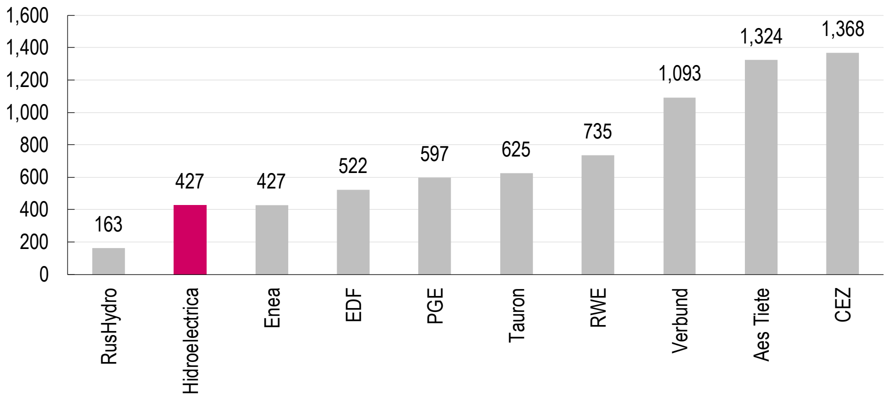
Strong profitability



Source: Hidroelectrica

We see further earnings upside potential through the liberalisation of Romania's electricity market. We believe there is an unjustified discount on this asset given where its peers are trading. Hidroelectrica is at 427,000 EV/installed capacity for 2012, vs a peer group that is, on average, operating at double that.

Figure 21: EV per installed capacity (2012 figures), kEUR/MW



Source: FP

Cheap vs peers; upside potential in valuations

We use peer group multiples to assess Hidroelectrica's contribution to NAV, using a combination of P/E (20%), EV/EBITDA (40%) and EV/capacity (40%). However, given the possibility of a further delay to the IPO and being an unlisted asset as of now, we apply a 15% discount to our final implied NAV, which gives us a value of RON1,813.38mn.

Figure 22: Hidroelectrica – peer group P/E and EV/EBITDA comparison, x

	Ticker	2013 P/E	2013 EV/EBITDA
PGE SA	PGE PW	9.32	5.04
ENEA SA	ENA PW	9.28	3.50
Tauron Polska Energia SA	TPE PW	7.03	6.50
CEZ AS	CEZ CP	8.66	8.95
ACEA SPA	ACE IM	12.30	8.50
SSE PLC	SSE LN	14.89	9.10
Iberdrola SA	IBE SM	11.95	6.90
MVV Energie AG	MVV1 GR	15.81	7.20
EVN AG	EVN AV	15.90	7.75
Fortum OYJ	FUM1V FH	4.72	8.10
Endesa SA	ELE SM	15.30	5.20
		11.38	6.98

Source: Bloomberg

Figure 23: Hidroelectrica – valuation summary, RONmn (unless stated otherwise)

	2012 EBITDA	2012 net profit	2012 sales	40% EV/EBITDA	30% P/E	P/S	EV	30% EV/Capacity	Total value	FP stake	Discount	RenCap NAV
Hidroelectrica	1,955.00	719.00	2,710.00	13,637.91	8,181.21	2,924.99	8,248.04	9,072.84	10,720.54	19.90%	15%	1,813.38

Source: Renaissance Capital estimates

Romgaz

Romgaz (not covered) is the second-largest gas producer and supplier in Romania, with a market share of around 50%. Its business lines are exploration and production, supply, underground gas storage, and electricity production. Romgaz is 70% owned by the government. The firm supplied close to 40% of Romania's natural gas demand in 2012. This, we believe, is a clear example of the upside potential in FP's valuations. The company completed an IPO last year, which was 14x oversubscribed, and listed 30% higher than FP's valuation for the firm.

IPO 14x oversubscribed and listed 30% higher than FP's valuation

Just like OMV Petrom, we believe Romgaz is set to benefit from the gas price liberalisation. As per the regulator, the ANRE, gas prices are set to be in line with those in the rest of Europe by 2018. Currently, the regulated price for producers is around RON540/mcm and will be closer to RON1,290/mcm once fully liberalised. Beyond this Romgaz reported reserves replacement as 70% in 2013, which was higher than that of OMV Petrom. The firm is also involved in two projects in the Black Sea where it has 10% stakes in each. The only issue Romgaz has had occurred when the government imposed a state donation of RON400mn. This is being contested in court.

