Renaissance Capital

Re-initiation of coverage
BUY
TP: RON0.93
Industrials
Romania

Fondul Proprietatea

Get ready for the second stage – **BUY**

Metin Esendal
+44 (207) 005-7925
MEsendal@rencap.com

We reinitiate coverage of Fondul Proprietatea (FP) with a BUY rating and a RON0.93/share TP. FP's strategy (asset disposals, cash distributions, share buybacks, etc) to lower its NAV discount paid off in 2011-2014, cutting the discount from 55% to 30%. However, a fall in oil prices and the prolonged insolvency of Hidroelectrica (HE) have resulted in a stable discount since then. We think the prospective IPO of HE and asset disposals could pave the way for a second stage of FP's value revival story. In addition to its regular cash distribution, we may even see a positive surprise ahead of HE's listing, which could lead to a 16% cash distribution yield in FY17E. In the medium term, we expect the discount to NAV to converge towards the global average (10%), as the share of the unlisted part is reduced and the impact of value-creative asset disposals is seen.

Hidroelectrica IPO is in the pipeline

HE exited insolvency in June and its appraisal value has been revised upwards by 23% YtD. We think these are the last steps ahead of the long-awaited IPO. Despite earlier expectation that the IPO might happen in 4Q16, we think it more likely in FY17 due to the Romanian parliamentary election scheduled for December and a lack of preparatory work following the end of insolvency. As 65% of FP's portfolio is still unlisted, the IPO of HE should cast light on the real value of a significant portion of the unlisted part. With this, the share of the unlisted part in total NAV would reduce to around 35%. In terms of valuation, assuming the same discount ratio on the unlisted part, a listing of HE itself could create around 20% upside potential.

Petrom SPO has successfully completed at a 14% discount

FP recently sold a 6% stake in Petrom in Bucharest and London. Limited free float (just 9%), a less diversified investor base and SPO overhang have historically led Petrom to trade at lower multiples vs peers. Thus, a successful SPO might be positive for Petrom's valuation and indirectly for FP's NAV via its remaining 13% stake.

Disposal of assets continues to create value for investors

So far in 2016, FP has sold its stakes in two distribution companies and its remaining stake in Romgaz. Management is having ongoing discussions with related parties (ENEL, Electrica, etc) regarding the disposal of the other assets. As FP manages to sell its assets at a more reasonable discount to fair values (vs its current NAV discount of 30%) and proceeds from these transactions are distributed via cash distributions (tax-free), we see asset disposals as value-creative for investors.

Cash distribution yield could surprise on the upside

FP has been a stable above-market average cash payer (6.5% yield on average over the past five years) owing to its stable high-yielding assets. In addition to its annual cash distribution policy (RON0.05/share in June), there will be a further cash distribution of RON0.05/share in March 2017 (subject to shareholder approval). We think a special dividend from HE ahead of its IPO is a possibility, which could in turn add up to RON0.03/share in additional cash distribution from FP next year. If this is realised, the total cash distribution yield might reach 16% in FY17E.

Report date:	**17 October 2016**
Current price, RON	0.80
Upside/downside, %	16
MktCap, $mn	1,960
Average daily volume, $mn	1.2 / 1.0
Free float	100%
Bloomberg	FP RO / FP LI

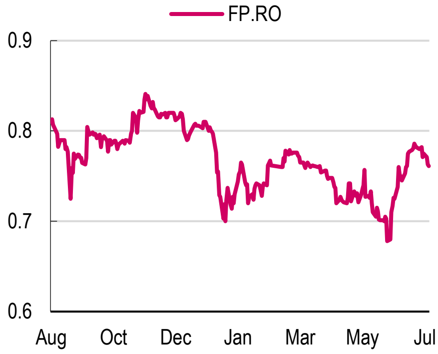
Prices as of market close on 13 October 2016

Valuation summary, FP vs Renaissance Capital estimates

	RenCap	FP
NAV, RONmn	10,027	11,357
Fair value per share, RON	1.03	1.17
Listed % of portfolio, %	22	29
Unlisted % of portfolio, %	63	65
Cash % of portfolio, %	15	6

Source: Company data, Renaissance Capital estimates

Figure 1: Price performance – 52 weeks, RON



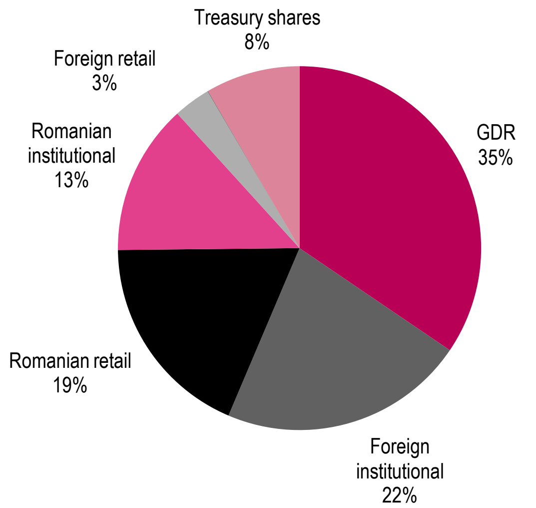
Source: Bloomberg

Investment summary

Fondul Proprietatea (FP) is a closed-end fund, incorporated in Romania, and trading on the Bucharest Stock Exchange since 1Q11 and the London Stock Exchange by means of GDRs since 2Q15. It was established by the Romanian government in mid-2005 in order to compensate the losses of eligible claimants who lost their property during communist rule. Accordingly, holders of compensation became shareholders of FP. In 2009, Franklin Templeton Investment Management (FTIM) was selected as the fund manager and it has run the fund since late 2010. its first mandate was for four years; this was renewed for another two years with effect from September 2014, and recently extended for another two years. FTIM has main two objectives: 1) to increase FP's NAV; and 2) to reduce the discount to NAV (to less than 15%). Thanks to its activist investor base, the fund is highly incentivised (with a base fee plus additional fees on distributions, buybacks, etc) to achieve these goals.

Based on September 2016 data, the GDRs amount to 35% of total shares, followed by foreign institutional investors (22%), Romanian individuals (19%) and Romanian institutional investors (13%). Foreign private individuals have a 3% share in total ownership. Treasury shares belonging to the company amount to 8% of the total shares, while the Romanian government has only a 0.04% stake in the fund. Among the largest shareholders, Elliott Associates and City of London Investment Management have stakes of 21% and 5%, respectively.

Figure 2: Shareholder structure as of September 2016



Source: Company data

Fund management

FTIM is the appointed fund manager, responsible for investment and risk management. The fund's investment objective is to maximise the return to investors via investing in Romanian equities. No new investment is planned until the discount to NAV narrows substantially. Fund management aims to maintain buyback programmes and cash distributions as much as possible. The performance objective is to narrow the discount to NAV to 15% or less, as well as increase the NAV of the fund by active management in current portfolio companies. Based on the current management agreement, the base fee per year is 0.60% if the discount to NAV is higher than 20%. If the discount is 15-20%, the base fee would be 0.65%, rising to 0.70% if the discount narrows below 15%. Apart from the base fee, there is also an incentive for the fund management on distribution fees (2% until March 2017, which gradually falls to 1% until April 2018), bringing management more in line with shareholder's short-term interest. The duration of the current agreement is two years, and a vote on its continuation will be held annually in October. FP's long-term objective is to increase its exposure to listed companies to 100%, by listing a number of underlying holdings and disposing of other stakes that are unlikely to be listed. Since the start of FTIM's mandate, FP has delivered an average annual cash distribution yield of 6.5%. It has also completed a number of buyback programmes (amounting to around 22% of shares in total). A secondary listing of the fund on the LSE was executed successfully in 2Q15.

Portfolio

The portfolio of assets is a combination of privately-held entities (43%), state-controlled entities (46%) and net cash (11%). As at end-September 2016, 65% of total NAV was unlisted. Electricity generation captures the largest share of the portfolio by sector, with a 31% share in total. Electricity & gas distribution and supply accounts for 26% of the total portfolio. The oil & gas sector accounts for 24% of total NAV. Infrastructure and banks have 8% and 3% shares, respectively. The portfolio remains heavily weighted to the power and oil & gas sectors.

Valuation

We value FP based on a SoTP methodology. For listed subsidiary companies, we use market valuations in our NAV calculation. For HE we use a combination of peer multiples and discounted cash-flow analysis. We also apply an additional 15% discount on HE ahead of its planned IPO. For the other key large asset (Bucharest Airports), we use a peer valuation methodology. For the remainder of the portfolio (mostly distribution companies), we incorporate a 20% discount to FP's reported NAV for the assets. Finally, we also apply an additional 10% discount to the total asset portfolio, in line with the long-term average of closed-end funds' discount to NAV. Through this methodology, we derive a TP of RON0.93/share, implying upside of 16% from the current price. We reinitiate coverage of FP with a **BUY** rating.

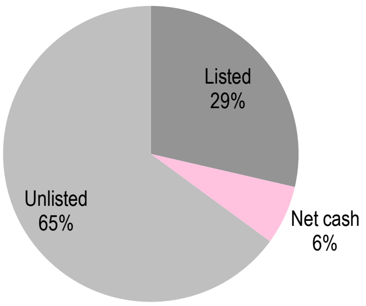
Risks

We believe political risk poses the main risk to FP given the large controlling stakes that the government possesses in many of FP's underlying assets. With the majority of FP's portfolio focused on the energy sector, any legislative changes affecting this sector could have an impact on the relevant companies. Another risk factor is litigation risk. The number of legal cases against the company has fallen significantly over the years, but there are still costs associated with these cases. We believe the company has a limited financial buffer (with no provision for this in its articles) for possible costs related to litigation.