We believe the market is fairly pricing the company as it is trading in line with its peers as can be seen in Figure 17. Thus we value Romgaz on a mark to market basis, but place a 15% discount on the final NAV due to having a free float of only 15%. Our final NAV contribution for Romgaz is RON1,679.35mn.

Energy distribution

ANRE sets a limit on the profitability of the sector

Individually, energy distribution companies account for a relatively insignificant portion of FP's NAV, however, FTIM treats this sector as one asset, since in 2012 it appointed Citigroup to advise on the sale of the 13 assets in this sector. Five of the 13 are in the top-10 holdings of the portfolio, and together compromise around 20%

of NAV. The main components are; ENEL Distributie Banat (EDB), ENEL Distributie Muntenia (EDM), GDF Suez Energy Romania, ENEL Distributie Dobrogea (EDD), E.ON Moldova Distributie.

The businesses are regulated like in other markets by the ANRE, which sets tariffs. The companies were allowed to earn a 10% return on the regulated asset base for 2008-2012 and 8.52% for 2013. For the third regulatory period (2014-2018), the allowed rate is also 8.52%.

Figure 24: ENEL (Romanian entities) financials, RONmn (unless stated otherwise)

EDB	2011	2012	2013 budget	2013
Operating revenues	621.3	636.6	628.7	659.3
Operating profit	238.3	181.2	209.0	203.4
Net income	220.5	167.2	168.5	190.7
EDD	**2011**	**2012**	**2013 budget**	**2013**
Operating revenues	487.9	509.4	474.9	544.5
Operating profit	126.4	103.0	135.3	149.0
Net income	108.9	94.5	103.6	133.5
EDM	**2011**	**2012**	**2013 budget**	**2013**
Operating revenues	815.8	966.7	1002.2	997.7
Operating profit	51.6	172.4	278.7	221.0
Net income	50.5	206.3	231.0	267.2
	EDM	**EDB**	**EDD**	
Cash/shareholder equity (as of Dec 2013)	39%	37%	24%	

Source: FP financials

Cash-rich assets…dividends that were halted will soon start to be paid again

These are cash-rich assets, and could therefore be liquidated fairly easily were it not for a put option that Electrica has on EDM, which has limited this capability. Essentially, the group of ENEL distributors were one company but were separated due to EU regulation. EDB and EDD were privatised in 2005 while EDM was privatised in 2008, at which time the put option was created. Electrica exercised this put option in 2012 and asked for EUR521mn for its 13.6% stake – more than 5x book value. FP contested this. When ENEL had bought into these distributors, it capitalised them fairly, which caused the valuation of these assets to be misstated. FTIM believes this will be resolved by mid-2014, when a final verdict is reached by the court; and so far we understand things look favourable for FP, based on management comments. Electrica is also due to undertake an IPO in July 2014, whereafter FTIM has eluded to Electrica creating a separate entity that will own stakes in the ENEL group, and allow better visibility of cash flows. Another hurdle in the past for disposing of these assets was that regulatory periods were not set for the pricing of distribution; therefore no transactions could take place as no clarity on future earnings was given. This is no longer the case, and a third regulatory period has been defined, which we believe will allow for an easier environment for possible transactions.

GDF Suez Energy Romania is a slightly differentiated asset among the energy distributors, as it more closely resembles a diversified energy producer and distributor, with capabilities in renewable energy as well. The company has received financial incentives from the government, and although pricing is not shared from management, end-of-year profitability has been impressive, with EBITDA and net profit growth of c. 26% and c. 24%, respectively, over 2012-2013.

Figure 25: GDF Suez Energy Romania – financial summary, RONmn

	2011	2012	2013 budget	2013	2014 budget
Total sales	3,859.1	4,047.0	4,359.0	4,127.1	4,448.6
Operating profit	258.7	414.9	258.0	518.7	453.3
Net profit	240.5	352.9	302.0	447.1	352.2

Source: FP financials

GDF Suez Energy Romania is a prized asset in the distribution space, with impressive EBITDA and net profit growth

We value the larger assets within this sector using peer group comparisons. A blend of P/E (50%) and EV/EBITDA (50%) is used to derive the NAV, and a 25% illiquidity discount applied. For the smaller assets, we place a 25% discount to FP's reported NAV.

Figure 26: FP energy distribution assets – valuation summary, RONmn (unless stated otherwise)

	EBITDA 2013	Net profit 2013	50% EV/EBITDA	50% P/E	Total value	FP stake	Discount	RenCap NAV
ENEL Distributie Banat	335.1	190.7	2,747.93	2,073.68	2,410.81	24%	25%	436.12
ENEL Distribute Muntenia	424	267.2	3,476.94	2,905.55	3,191.25	12%	25%	287.21
ENEL Distributie Dobrogea	248.2	133.5	2,035.32	1,451.69	1,743.50	24%	25%	315.01
E ON Moldova Distributie	254.96	87	2,090.76	946.04	1,518.40	22%	25%	250.54
GDF Suez Energy Romania	730.5	447.1	5,990.34	4,861.80	5,426.07	12%	25%	488.35
Electrica Distributie Muntenia Nord	220.2	126.5	1,805.71	1,375.57	1,590.64	22%	25%	262.34
Electrica Distributie Transilvania Nord	205.5	63.7	1,685.17	692.68	1,188.92	22%	25%	196.17
Electrica Distributie Transilvania Sud	211.9	63.7	1,737.65	692.68	1,215.16	22%	25%	200.41

	NAV 2013	Discount	RenCap NAV
E. ON Gaz Distributie SA	165.19	25%	123.8925
E. ON Energie Romania	65.13	25%	48.8475
Enel Energie	54.29	25%	40.7175
Enel Energie Muntenia	45.87	25%	34.4025
Electrica Furnizare SA	0.00	25%	0

Source: Company data, Renaissance Capital estimates

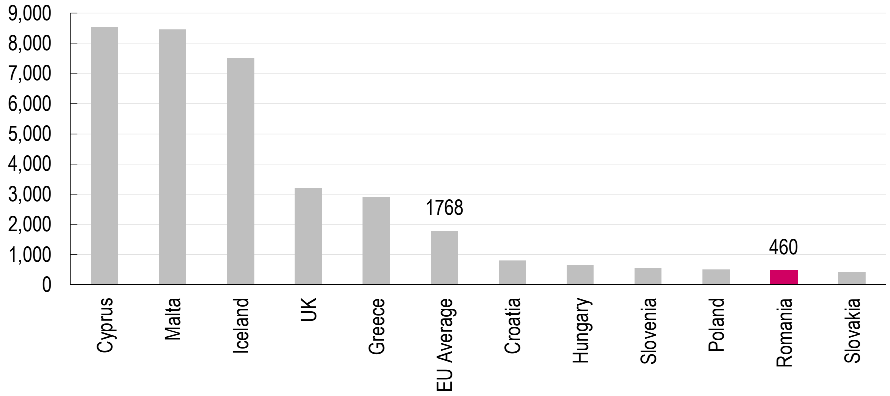
CN Aeroporturi Bucuresti

CN Aeroporturi Bucuresti, the Bucharest Airport asset, provides services for passengers, cargo and mail transportation, including administration, investments and maintenance of goods, in order to ensure the safety and security of aircraft operations and passenger, cargo and mail transfers within the airport. The firm is the culmination of the merger between Bucharest's two main airports. These two airports make up approximately 75% of passenger transportation for the country.

Romania soon to be approved as part of Schengen

This is not a large asset, accounting for less than 2% of FP's NAV. However, what is interesting is that Romania will soon enter into the EU's Schengen Agreement, which will allow for passenger growth to double over the coming years. Romania currently has a very low passengers/1,000 inhabitants ratio – around 470 for 2012 – which is close to a quarter of the EU average. Further, passenger volume growth has been impressive, with the first four months of 2014 already reporting 7% growth compared with 2013.