Portfolio of assets

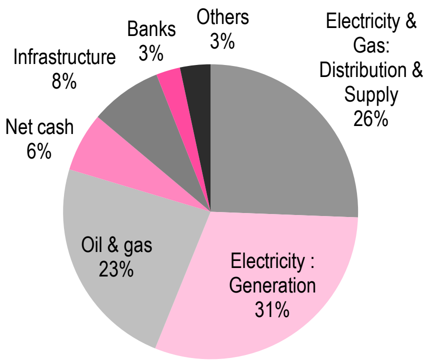
The portfolio is composed of holdings in 13 listed and 32 unlisted companies as at September 2016. The portfolio of assets is a combination of privately-held entities (43%), state-controlled entities (46%) and net cash (11%). As at end-September 2016, 65% of total NAV was unlisted. As for sectoral breakdown, electricity generation captures the largest share, with a 31% share in total. Electricity & gas distribution and supply accounts for 26% of the total portfolio. The oil & gas sector accounts for 23% of total NAV. Infrastructure and banks have 7% and 3% shares, respectively. Clearly, the portfolio remains heavily weighted to the power and oil & gas sectors.

Figure 3: Portfolio structure by asset type as of September 2016



Source: Company data

Figure 4: Portfolio structure by sector as of September 2016



Source: Company data

The largest unlisted holding is HE, which captures around 45% of the total value of unlisted holdings in the portfolio. The largest listed holding is OMV Petrom, accounting for around 80% of the total value of listed holdings in the portfolio.

Figure 5: FP – list of assets as of 1H16

Company	Asset type	FP stake value	% of NAV
Hidroelectrica SA	Unlisted	19.9%	28%
OMV Petrom SA	Listed	19.0%	22%
CN Aeroporturi Bucuresti SA	Unlisted	20.0%	5%
Enel Distributie Banat SA	Unlisted	24.1%	5%
Enel Distributie Muntenia SA	Unlisted	12.0%	4%
Engie Romania SA	Unlisted	12.0%	4%
Enel Distributie Dobrogea SA	Unlisted	24.1%	3%
Electrica Distributie Muntenia Nord SA	Unlisted	22.0%	2%
BRD Groupe Societe Generale SA	Listed	3.6%	2%
Electrica Distributie Transilvania Sud SA	Unlisted	22.0%	2%
Electrica Distributie Transilvania Nord SA	Unlisted	22.0%	2%
CN Administratia Porturilor Maritime SA	Unlisted	20.0%	2%
Societatea Nationala a Sarii SA	Unlisted	49.0%	2%
Electrica Furnizare SA	Unlisted	22.0%	1%
Nuclearelectrica SA	Listed	9.1%	1%
Enel Energie SA	Unlisted	12.0%	1%
Alro SA	Listed	10.2%	1%
Enel Energie Muntenia SA	Unlisted	12.0%	1%
Complexul Energetic Oltenia SA	Unlisted	21.6%	1%
Posta Romana SA	Unlisted	25.0%	1%
Top 20 equity holdings			88%
Total equity holdings			89%
Net cash and receivables			11%
Total NAV			**100%**

Source: Company data

The majority of the holding companies are large dividend distributors. Hence, a significant proportion of cash that is re-distributed to shareholders comes from a stable source. The fund's dividend policy is to pay out all of the dividends received plus interest income less operational expenses and taxes less legal reserves. Accordingly, since the appointment of FTIM as fund manager, FP's cash distribution yield has averaged 6.5%. Over the past five years, total dividends from listed companies constituted 58% of total dividend income of the fund. Moreover, with the additional dividend contribution from unlisted companies, FP has reached an above-market-average dividend yield (averaging 4.5% between 2011 and 2015). The fund has a clear target of sustaining at least RON0.05/share in annual cash distribution. Moreover, fund management has stated that just the current credit lines with banks would be adequate to cover two years of cash outflow in the absence of internal liquidity. We therefore see a sustainable above-market-average cash distribution yield as an important factor distinguishing FP from other Romanian companies.

Figure 6: Dividend income – top 20 portfolio companies

	Dividend payout, %						FP net dividend, RONmn					
	FY10	FY11	FY12	FY13	FY14	FY15	FY11	FY12	FY13	FY14	FY15	FY16
Hidroelectrica SA	90	-	-	-	80	80	53	-	-	-	129	135
OMV Petrom SA	46	47	40	36	35	-	202	353	319	331	121	-
CN Aeroporturi Bucuresti SA	90	89	85	85	50	75	10	9	9	12	10	27
Enel Distributie Banat SA	56	-	-	-	50	44	20	-	-	-	21	17
Enel Distributie Muntenia SA	-	-	-	-	-	-	-	-	-	-	-	-
Engie Romania SA	40	-	50	60	51	-	10	-	23	34	24	-
Enel Distributie Dobrogea SA	56	-	-	-	50	44	14	-	-	-	11	12
Electrica Distributie Muntenia Nord SA	-	12	84	83	85	85	-	2	16	23	25	27
BRD Groupe Societe Generale	25	25	-	-	-	50	2	4	-	-	-	8
Electrica Distributie Transilvania Sud	-	-	-	83	85	85	-	-	-	13	18	26
Electrica Distributie Transilvania Nord	-	-	-	83	85	85	-	-	-	12	17	28
CN Administratia Porturilor Maritime	-	71	75	78	50	75	-	7	5	10	7	14
Societatea Nationala a Sarii Salrom SA	90	90	92	85	85	-	1	0	9	20	10	-
Electrica Furnizare SA	-	-	46	88	85	85	-	-	9	20	38	25
Nuclearelectrica SA	-	-	83	81	68	70	-	-	2	28	7	9
Enel Energie SA	-	-	-	-	50	50	-	-	-	-	7	2
Alro SA	100	99	-	-	-	-	13	19	-	-	-	-
Enel Energie Muntenia SA	-	-	-	-	-	-	-	-	-	-	-	-
Complexul Energetic Oltenia SA	1	80	85	-	-	-	0	7	10	-	-	-
Posta Romana SA	-	-	-	-	-	-	-	-	-	-	-	-
Total top 20 holdings, RONmn							323	400	404	502	443	332
Total dividends from listed companies, RONmn							304	450	374	539	252	36
Total dividends from unlisted companies, RONmn							215	169	276	144	316	314
Total dividend income, RONmn							519	619	650	682	567	350
Total dividend income per share, RON							**0.06**	**0.047**	**0.05**	**0.057**	**0.053**	**0.034**
Dividend/distribution per share, RON							**0.039**	**0.041**	**0.05**	**0.05**	**0.05**	
Share price, RON							0.555	0.66	0.764	0.813	0.72	
Yield							**6.90%**	**6.20%**	**6.50%**	**5.80%**	**6.90%**	
Yield for Romanian companies (BET)							4.20%	5.10%	5.10%	3.50%	4.60%	

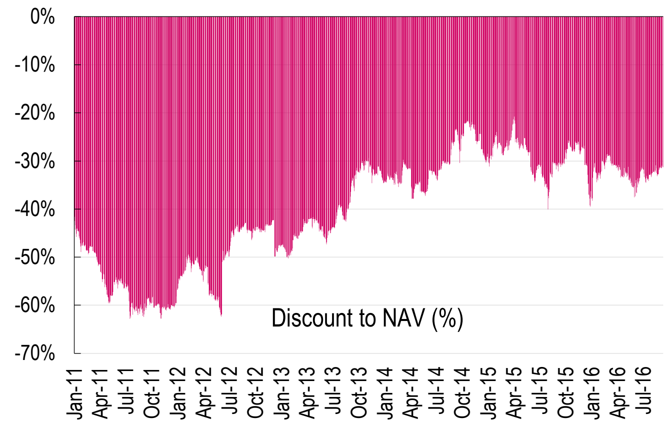
Source: Company data

We see the primary reasons behind the high discount to NAV as the high proportion of unlisted assets (with relatively low transparency) and the concentrated portfolio (the largest two assets make up almost 50% of total NAV). Having said that, the company has been working on unlocking the hidden value of subsidiary companies by making the unlisted portfolio public in the short-to-medium term, or increasing the liquidity of the listed companies via SPOs. The fund has a successful track record of listing assets in the past. In our view FP has performed well in this regard since its listing in early 2011, having helped not only subsidiary companies but also the overall Romanian market to attract foreign investors, especially after the 2008 financial crisis. FP has successfully divested partial or total stakes in some of Romania's largest state-owned companies (Romgaz, Transelectrica, Transgaz, Conpet and OMV Petrom) or taken part in large IPOs (Romgaz and Nuclearelectrica).

NAV discount

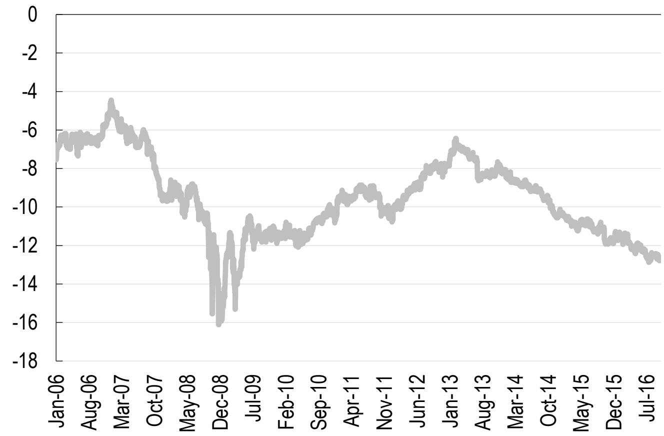
The discount to NAV has sustainably narrowed in recent years, from above 50% in 2011 to around 30% in 2016 on the back of fund management's efforts. It now stands at 31% as of end-September, which is still high in comparison with other closed-end funds globally. Our analysis of emerging market (EM) and frontier market (FM) focused closed-end funds indicates that the average discount to NAV was 10% based on data for the past 10 years. As FP's portfolio becomes more transparent through public offerings, we expect its NAV discount to converge to global averages.

Figure 7: FP – discount to NAV evolution



Source: Company data, Bloomberg

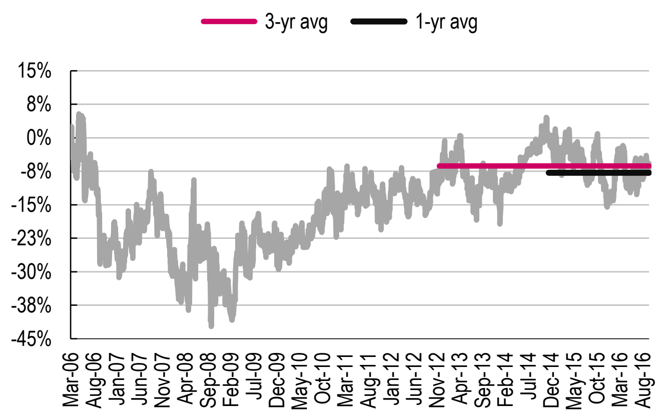
Figure 8: Average NAV discount of closed-end funds (excluding developed market focused funds), %



Source: Bloomberg

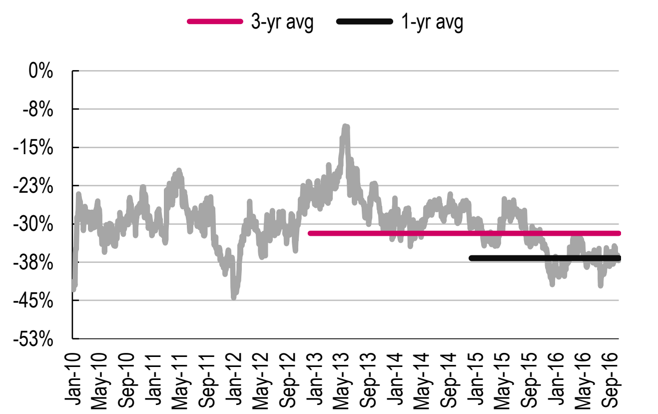
We also compare Fondul's discount to NAV with that of the largest two holding companies in Turkey, namely Koc Holding (KCHOL) and Sabanci Holding (SAHOL). KCHOL's traditionally tight discount to NAV and its largely unchanged asset portfolio since 2008 suggest that investors treat KCHOL like a high-quality Turkey-dedicated closed-end fund given the quality of its underlying assets, well-managed companies and strong balance sheet. Accordingly, KCHOL's discount to NAV has narrowed to 5% from above the 30% level over the years. On the other hand, SAHOL has witnessed higher discounts on its less diversified portfolio and a string of operational disappointments in subsidiary holdings. Thus, SAHOL's discount traditionally hovers around the 35% level. To us, Fondul's case is more similar to KCHOL's re-rating story on the back of improving fundamentals in the underlying companies (HE, Bucharest Airports, Constanta Port, Salrom, etc), or disposing of assets (distribution companies, Romgaz, etc). We expect Fondul's discount to NAV to narrow as it strengthens its market position as a high quality closed-end fund by: 1) making its portfolio more transparent via listings; and 2) maintaining value-accretive transactions (share buybacks, cash distributions, etc).

Figure 9: Koc Holding – historical discount to NAV



Source: Company data, Rasyonet, Renaissance Capital estimates

Figure 10: Sabanci Holding – historical discount to NAV



Source: Company data, Rasyonet, Renaissance Capital estimates

Steps to lower the discount to NAV

We believe the planned IPOs of HE, Constanta Port, Salrom, Bucharest Airports and Posta Romana, etc could be positive for the valuation of the unlisted portfolio in years to come. According to Reuters, HE plans to go public in November 2016 by selling a minority stake (a 15% stake via new share issues, based on a plan approved by the government three years ago). Given the elections scheduled for December 2016 and insufficient time after the end of HE's period of insolvency (which ended in June), we see the IPO of HE as most likely to take place in 2017. We believe the IPO should attract decent market interest, as the company is among the largest electricity producers in Europe. More importantly, it might also increase the Romanian government's appetite for more IPOs in the future; the government has been the only driver of public offerings in the recent history of the Romanian capital market.

Figure 11: IPO calendar

Company	Offering size, %	Offering size, $mn	Status	FP expected timing
Hidroelectrica SA	15	818.4	Approved	2H16/2017
CE Oltenia	12.0/15.3	15.5	Approved	Suspended
Bucharest Airports	na	na	No decision yet	na
Constanta Port	na	na	No decision yet	na
Salrom	na	na	Postponed	na
Posta Romana	na	na	No decision yet	na

Source: Company data

Another important development is the SPO of OMV Petrom. FP recently completed the divestment of its 6.4% stake in OMV Petrom via an SPO in Bucharest and London (6-13 October). The final price in the SPO was set at RON0.21 per share, corresponding to around a 15% discount to market close prior to the announcement. 90% of shares offered in the offering were purchased in the form of shares and 10% of shares were purchased in the form of GDRs. With this partial stake sale, FP aims to enhance the trading liquidity of OMV Petrom's shares, which we see as positive for the company in the long term. Low liquidity and SPO overhang appear to us to be the primary explanations of the relatively cheaper valuation of OMV Petrom vs peers. As the SPO took place in the form of shares and GDRs, and almost doubled the amount of the shares trading publicly, we expect pressure on OMV Petrom's valuation to dissipate in the short-to-medium term.

Furthermore, FP has been pursuing its plans for a gradual disposal of assets. It sold its stakes in the local subsidiaries of E.ON (namely E.ON Distributie Romania and E.ON Energie Romania) in 2Q16. Full details of the deal were not disclosed but we believe it is highly possible that FP accepted a discount to the value registered in its portfolio. We think these transactions are key, as they are the first significant transactions that FP has implemented outside the capital markets (given that it had previously sold large portions of its listed stakes in state-owned energy companies on the stock market through private placements). Moreover, in early 2Q16, FP sold its stake in Romgaz via an accelerated bookbuilding offering at around an 8% discount to the previous day's market price. This completed the divestment of FP's entire stake in Romgaz (15%, which it received on the inception of the fund in 2006), after three private placements.

In addition to asset sales, FP has also carried out various rounds of share buybacks and tender offers in order to provide capital appreciation for shareholders. It recently completed its sixth buyback programme and started its seventh in September 2016. Although the scale of these programmes has varied, the discount to NAV has narrowed by 2-3% on average during previous buyback periods. Given the fund's intention to support the share price via buyback programmes, we see any future buybacks as positive for the NAV discount.

Figure 12: Buyback (including tender offers) programmes

Program	Period	Status	No. of shares to be repurchased / % of the fund's issued share capital	Average share price, RON/share
1	May-Sep 3011	Completed	240mn / 1.7%	0.4994
2	Apr-Dec 2013	Completed	1.1bn / 8.0%	0.8743
3	Mar-July 2014	Completed	253mn / 1.9%	0.8126
4	Oct 2014-Feb 2015	Completed	991mn / 8.3%	1.0557
5	Feb-July 2015	Completed	228mn / 1.9%	0.8501
6	Sep 2015-June 2016	Completed	892mn / 7.5%	0.8210
7	Sep 2016-current	Ongoing		

Source: Company data

In order to accelerate the buybacks, the company has also completed three tender offers (in 2013, 2014 and 2016). The average premium (the difference between the tender price and the pre-announcement share price) during these tender offers was 25%. Because of this premium to the market price, tender offers have also tended to have a positive impact on the share price.

Figure 13: Tender offers

Program	Period	Tender price, RON/share	Pre-annoucemment price, RON/share	Premium
1	Sep-13	1.000	0.7230	38.3%
2	Oct-14	1.110	0.8965	23.8%
3	Aug-16	0.842	0.7380	14.1%

Source: Company data

Valuation

We value FP based on a SoTP methodology. For listed subsidiary companies, we use market valuations in our NAV calculation. For He, we use a combination of peer analysis and discounted cash flow. We also apply a 15% IPO discount to this. With the other key large asset, Bucharest Airports, we use a peer valuation methodology. For the remainder of the portfolio (mostly distribution companies), we incorporate a 20% discount to FP's reported NAV for the assets. Finally, we apply an additional 10% discount to the total asset portfolio, in line with the long-term average of closed-end funds' discount to NAV. Through this methodology, we derive a TP of RON0.93/share, implying upside of 16% from the current price. We reinitiate coverage of FP with a **BUY** rating.

Figure 14: FP NAV summary, RONmn (unless otherwise stated)

Cash & receivables (after Petrom stake sale)	1,501
Total NAV	10,027
Number of shares issued, mn (excluding treasury shares)	9,708
Fair value per share, RON	1.03
Target closed-end fund discount	10%
RenCap NAV/share, RON	**0.93**
Current price, RON	0.80
Upside potential	**16%**

Intraday prices on 14 October 2016

Source: Company data, Bloomberg, Renaissance Capital

Figure 15: FP NAV

Listed	RenCap NAV, RONmn	Methodology	% of NAV
OMV Petrom SA	1,608	Market price	16.0%
BRD-Groupe Societe Generale SA	278	Market price	2.8%
Nuclearelectrica SA	133	Market price	1.3%
Alro Slatina SA	88	Market price	0.9%
Conpet SA	41	Market price	0.4%
Romaero SA	27	Market price	0.3%
Primcom SA	13	Market price	0.1%
Banca Transilvania SA	16	Market price	0.2%
Alcom SA	4	Market price	0.0%
Oil Terminal SA	4	Market price	0.0%
Palace SA	3	Market price	0.0%
IOR SA	1	Market price	0.0%
Mecon SA	0	Market price	0.0%
Total listed	**2,215**		**22.1%**