Figure 27: Number of passengers per 1,000 inhabitants (2013)



Source: Eurostat

Connectivity to Asia and the Middle East

We expect passenger growth to remain robust, as the airport now serves flights connecting directly into Asia and the Middle East, with low-cost airlines such as Fly Dubai. FP sits on the board of this company and is focused on increasing cost efficiency as this has been a problem in the past. Accordingly, for the past two years we have seen the cost base shrink by almost 10%, and a net margin close to 15%. In addition, we see numerous potential sources of revenue that the company has not tapped into, such as advertising and maintenance. Capex is set to remain elevated as improvements are ongoing at the airport: in 2013, the firm witnessed a 39% YoY capex increase.

We value this asset by comparing with its peer group globally and placing a 20% illiquidity discount. We use P/E (50%) and EV/EBITDA (50%) to derive a NAV of RON290.63mn.

Figure 28: CN Aeroporturi Bucuresti – valuation summary, RONmn (unless stated otherwise)

	2013 EBITDA	2013 net profit	2013 sales	40% EV/EBITDA	50% P/E	Total value	FP stake	Discount	RenCap NAV
CN Aeroporturi Bucuresti	298.10	53.60	2,710.00	2,688.07	944.78	1,816.43	20.00%	20.00%	290.63

Source: Renaissance Capital estimates

CE Oltenia

The largest integrated lignite-fired power producer in Romania: 25% market share in 2013

CE Oltenia was set up in May 2012 through the merger of three thermal power plants and their lignite supplier. It is Romania's largest integrated lignite fired power producer with an approximate 25% market share as of 2013, installed capacity of 3.900 MW, an average annual production of 18 TWh of electricity and 30mnt of lignite. The firm employs more than 19,000 people, which makes it one of Romania's largest employers.

CE Oltenia is one of the top-20 assets within FP, but we see it as more interesting currently due to its proposed 12-15% IPO in June 2014. The company did not have a great year last year having produced only 12 TWh, vs its usual 18.8 TWh. Further, the bottom line was hit due to new regulatory impositions of CO_2 certificates (the company did not buy all that was needed here). The firm has not been selected to sell on the regulated market; however, this is no bad thing in our view, since pricing in the unregulated market has been 25% higher, on average.

Outlook less rosy than in the past: expect declining earnings

We do not regard CE Oltenia as the best asset in FP's portfolio, due to a lack of transparency and a changing regulatory environment. Looking forward, the sector does not seem to be improving much, with demand widely expected to decrease, but at a slower pace than over the past few years. Furthermore, the firm has significant capex requirements in order to modernise facilities, totalling around RON350mn (close to 12% of 2012 revenues).

Figure 29: CE Oltenia financial summary, RONmn

	2010	2011	2012 (7M)	2013 budget
Revenues	3,165.0	4,026.5	3,347.1	5,664.5
EBIT	-25.0	348.0	44.0	249.0
EBITDA	400.0	857.8	409.8	892.9
Net profit	-126.0	179.9	118.3	123.0

Source: FP

We would expect an IPO to bring greater transparency and true price-discovery

Although this is not a prized asset in the portfolio, we believe an IPO will bring about much needed transparency and finally allow for a market valuation on the asset. Due to these issues, we place a 40% discount on FP's valuation. We use peer group comparables to derive our NAV. Similar to Hidroelectrica, we use a mix of EV/EBITDA (40%), P/E (30%) and EV/capacity (30%), which brings us to a NAV of RON405.82mn.

Figure 30: CE Oltenia – valuation summary, RONmn (unless stated otherwise)

	2012 EBITDA	2012 net profit	2012 sales	40% EV/EBITDA	30% P/E	30% EV/Capacity	Total value	FP stake	Discount	RenCap NAV
CE Oltenia	409.80	191.20	3,347.00	3,471.03	2,349.19	3,509.12	3,145.90	21.50%	40%	405.82

Source: Renaissance Capital estimates

Figure 31: FP assets – valuation summary, RONmn (unless stated otherwise)