Unlisted	RenCap NAV, RONmn	Methodology	FP NAV, RONmn	Variation	% of NAV
Hidroelectrica SA	2,758	Peer comparison & DCF with 15% discount	3,269	-511	27.5%
CN Aeroporturi Bucuresti SA	776	Peer comparison	632	143	7.7%
Electrica Distributie Muntenia Nord SA	203	Fair valuation with 20% discount	254	-51	2.0%
Electrica Distributie Transilvania Nord SA	172	Fair valuation with 20% discount	216	-43	1.7%
Electrica Distributie Transilvania Sud SA	178	Fair valuation with 20% discount	222	-44	1.8%
Electrica Furnizare SA	120	Fair valuation with 20% discount	150	-30	1.2%
Enel Distributie Banat SA	499	Fair valuation with 20% discount	624	-125	5.0%
Enel Distributie Dobrogea SA	321	Fair valuation with 20% discount	401	-80	3.2%
Enel Distributie Muntenia SA	364	Fair valuation with 20% discount	455	-91	3.6%
Enel Energie Muntenia SA	51	Fair valuation with 20% discount	64	-13	0.5%
Enel Energie SA	61	Fair valuation with 20% discount	77	-15	0.6%
Engie Romania SA	357	Fair valuation with 20% discount	446	-89	3.6%
Other unlisted assets	450	Fair valuation with 20% discount	563	-113	4.5%
Total unlisted assets	**6,311**				**62.9%**

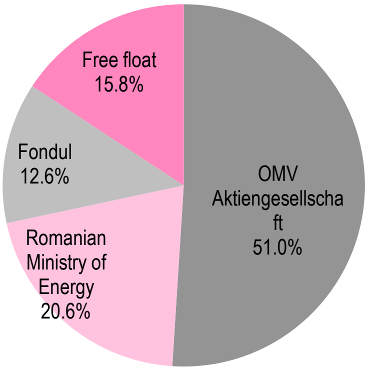
Intraday prices on 14 October 2016

Source: Company data, Bloomberg, Renaissance Capital

OMV Petrom

OMV Petrom is the largest integrated oil & gas group in Southeastern Europe, with annual oil & gas production of c. 65mn boe in FY15. Its refining capacity is 4.5mn tpa. It operates an 860 MW power plant and a 45 MW wind park, and also sells oil products in Romania and neighbouring countries (Moldova, Bulgaria and Serbia) via 800 filling stations (as at end-2015). It is Romania's main energy supplier, accounting for c. 40% of oil, gas and fuel supply and up to 10% of power generation.

Figure 16: OMV Petrom – ownership structure following SPO



Source: Company data, Renaissance Capital

FP's management recently decided to sell its 6% stake in OMV Petrom via a public offering of both shares and GDRs. Accordingly, FP was the only seller and OMV Petrom did not receive any proceeds from the offering. The shares/GDRs were offered to both retail and institutional investors. After the stake sale, FP continues to be a minority shareholder but intends to remain a long-term shareholder in the company. Following the public offering, OMV has a 51% stake in the company. The Romanian state holds 21% of OMV Petrom shares, FP holds 12% and a 16% stake (shares and GDRs) is trading publicly in Bucharest and London.

OMV Petrom has historically traded at cheaper multiples than its peer group. We believe this is related to its limited free float, which is around 9% of total shares. Having said that, the decision to increase the free float by a partial sale of FP's stake could have a positive impact on OMV Petrom's market cap in the future, thanks to increasing liquidity, a diversifying investor base and the dissipation of overhang risk. Similar to FP's own valuation, we use the market value of OMV Petrom in our NAV calculation. A possible future re-rating of OMV Petrom could therefore imply an upside risk to our valuation for FP.

Figure 17: OMV Petrom – multiples

	P/E, x			EV/EBITDA, x		
	FY15	FY16E	FY17E	FY15	FY16E	FY17E
Omv Petrom Sa	**nm**	**11.7**	**9.1**	**2.2**	**2.7**	**2.5**
Societatea Natio	7.4	8.4	7.9	2.1	2.9	2.7
Omv Ag	nm	14.6	11.9	n.m.	6.0	5.3
Mol	nm	9.8	9.6	4.4	4.8	4.4
Lukoil Pjsc-Adr	nm	12.1	10.6	n.m.	4.1	3.5
Oil & Natural Ga	16.2	13.3	12.9	6.3	5.4	5.6
Cnooc	22.8	nm	nm	5.1	6.3	4.2
Petrobras-pref	nm	35.2	14.4	n.m.	6.6	5.8
Group average	***15.5***	***15.6***	***11.2***	***4.5***	***5.2***	***4.5***

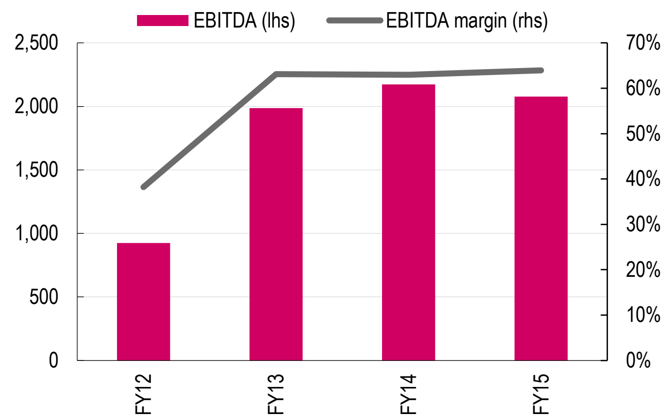
Intraday prices on 14 October 2016

Source: Bloomberg estimates

Hidroelectrica

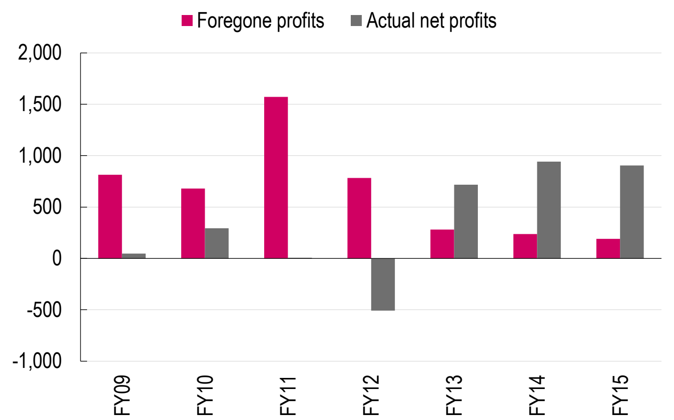
The Romanian state owns 80.1% of HE and FP owns the remaining 19.9%. HE manages hydropower plants (HPP) strategically located throughout Romania. It accounts for almost all of the country's hydropower production (97% in FY15). It was established after the restructuring of the power sector in Romania in 2000 and has occupied a key role in the Romanian energy market since then. The company provides around 25% of the country's total electricity production. Due to a severe drought and a string of contracts under which it sold the bulk of its output at lower than market prices due to bilateral contracts, it had to declare insolvency in mid-2012. However, the insolvency process has been used to reshape its business activity. Accordingly, the judicial administrator abrogated bilateral contracts with energy traders and renegotiated more than 425 commercial contracts; initiated and conducted a significant restructuring of the company's activity and personnel; and obtained additional income from trading. Moreover, despite a stable top line since then, headcount has been reduced by 34% and operational expenses per MWh fell by 32% compared with FY11; the EBITDA margin therefore improved from 28% in FY11 to 64% in FY15. In addition, owing to gradually increasing liberalisation in the electricity market, foregone profit has declined substantially, from RON1,573mn in FY11 to RON192mn in FY15. Starting from 2018, we would expect foregone profit to fall to zero, as liberalisation in the electricity market is completed. From 2017, FP's management states that HE will start to pay around RON135mn (EUR30mn) less in taxes (infrastructure tax) owing to a favourable change in regulations.

Figure 18: HE – EBITDA (RONmn) and EBITDA margin



Source: Company data

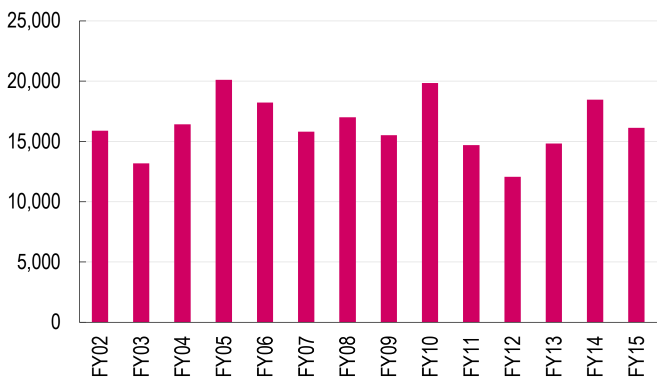
Figure 19: HE – foregone profits, RONmn



Source: Company data

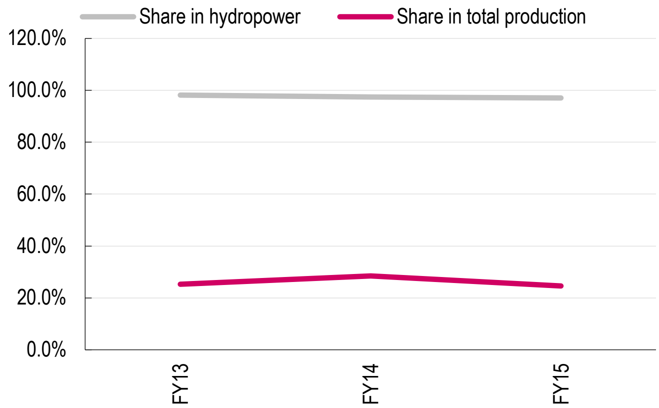
As of FY15, the company had a total installed capacity of 6,435 MW. It has seven branches – Bistrita (683 MW), Curtea de Arges (741 MW), Cluj (557 MW), Hateg (707 MW), Portile de Fier (1,660 MW), Ramnicu Valcea (1,586 MW) and Sebes (502 MW). It has made a strategic decision to focus on energy production at large generation capacities. Therefore, 87 small HPPs were sold between 2004 and 2008 and 36 small HPPs were sold between 2013 and 2015. Currently, 20 small HPPs, with a total of 16.5 MW installed capacity and 49.2 GWh potential energy generation, are available for sale. The company also intends to sell an additional 30-40 small HPPs, with a total of c. 30 MW installed capacity and 100 MW potential energy generation. Around 75% of HE's production is sold in the competitive market, whereas the rest is sold in the regulated market. The Romanian Energy Regulatory Authority (ANRE) determines the quantity and price at which HE sells energy on the regulated market, which can lead to foregone profit; however, as the energy market is fully liberalised, we do not expect this to be the case starting from 2018 – which is likely to mean another RON200mn contribution to the bottom line in 2018, compared with 2015, on our estimates.