Listed	RenCap NAV	Methodology	FP NAV	Variation	% of NAV
OMV Petrom	5,054.41	Mark to market	5,054.41	0.00	37.40%
Romgaz	1,679.35	Mark to market & discount	1,975.70	-296.36	12.43%
Nuclearelectrica	229.22	Mark to market & discount	306.70	-77.48	1.70%
Transelectrica	162.52	Mark to market & discount	156.25	6.28	1.20%
Alro Slatina	82.82	Mark to market & discount	105.46	-22.64	0.61%
BRD - Group Societe Generale	190.86	Mark to market & discount	228.49	-37.62	1.41%
Banca Transilvania	106.46	Mark to market & discount	106.79	-0.33	0.79%
Erste Group Bank AG	41.80	Mark to market & discount	44.75	-2.95	0.31%
Raiffeisen Bank International AG	77.19	Mark to market & discount	77.19	-0.00	0.57%
Conpet	114.54	Mark to market & discount	115.72	-1.18	0.85%
Alcom	5.54	Mark to market & discount	4.91	0.63	0.04%
IOR SA	0.78	Mark to market & discount	0.60	0.17	0.01%
Mecon SA	0.17	Mark to market & discount	0.18	-0.01	0.00%
Oil Terminal SA	4.87	Mark to market & discount	5.59	-0.71	0.04%
Palace SA	1.15	Mark to market & discount	1.22	-0.07	0.01%
Primcom SA	12.65	Mark to market & discount	23.41	-10.76	0.09%
Romaero SA	16.52	Mark to market & discount	20.72	-4.21	0.12%
Severnav SA	4.44	Mark to market & discount	5.13	-0.69	0.03%
Illiquid					0.00%
Comcereal Cluj SA	0.00	Mark to market & discount	0.00	-0.00	0.00%
Forsev	0.00	Mark to market & discount	7.24	-7.24	0.00%
Resib SA	0.00	Mark to market & discount	0.00	0.00	0.00%
Romplumb	0.00	Mark to market & discount	0.00	0.00	0.00%
Transilvania-Com SA	0.00	Mark to market & discount	1.66	-1.66	0.00%
Turdapan SA	0.00	Mark to market & discount	0.11	-0.11	0.00%
	7,785.30				58%

Unlisted	RenCap NAV	Methodology	FP NAV	Variation	% of NAV
Hidroelectrica	1,813.38	Comps (EV/EBITDA, P/E, EV/CAPACITY)	2,239.41	-426.03	13.42%
CE Oltenia	405.82	Comps (EV/EBITDA, P/E, EV/CAPACITY)	321.64	84.18	3.00%
ENEL Distribute Muntenia	287.21	Comps (EV/EBITDA, P/E)	473.07	-185.86	2.13%
ENEL Distribute Banat	436.12	Comps (EV/EBITDA, P/E)	573.25	-137.13	3.23%
E ON Moldova Distributie	250.54	Comps (EV/EBITDA, P/E)	345.36	-94.82	1.85%
ENEL Distributie Dobrogea	315.01	Comps (EV/EBITDA, P/E)	379.11	-64.10	2.33%
Electrica Distributie Muntenia Nord	262.34	Comps (EV/EBITDA, P/E)	296.20	-33.86	1.94%
Electrica Distributie Transilvania Nord	196.17	Comps (EV/EBITDA, P/E)	206.70	-10.53	1.45%
Electrica Distributie Transilvania Sud	200.41	Comps (EV/EBITDA, P/E)	192.00	8.41	1.48%
E ON Gaz Distributie	123.89	Comps (EV/EBITDA, P/E)	165.20	-41.31	0.92%
GDF Suez Energy Romania	488.35	Comps (EV/EBITDA, P/E)	404.41	83.94	3.61%
Aeroprturi Bucuresti	290.63	Comps (EV/EBITDA, P/E)	287.65	2.97	2.15%
Other Unlisted Assets	211.77	FP NAV * 35% Discount	491.10	-279.33	1.57%
	5,281.63				39%

Cash & recievables	445.75
Total NAV	13,512.67
Shares outstanding	12,071.88
NAV/shs (RON)	1.12

Source: Company data, Renaissance Capital estimates

Key risks

Given the history of the fund and Romania, we see a number of risks when it comes to FP. However, with FTIM at the helm we are confident many of these are being mitigated.

Political risk

Risks aren't minimal, but this is where having strong management helps

Due to the Romanian government's large controlling stakes in many of FP's underlying assets, political risk remains a factor. The state does seem to be moving in the right direction and creating a more free market economy; however, there is a risk of reforms being delayed. With the majority of NAV focused on the energy sector, any legislation changes will be pertinent. Also, as we have witnessed, the government has sporadically come up with new taxes, such as the infrastructure tax and arbitrary state donation from Romgaz. FTIM seems to be addressing these, and we would expect pressure from the IMF to eventually halt these unfavourable movements, but the risk remains.

Regulatory risk and litigation

A history of regulatory interference

This is the main risk for FP, in our view. Given the goal of disposing of assets in order to distribute cash to shareholders, approval is required from the regulators on the majority of FP's transactions – especially given the size FP's stakes in the underlying assets. For example, the regulator has yet to approve the cancellation of the shares repurchased in the first buyback, even though this should be simple.

FP is involved in more than 300 ongoing litigation cases, which FTIM is moving to deal with. Although many of these are minor, there are costs involved in dealing with many of these cases. We note also that one of FP's main shareholders has questioned the legitimacy of FTIM running FP.

Portfolio assets

Gaining transparency on many of the unlisted assets can be difficult, although there have been very few surprises in the past. However, predicting cash flows does become problematic with the main moving parts of each company. Further, on the listed assets side, since FP makes up a large proportion of the free float, it can be difficult to dispose of these assets at market value. For example, a portion of Romgaz was sold last year, but at a 10% discount to the listed price.

Unlisted portfolio provides little transparency…

Market risk

The evolution of the portfolio has been moving towards being 100% listed, which we see as positive from a valuation perspective, although it adds market risk to FP. On a mark-to-market basis, should there be any adverse market movements, then the valuation for FP could swing.

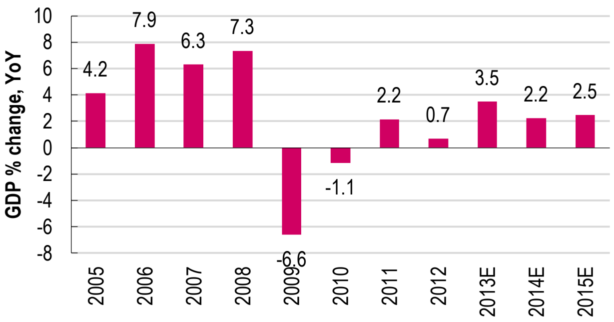
Appendix 1: Economic overview

Romania has had a rocky history post the 1989 revolution. In the more recent past, it has experienced a tough time economically. The country saw its current account deficit balloon to almost 14% of GDP due to the government drastically increasing public sector wages during the credit boom in 2006-2007. This is double the level seen in the 1990s. On the fiscal side, the deficit was also not much better sitting at around 8.5% of GDP in 2009.

A strong macro outlook: one of the best-performing economies in Europe

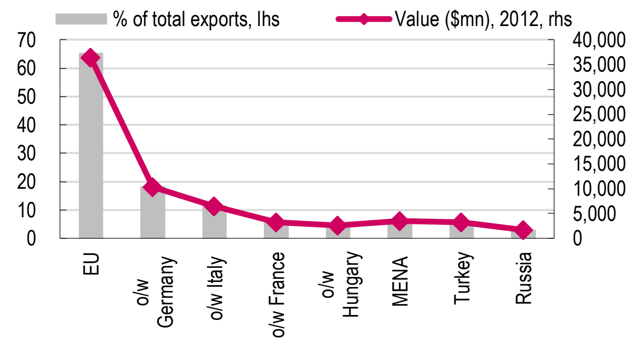
However, as our Chief Economist, Charles Robertson has pointed out, the government has taken drastic measures to improve the macro environment. We believe absolute levels of debt have remained low enough, implying a good chance that Romania will experience another period of strong growth through to 2015. Further, with the government working closely with the IMF, many structural issues have been resolved, and Romania has also gained membership of the EU, which has helped from an FDI perspective.