Figure 20: HE – power output (GWh) by years



Source: Company data

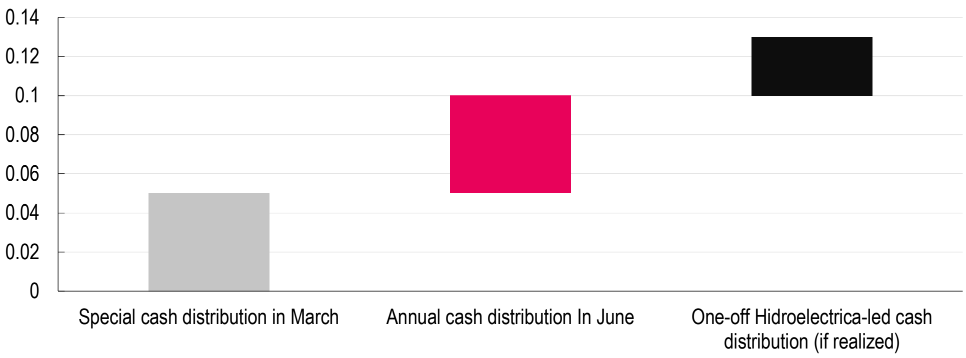
Figure 21: HE – share in Romanian energy production



Source: Company data

FP has long been preparing for a stock listing of its stake. After completing its reorganisation process, HE resumed its preparations for an IPO of newly issued shares (a 15% stake) in 4Q16 or 2017. As HE's insolvency procedure was completed as at 2Q16 and its valuation has been recently revised, we see a higher likelihood of the long-awaited listing procedure to gain pace in the short-to-medium term. We expect it to take place in 2017. The existing IPO mandate (approved three years ago, when the company had a debt position of RON614mn in FY12, vs its current net cash position of RON1.821mn), indicates a 15% stake sale via a new share issue (leading to a capital injection of EUR500mn into HE based on our calculation). Despite the fact that HE has a budget of EUR1bn for refurbishment, maintenance and development projects and another EUR300mn for acquisitions in renewable sources for 2015-2020, the 2013-2015 cash flow average of EUR375mn indicates that internal cash-flow generation would be enough to cover not only these capex plans (EUR200mn per year) but also the dividends (around EUR175mn per year). However, Fondul's management believes that HE has already completed its major investments and its annual capex requirement would be fairly low (around EUR50mn). Given the company's high free cash-flow generation capability along with its high net cash position and planned cash injection via the IPO, we believe we could see a special dividend distribution ahead of its IPO. FP's management said that such a proposal had previously been made to the government. If this happens, it could lead to a sizeable additional cash inflow to FP (depending on the government's decision). If HE decides to distribute all of the cash it currently possesses, this could bring an additional RON300mn in dividend income for FP, which might in turn add up to RON0.03 in cash distribution for FP investors. Otherwise, the cash distribution yield would still be attractive at 12.5% in FY17E, in our view.

Figure 22: FP – cash distribution projection for FY17E, RON



Source: Company data

The other option regarding HE's IPO is that the government might change the mandate from new share issuances to selling existing shares. We think this option is less likely, as it would require another postponement. Given the intention of government officials to carry out the IPO as early as possible, following years of waiting due to the insolvency process, we think a new share issue is more likely. If so, FP's cash distribution yield could reach 16% in FY17E, on our estimates, owing to a combination of annual cash distribution (RON0.05/share), a special cash distribution (RON0.05/share – subject to approval at the extraordinary general shareholders' meeting convening in late October 2016) and a one-off HE-led cash distribution (RON0.03/share).

We look at peer group multiples to value HE using a combination of FY16E P/E (40%), FY16E EV/EBITDA (40%) and DCF (20%). We also apply a 15% IPO discount on the combination of those. Accordingly, we derive a value of RON2.8bn, indicating a discount of around 15% compared with FP's reported fair value (RON3.3mn) and around a 40% discount to the target IPO valuation (RON4.5bn, equivalent to EUR1bn), as previously communicated by the government. We therefore believe our already discounted valuation would be a fair estimate for HE in the context of the company's IPO.

Figure 23: HE – peer group P/E and EV/EBITDA comparison, x

Name	FY16E EV/EBITDA	FY16E P/E
Rushydro	5.0	6.7
Cez As	6.2	12.8
Entel	8.3	n.m.
Nhpc Ltd	8.3	11.1
Edegel-Comun	8.4	14.5
Aksa Enerji Uret	8.1	n.m.
Akenerji Elektri	10.9	n.m.
Average	**8.1**	**13.1**

Intraday prices on 14 October 2016

Source: Bloomberg

In our DCF, we use a stable EBITDA margin estimate (67%), slightly increase the top line given ongoing liberalisation in the electricity market, and a total of EUR1bn new capex over the following five years. For the cost of equity, we use a 4% risk free rate, 0.8x beta and a 5% equity market premium, thereby driving a cost of equity of 8%. With a 0% terminal growth rate, our analysis derives a fair value of RON17bn for the company (RON3.5bn for FP's stake, corresponding to 3% premium to FP's valuation).

Figure 24: HE – DCF analysis

DCF	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	Terminal
EBIT	1,082	1,103	1,125	1,148	1,171	1,194	1,218	1,242	1,267	1,293	
EBIT*(1-tax)	909	927	945	964	983	1,003	1,023	1,044	1,065	1,086	
Depreciation	926	945	964	983	1,002	1,023	1,043	1,064	1,085	1,107	
Maintenance Capex	-250	-250	-250	-250	-250	-250	-250	-250	-250	-250	
New capex	0	-725	-725	-725	-725	-725	-725	0	0	0	
FCF	1,585	896	934	972	1,011	1,051	1,091	1,857	1,900	1,943	1,086
Discount factor	1.00	1.08	1.17	1.26	1.36	1.47	1.59	1.71	1.85	2.00	
Discounted cash flow	1,585	830	801	772	743	715	688	1,084	1,026	972	

Value for FY16E-FY25E	8,422	Rfr	4%	Terminal growth	0%
Terminal value with 1% growth	6,790	Beta	0.8		
Net cash	1,821	Equity premium	5%		
Fair value	17,033	CoE	8%		

Source: Company data, Renaissance Capital estimates

Figure 25: HE – valuation summary, RONmn (unless otherwise stated)

	FY16E EBITDA	FY16E net profit	40% EV/EBITDA	40% P/E	20% DCF	Total value	FP stake	Discount	RenCap NAV
Hidroelectrica	2,008	1,071	18,156	14,015	17,033	16,275	20%	15.0%	2,758

Intraday prices on 14 October 2016

Source: Company data, Bloomberg, Renaissance Capital estimates

Bucharest Airports

Bucharest Airports operate two airports in Bucharest, which service 71% of total air traffic in Romania. Total passenger numbers reached 9.3mn in FY15, up by 12% compared with 8.3mn in FY14. Passenger numbers have increased steadily over recent years, showing a CAGR of 6% since FY11. In line with rising traffic, Bucharest Airports' bottom line has also improved, more than tripling over the same period.

Figure 26: Bucharest Airports – peer group P/E and EV/EBITDA comparison

Name	LTM EV/EBITDA, x	LTM P/E, x
Fraport Ag	9.6	17.1
Adp	9.7	20.2
Flughafen Wien	8.0	17.1
Tav	5.4	8.1
Airports Of Thai	17.6	29.2
Aero Del Sures-B	17.9	27.3
Shenz Airport-A	12.7	32.1
Malaysia Airport	11.7	n.m.
Average	**11.6**	**21.6**

Intraday prices on 14 October 2016

Source: Bloomberg

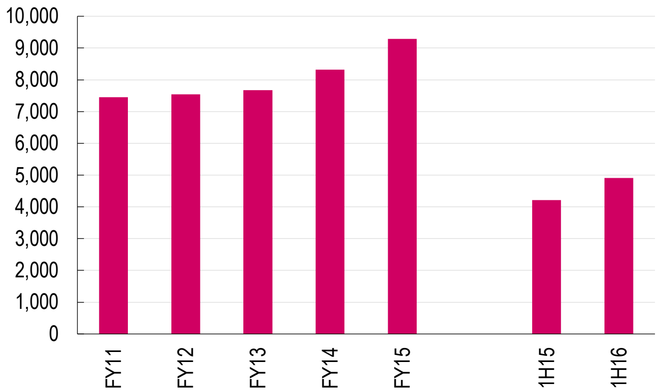
Figure 27: Bucharest Airports – valuation summary, RONmn (unless otherwise stated)

	LTM EBITDA	LTM net profit	50% EV/EBITDA	50% P/E	Total value	FP stake	RenCap NAV
CN Aeroporturi Bucuresti	253	211	3,210	4,548	3,879	20.00%	776

Intraday prices on 14 October 2016

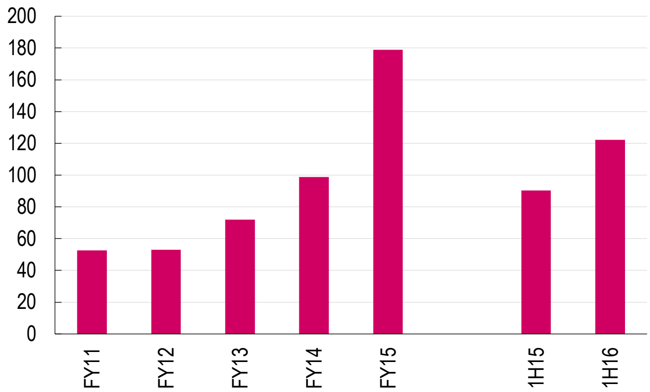
Source: Company data, Bloomberg, Renaissance capital estimates

Figure 28: Bucharest Airports – passenger numbers, '000



Source: Company data

Figure 29: Bucharest Airports – net income, RONmn

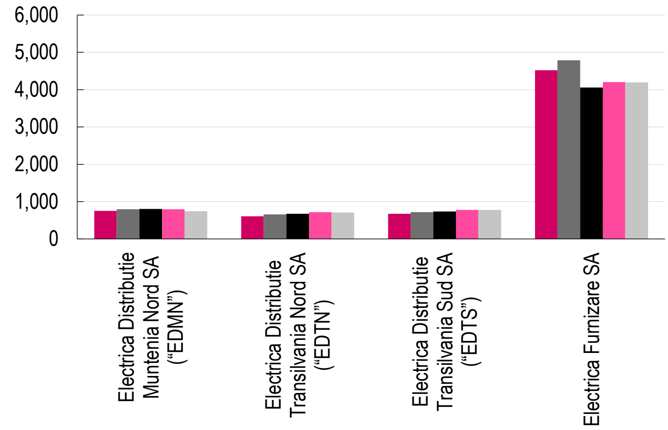


Source: Company data

Energy distribution

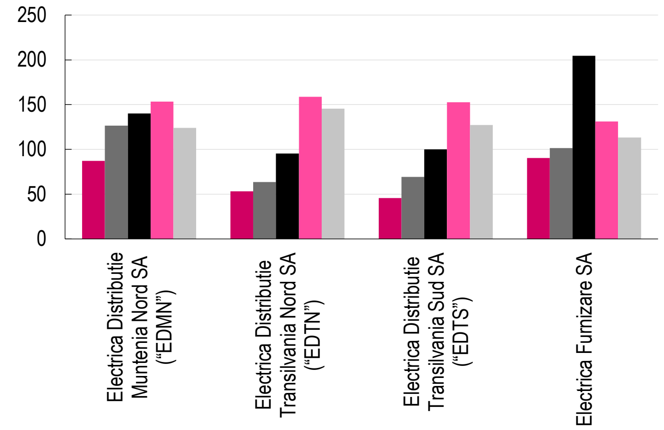
FP sold its entire stakes in two local E.ON subsidiaries in late 2Q16. As at 1Q16, E.ON holdings corresponded to 6% of the Fund's NAV. There have also been negotiations between FP and Electrica about energy distribution holdings in which Electrica is the majority shareholder (with a 78% stake in total capital), respectively Electrica Distributie Transilvania Sud (EDTS), Electrica Distributie Transilvania Nord (EDTN), Electrica Distributie Muntenia (EDM) and Electrica Furnizare. However, it was announced in 1Q16 that no agreement had been reached. The effective price offered by Electrica for FP's holdings in the four subsidiaries was RON684mn, which is almost a 20% discount to FP's own valuation of RON841mn. Despite the lack of an agreement, FP has said it is willing to resume negotiations at a future point. FP is also holding discussions with Enel and Engie about its stakes in their respective assets.

Figure 30: Electrica companies – revenue in FY12-FY16E, RONmn



Source: Company data

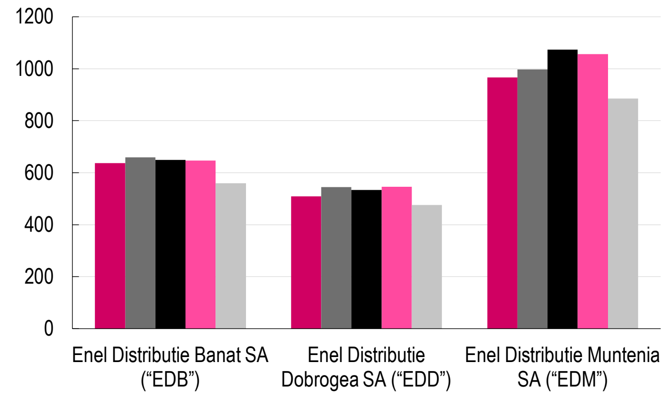
Figure 31: Electrica companies – net income in FY12-FY16E, RONmn



Source: Company data

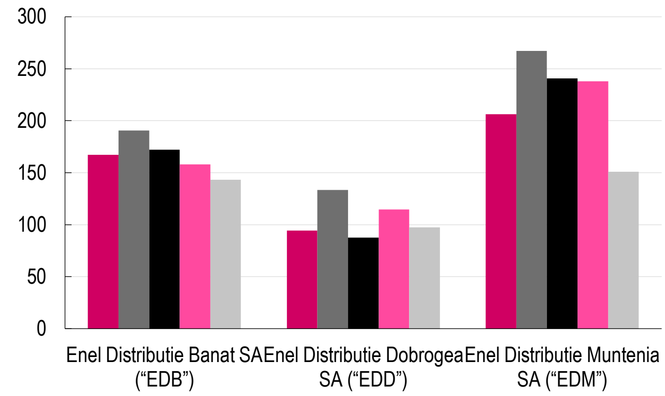
ENEL's distribution business is also regulated and tariffs are set by a regulatory agency. In 2015, the rate of return (7.7%) was decided by the regulator. In 2016, regulated electricity distribution tariffs were lowered on average by 15% for Enel Distributie Banat, by 13% for Enel Distributie Dobrogea and by 16% for Enel Distributie Muntenia.

Figure 32: ENEL companies – revenue in FY12-FY16E, RONmn



Source: Company data

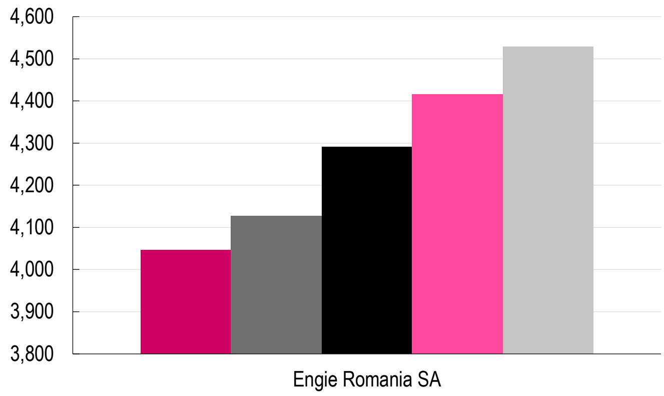
Figure 33: ENEL companies – net income in FY12-FY16E, RONmn



Source: Company data

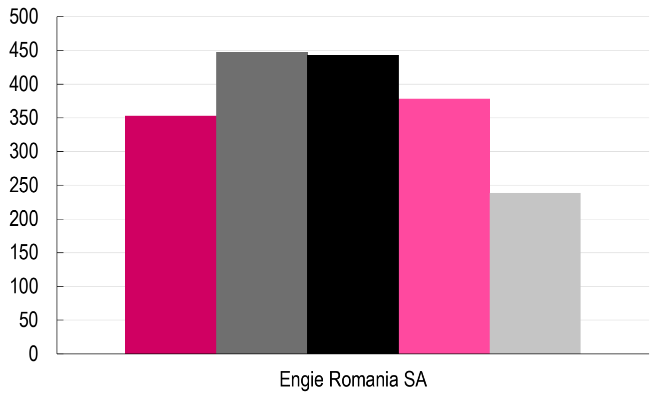
For Engie Romania, the pre-tax regulated rate of return for the distribution and gas supply businesses was set at 8.43% for 2013-2017. In 2Q16, the regulated supply tariffs for households were increased by around 11%.

Figure 34: Engie Romania – revenue in FY12-FY16E, RONmn



Source: Company data

Figure 35: Engie Romania – net income in FY12-FY16E, RONmn



Source: Company data

We value all of the distribution assets at a discount to their FP-reported value. Even though FP did not accept Electrica's offer (2.9x EV/EBITDA and 6.0x P/E) for its stakes in early 2016, which corresponded to almost a 20% discount to the FP-reported fair value, we believe it is reasonable to use this discount (20%) for all of its stakes in distribution assets in our NAV calculation, as FP still intends to sell these assets.