Figure 32: Romania – GDP growth



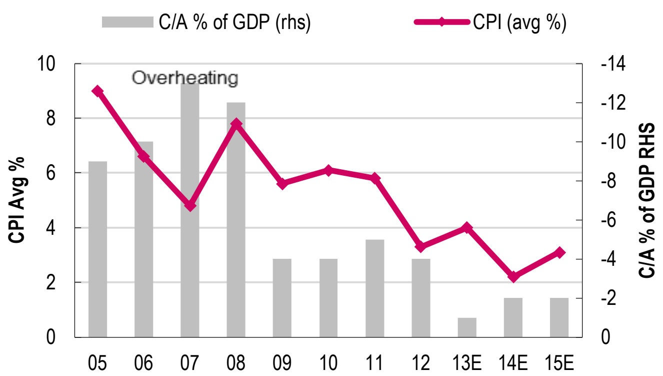
Source: World Bank

Figure 33: Romania – export destinations



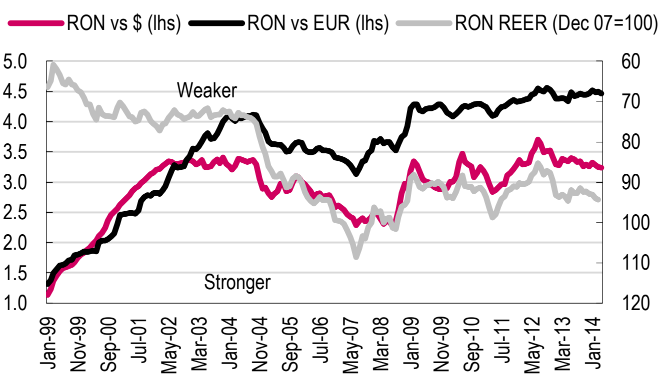
Source: Bloomberg

Figure 34: Romania – CPI avg %, C/A % GDP



Source: Word Bank, Bloomberg

Figure 35: RON performance



Source: Bloomberg, Bruegel

Accommodative monetary policy, improving macro indicators

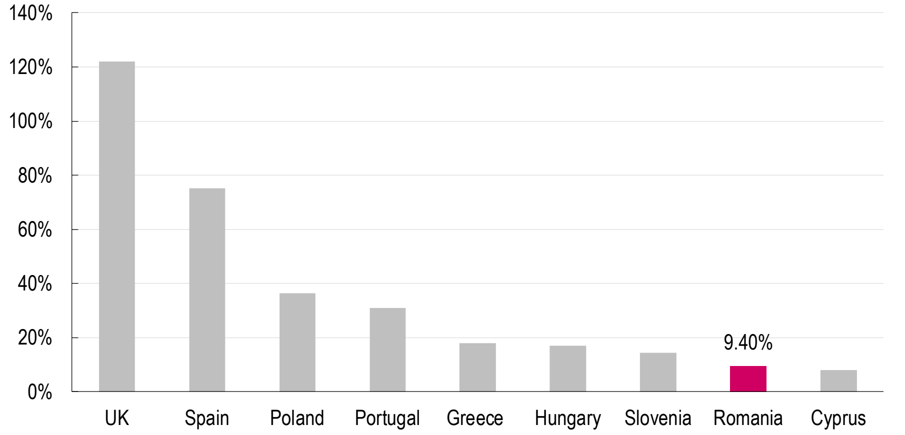
Inflation is under control and the central bank continues with an accommodative monetary policy having cut rates last year to 5% (we expect a further cut this year). We believe inflation will be below 2% by the end of 2014, and the current-account deficit is close to 2%. The leu has been one of the best-performing currencies in the eurozone and the GEM space. We expect Romania to continue its growth trajectory, and to be one of the best-performing countries in Europe.

Appendix 2: Financial market overview

The Romanian financial market is still very small, with a total market capitalisation close to EUR24bn. Liquidity is not high on the Bucharest Stock Exchange, with average trading volume at around EUR8mn daily.