Figure 36: FP energy distribution assets – valuation summary, RONmn (unless otherwise stated)

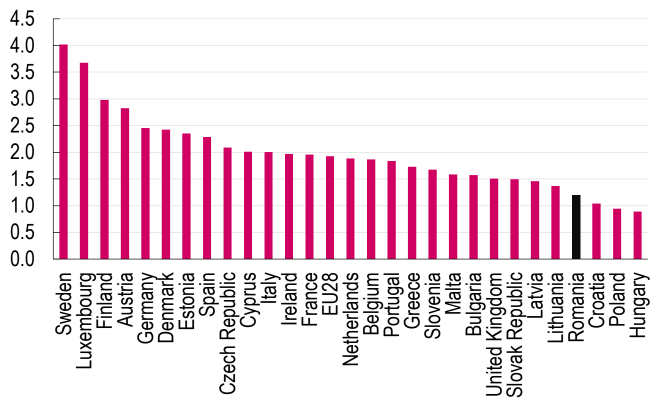
	Total value	FP stake	Discount	RenCap NAV
Electrica Distributie Muntenia Nord SA	1,155	22.0%	20%	203
Electrica Distributie Transilvania Nord SA	980	22.0%	20%	172
Electrica Distributie Transilvania Sud SA	1,011	22.0%	20%	178
Electrica Furnizare SA	680	22.0%	20%	120
Enel Distributie Banat SA	2,587	24.1%	20%	499
Enel Distributie Dobrogea SA	1,665	24.1%	20%	321
Enel Distributie Muntenia SA	3,795	12.0%	20%	364
Enel Energie Muntenia SA	533	12.0%	20%	51
Enel Energie SA	638	12.0%	20%	61
Engie Romania SA	3,721	12.0%	20%	357

Source: Company data, Renaissance Capital estimates

Romanian energy market

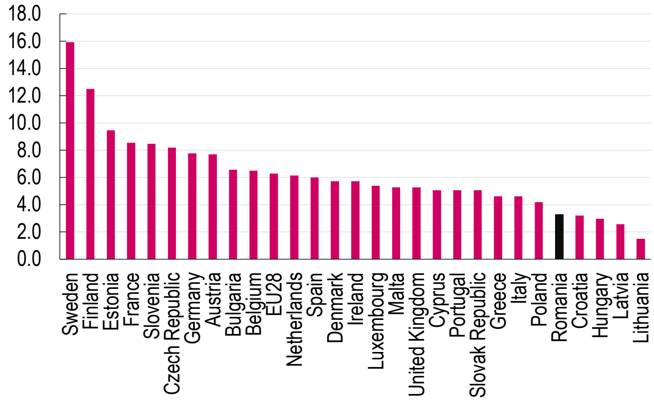
Romania possesses extensive oil & gas reserves (it is one of the largest producers of natural gas in the EU), making it one of the least energy-dependent member states of the EU. Import dependency amounted to 17% in 2014, against an EU average of 53%. However, Romania also has one of the lowest per-capita electricity consumption rates in the EU, of 3.3ktoe, around half of the EU average of 6.3ktoe consumption (2014 data).

Figure 37: Per-capita installed capacity as of 2014, kW/person



Source: Eurostat

Figure 38: Per-capita energy consumption as of 2014, ktoe/person



Source: Eurostat

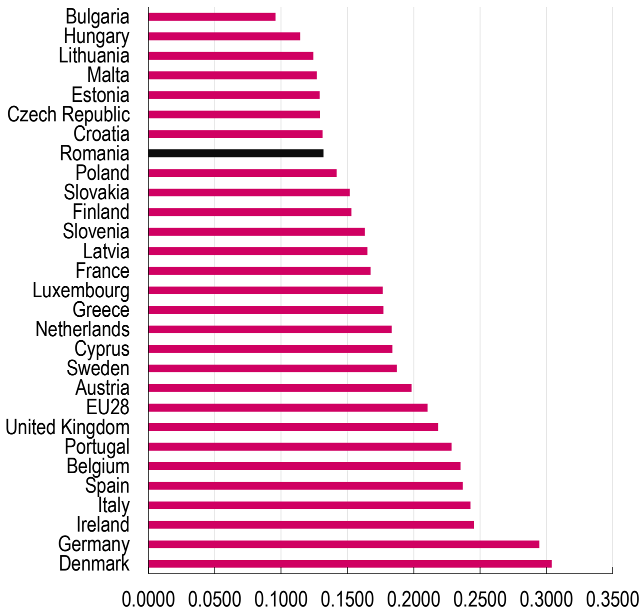
After the fall of communism in 1990, the state was the only player in the Romanian electricity market. Transition from a regulated to a liberalised market began in 2000 and was partially completed in 2007 (as part of preparations to join the EU). It still includes both a competitive market and a regulated market. The regulated activities are transmission, distribution and supply to household consumers (which are gradually being liberalised). Prices and tariffs in the regulated market are determined by the ANRE. However, consumers have the right to freely select their electricity supplier. Prices for non-household consumers were totally liberalised in January 2014, whereas electricity price liberalisation for household consumers has yet to be completed. The percentage of electrical energy acquisition from the competitive market for household clients amounted to 70% as of July 2016. Based on the government's proposed timetable, this proportion will reach 100% by the end of 2017. Until full liberalisation of the market, the tariff on households is to be composed of regulated prices and quantities determined by the ANRE and a component with tariffs determined in the competitive market. We believe this process will likely translate into higher prices paid by end-users in the short term.

Figure 39: Percentage acquisition from the competitive market

	Non-household consumers	Household consumers
Jan-13	30%	0%
Apr-13	45%	0%
Jul-13	65%	10%
Sep-13	85%	10%
Jan-14	100%	20%
Jul-14	100%	30%
Jan-15	100%	40%
Jul-15	100%	50%
Jan-16	100%	60%
Jul-16	100%	70%
Jan-17	100%	80%
Jul-17	100%	90%
Dec-17	100%	100%

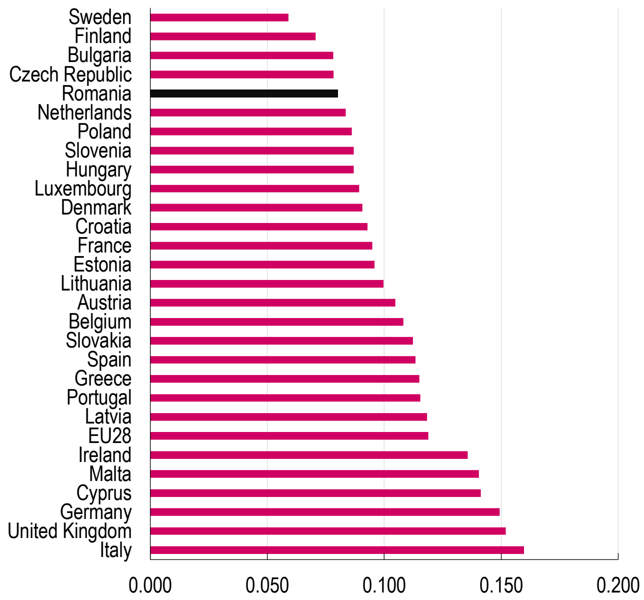
Source: Company data

Figure 40: Household electricity prices in 2015, EUR/kWh



Source: Eurostat

Figure 41: Industry electricity prices in 2015, EUR/kWh



Source: Eurostat

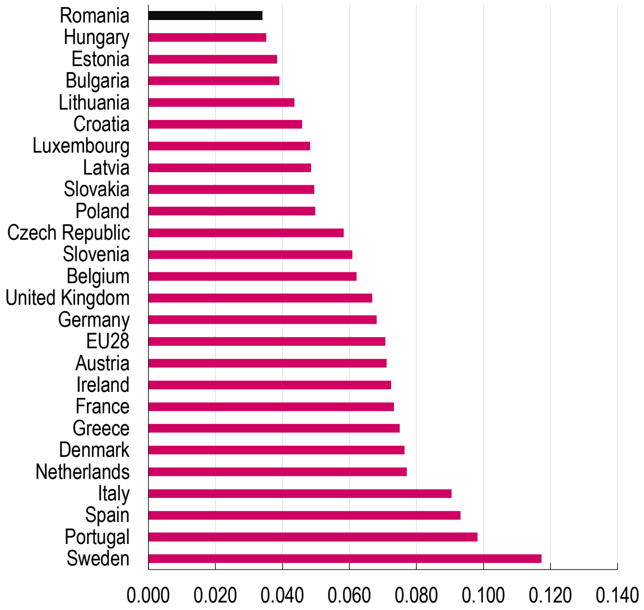
Gas end-user prices are regulated and are the lowest in the EU (half of the EU average in 2015 for households and 15% lower than the EU average in 2015 for industry). Gas prices for non-household consumer started to be determined freely in 2015. For household consumers, the government plans gradual elimination of regulated prices by April 2020. The plan was originally aimed at taking domestic gas prices for household users to the same level as import gas prices by 2018. However, liberalisation for household consumers was halted due to a drop in gas prices in Europe (declining towards RON60/MWh, which was close to the Romanian target). A new assessment will be carried out in early 2017 as to whether further steps should be taken regarding the liberalisation process.

Figure 42: Plan for Romanian gas tariff changes (before pause in June 2016)

Date	Household prices, RON/MWh
Jul-15	60
Jul-16	66
Apr-17	72
Apr-18	78
Apr-19	84
Apr-20	90

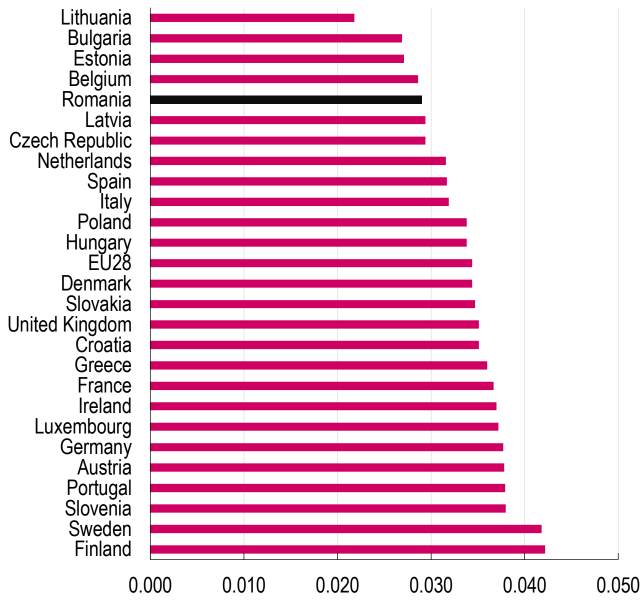
Source: Company data

Figure 43: Household gas prices in 2015, EUR/kWh



Source: Eurostat

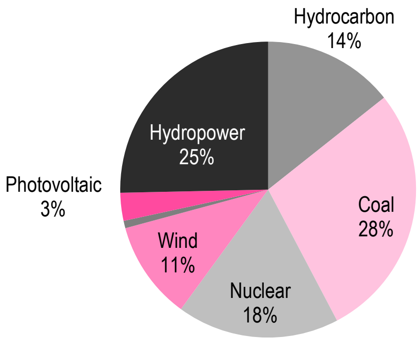
Figure 44: Industry gas prices in 2015, EUR/kWh



Source: Eurostat

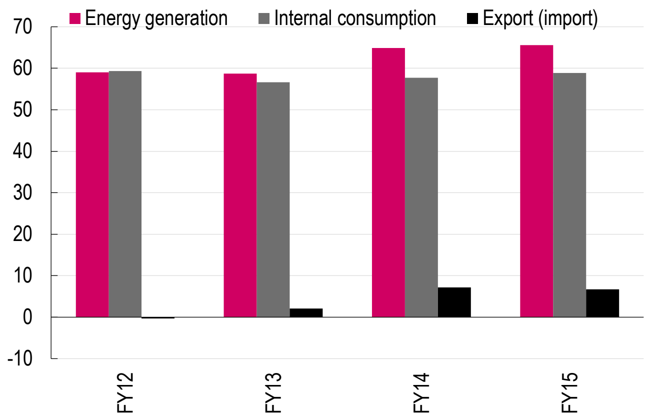
Generation: The Romanian electricity system currently has overcapacity and export capacity is limited. Stagnation of electricity demand is adding to overcapacity-driven pressure on the sector. Moreover, subsidised renewables and cogeneration cut the profitability of inefficient coal- and gas-powered plants to some extent. Based on 2015 figures, the main electricity generation resources are coal (28%), hydro (25%), nuclear (18%) and hydrocarbons (14%). Total power generation in Romanian in 2015 was 65.6TWh, and total domestic consumption was 58.9TWh. The balance of production, 6.7TWh, was exported. Remain an electricity exporter is a key strategic priority for the country, due to the domestic demand and supply imbalance. Hungary, Serbia and Bulgaria are the main export destinations.

Figure 45: Romanian power generation by type, GWh



Source: Hidroelectrica

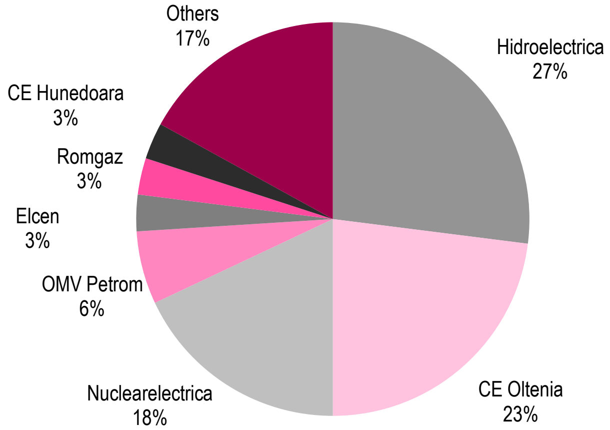
Figure 46: Romanian energy balance, TWh



Source: Hidroelectrica

Electricity generation is dominated by state-owned companies including Nuclearelectrica (the only nuclear power plant in the country), HE (hydropower) and around 20 coal-fired power plants. Among the private players, OMV Petrom has the largest gas-fired power plant (800 MW) and CEZ controls the largest wind power assets (600 MW).

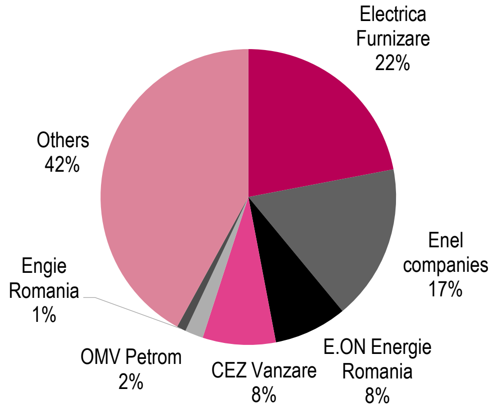
Figure 47: Romanian power generation breakdown by company in FY15



Source: Company data

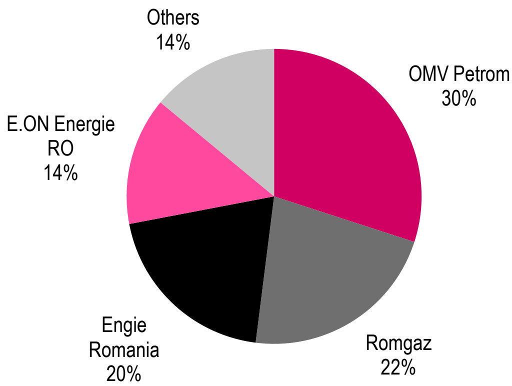
Transmission & distribution: Transelectrica is responsible for the electricity transmission system in Romania. It is 58.7% owned by the state and listed on the Bucharest Stock Exchange. In distribution, the level of connectivity is fairly high at 96%. In 2015, a total of 49 electricity distribution operators operated in the Romanian electricity market, of which eight serve over 100k users. Three of these are state-owned and the remaining five are private companies (majority-owned by ENEL, E.ON and CEZ), which obtained concession rights in a given region following privatisations. Apart from one company (CEZ), FP has minority stakes in all of the large distribution companies.

Figure 48: Romanian power distribution by company in FY15



Source: Company data

Figure 49: Romanian gas distribution by company in FY15



Source: Company data

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Renaissance Capital research team

Head of Research & Turkish Product	Michael Harris	+44 (207)	005-7982	MHarris2@rencap.com
Deputy Head of Research	David Ferguson	+7 (495)	641-4189	DFerguson@rencap.com
Head of South African Research	Johann Pretorius	+27 (11)	750-1450	JPretorius2@rencap.com

Name	Telephone number		Coverage
Macro			
Charles Robertson	+44 (207)	005-7835	Global
Yvonne Mhango	+27 (11)	750-1488	Sub-Saharan Africa
Oleg Kouzmin	+7 (495)	258-7770 x4506	Russia/CIS
Equity strategy			
Daniel Salter	+44 (207)	005-7824	Global
Michael Harris	+44 (207)	005-7982	Turkey
Charles Robertson	+44 (207)	005-7835	Global
Vikram Lopez	+44 (207)	005-7974	Global
Financials			
Armen Gasparyan	+7 (495)	783-5673	Russia/CIS, CEE
Ilan Stermer	+27 (11)	750-1482	South Africa
Francois Du Toit	+27 (11)	750-1162	South Africa
Olamipo Ogunsanya	+234 (1)	448-5300 x5368	Sub-Saharan Africa
Seki Mutukwa	+44 (207)	005-7736	Sub-Saharan Africa/MENA
Balram Ramesh	+971 (4)	409-2054	MENA
Consumer/Retail/Agriculture			
David Ferguson	+7 (495)	641-4189	Russia/CIS, Africa
Kirill Panarin	+7 (495)	258-7770 x4009	Russia/CIS, Africa
Zaheer Joosub	+27 (11)	750-1427	South Africa
Olaloye Oyawoye	+234 (1)	448-5300 x5377	Sub-Saharan Africa/CEE
Robyn Collins	+27 (11)	750-1480	South Africa
Mohamed Zein	+971 (4)	409-2032	MENA
Seki Mutukwa	+44 (207)	005-7736	Sub-Saharan Africa/MENA
Amine Wafy	+971 (4)	409-2052	MENA
Media/Technology/			
David Ferguson	+7 (495)	641-4189	Russia/CIS, Africa
Kirill Panarin	+7 (495)	258-7770 x4009	Russia/CIS, Africa

Name	Telephone number		Coverage
Oil and gas			
Ildar Davletshin	+44 (207)	005-7954	EMEA
Temilade Aduroja	+234 (1)	448-5300 x5363	Sub-Saharan Africa
Evgeny Stroinov	+7 (495)	258-7770 x4046	Russia/CIS
Metals and mining			
Johann Pretorius	+27 (11)	750-1450	South Africa
Steven Friedman	+27 (11)	750-1481	South Africa
Kabelo Moshesha	+27 (11)	750-1472	South Africa
Vladimir Sklyar	+7 (495)	641-4188	Russia/CIS
Anastasia Burkhanova	+7 (495)	258-7770 x4594	Russia/CIS
Real estate			
Seki Mutukwa	+44 (207)	005-7736	Sub-Saharan Africa/MENA
Telecoms/Transportation			
Alexander Kazbegi	+41 (78)	883-4527	Global
Artem Yamschikov	+7 (495)	258-7770 x7511	Russia/CIS
Amine Wafy	+971 (4)	409-2052	MENA
Utilities/Electric Equipment			
Vladimir Sklyar	+7 (495)	641-4188	Russia/CIS/SSA/Pakistan
Anastasia Tikhonova	+7 (495)	604-4493	Russia/CIS/SSA/Pakistan
Fertilisers			
Vladimir Sklyar	+7 (495)	641-4188	Russia/CIS/MENA/Pakistan
Anastasia Burkhanova	+7 (495)	258-7770 x4594	Russia/CIS/MENA/Pakistan
Diversified/Industrials			
Seki Mutukwa	+44 (207)	005-7736	Sub-Saharan Africa/MENA
Brent Madel	+27 (11)	750-1160	South Africa
Metin Esendal	+44 (207)	005-7925	Turkey

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Renaissance
Capital

Renaissance Capital
Moscow
T + 7 (495) 258-7777

Renaissance Capital Ltd.
London
T + 44 (203) 379-7777

Renaissance Capital
Johannesburg
T +27 (11) 750-1400

Renaissance Securities (Cyprus) Ltd.
Nicosia
T + 357 (22) 505-800

Renaissance Securities (Nigeria) Ltd.
Lagos
T +234 (1) 448-5300

Renaissance Capital
Nairobi
T +254 (20) 368-2000

Renaissance Capital
Dubai
T +971 (4) 409-2000

Renaissance Capital
Cape Town
T +27 (11) 750-1164