Starting from a very low base…the only way is up

Figure 36: Europe, selected countries – market capitalisation/GDP



Source: The World Bank

Addressing the issues stifling the market place

Foreigners make up approximately 25% of shareholders, but this number may be misleadingly high. Traditionally, there has been a lack of public equity culture in Romania, thus very few issuers come to the market. This is one of the main reasons behind the market having remained fairly small. The situation is due to change, however, as The Great Barriers Shift Task Force, which is dedicated to creating a modern, international capital market in Romania was commissioned this year. It has identified the following barriers in the market, and plans to resolve them:

- *Access to the local market* – opening an account can take up to six months, vs a few hours in other CEE countries.
- *Fiscal registration* – a lengthy, time-consuming and expensive process.
- *Investors' corporate rights* – process not aligned to EU standards; shareholders are not receiving dividends automatically.
- *Excessive trading costs* – market access costs very high.
- *Primary market* – listing procedures and cost too cumbersome.
- *Bond market* – old and inflexible regulatory environment.

Pension reform to help drive liquidity and increasing market capitalisation

Romania has pushed through pension reform recently. Thus, by increasing mandatory pension contribution, AuM for the industry has already doubled in two years, yet remains under 5% of GDP. Overall, we believe given the low base currently, Romania's financial market will witness string growth going forward.

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	296			**8**	

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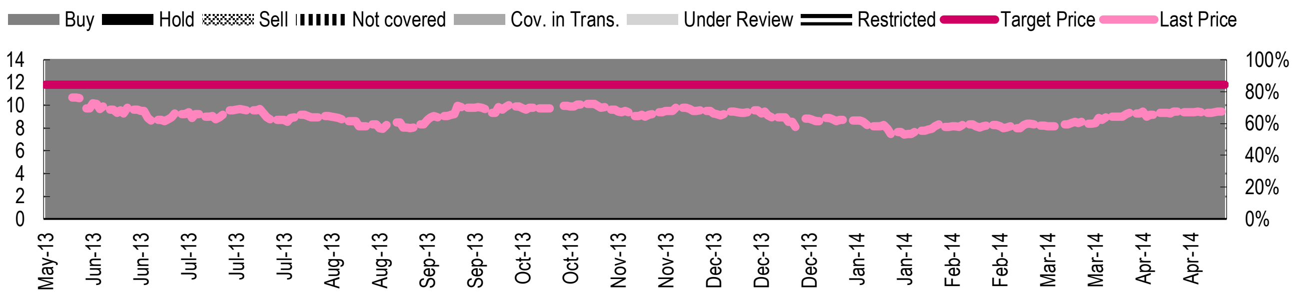
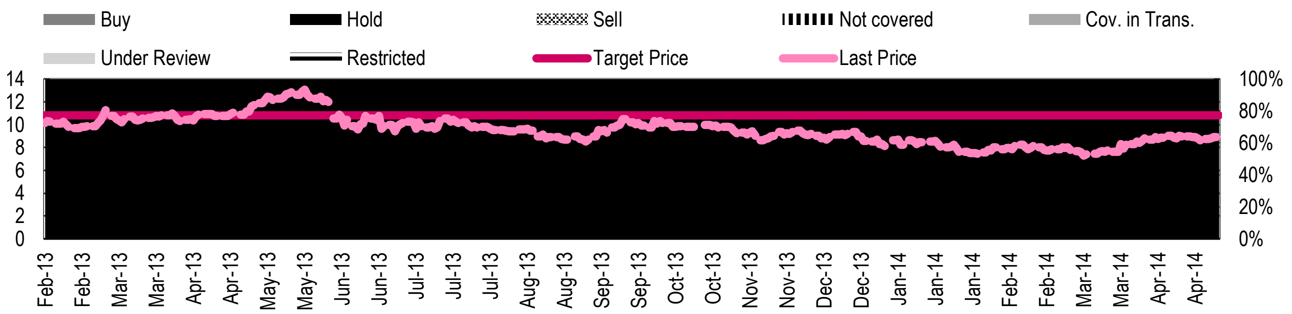
Koc Holding share price, target price and rating history



Source: Bloomberg

Sabanci Holding share price, target price and rating history



Source: Bloomberg

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