

# Transelectrica

Supported by market recovery

15 November 2010

Utilities

Current price\*

RON 18.00

**Hold**

Romania

Fair value

RON 19.10

Rating upgraded

Performance over	1M	3M	12M
Absolute	-1.1%	-3.2%	52.5%
Rel. to BET	-0.5%	-3.4%	37.0%
12M Lo/Hi	RON 11.5 / 21.9		
Reuters	TSEL.BX		
Bloomberg	TEL RO		
Market cap	€ 307.7m		
Free float	12.81%		
Next corporate event	4Q 2010 results		

IFRS cons. FY/e 31.12	2009A	2010F	2011F	2012F
Sales (RON m)	2,551.6	2,735.8	2,940.8	3,171.7
EBITDA (RON m)	355.7	346.2	425.4	492.1
EBIT (RON m)	98.5	87.5	145.5	184.1
Net profit (RON m)	18.3	25.0	98.8	163.4
EPS (RON)	0.2	0.3	1.3	2.2
DPS (RON)	0.3	0.1	0.7	1.1
P/E* (x)	72.3	52.7	13.4	8.1
Yield* (%)	1.7%	0.3%	3.7%	6.2%
EV/EBITDA*	6.2	7.3	6.6	6.0

Source: KBC Securities

\*Priced at COB 11 November 2010

We have revised upwards our near-term revenue estimates for Transelectrica to reflect stable growth in electricity consumption and exports. We have lowered our EBIT forecast by 18% for 2010 after the company postponed some expenses from last year, while higher projected revenues and efficiency improvements have prompted us to raise our EBIT forecasts by 1.9% for 2011 and 7.2% for 2012. More pessimistic FX estimates have dragged down our net income forecasts by 64.6% to RON 25.0m for 2010 and 24.5% to RON 98.8m for 2011. Expectations for a better operating performance have pushed up our fair value by 25% to RON 19.10 per share, which implies 6.1% upside. We upgrade our rating from Sell to Hold.

## Rating upgraded to Hold

- **Resilient electricity consumption:** Electricity consumption in Romania was up 4.2% y/y in 9M10. Exports also recovered in the period on the back of increased cross-border exchanges in the region. We expect quantities transported to reach 54.35m MWh in 2010, representing 4.0% y/y growth versus our previous estimate of 3.0% y/y.
- **Improved 9M10 results:** Transelectrica posted net income of RON 63.3m for 3Q10 (non-consolidated, RAS), reversing the RON 108.6m loss in 2Q10 and up almost 25 times y/y. On the operational side, the improvement was due to higher quantities, higher tariffs and better cost control, while on the financial side the improvement stemmed from the revaluation of €-denominated debt after RON strengthening in 3Q10.
- **Tariff hike expected to match inflation in 2011:** We expect Romanian energy regulator ANRE to deliver a tariff hike of around 6.5% in January 2011, which would match the average expected inflation rate for 2010. Political and social pressure could lead to ANRE putting a cap on the tariff hike, although compensations accrued by Transelectrica due to forecast quantity mismatches would impose a more abrupt tariff increase in 2012, when the current regulatory period ends.
- **Possible financing difficulties:** Transelectrica's current investment plan envisages expenditures of €160m in 2010-2013. Connecting new wind power plants to the national grid could necessitate additional investments of €250m in the period. The management said recently it would be difficult and expensive for the firm to obtain new debt financing. This could hurt profits, especially as FX risk hedging is still not being considered by the firm.
- **No significant impact from reorganization of subsidiary:** Romania's Ministry of Economy recently decided to merge maintenance subsidiary Smart with Transelectrica for cost reduction purposes. Smart is already consolidated as it is 100%-owned by Transelectrica. Although the firm could incur some costs related to the merger (e.g. obtaining new licenses) we do expect them to be significant for the consolidated results.
- **Trading at a discount to peers:** On a 2011F P/B of 0.7x and a 2011F EV/EBITDA of 6.6x, Transelectrica trades at discounts to peers of 63.4% and 19.6% respectively. We see these discounts as justified by the company's higher cost of capital and possible delays in ANRE applying the tariff methodology.

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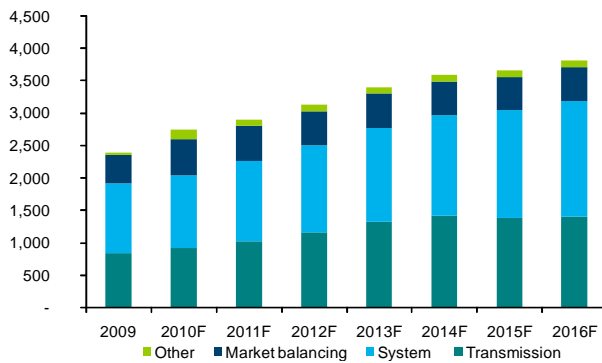
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### Transelectrica: Income statement (old versus new forecast)

(RON m)	2010F			2011F			2012F		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Transmission services revenues	915.2	924.0	1.0%	1,027.3	1,028.4	0.1%	1,154.2	1,164.5	0.9%
System services revenues	1,630.3	1,684.9	3.4%	1,687.7	1,781.1	5.5%	1,773.9	1,872.4	5.6%
<b>Total operating revenues</b>	<b>2,643.0</b>	<b>2,735.8</b>	<b>3.5%</b>	<b>2,815.1</b>	<b>2,940.8</b>	<b>4.5%</b>	<b>3,031.6</b>	<b>3,171.7</b>	<b>4.6%</b>
Operating costs	2,536.3	2,648.3	4.4%	2,672.4	2,795.3	4.6%	2,859.9	2,987.6	4.5%
<b>EBITDA</b>	<b>371.3</b>	<b>346.2</b>	<b>-6.8%</b>	<b>430.3</b>	<b>425.4</b>	<b>-1.1%</b>	<b>477.9</b>	<b>492.1</b>	<b>3.0%</b>
Depreciation	264.6	258.7	-2.2%	287.6	280.0	-2.7%	306.3	307.9	0.5%
<b>EBIT</b>	<b>106.7</b>	<b>87.5</b>	<b>-18.0%</b>	<b>142.7</b>	<b>145.5</b>	<b>1.9%</b>	<b>171.7</b>	<b>184.1</b>	<b>7.2%</b>
Net interest	-32.3	-32.9	-1.9%	-41.1	-54.6	-24.8%	-71.6	-65.2	-8.9%
Other financial result	8.1	-23.5	n.a.	54.0	16.5	-69.5%	33.8	67.2	98.7%
Pre-tax profit	82.5	31.0	-62.4%	155.6	107.3	-31.0%	133.9	186.1	39.0%
Taxes	11.8	6.0	-49.4%	24.8	8.6	-65.5%	21.2	22.7	7.1%
<b>Net profit</b>	<b>70.7</b>	<b>25.0</b>	<b>-64.6%</b>	<b>130.9</b>	<b>98.8</b>	<b>-24.5%</b>	<b>112.8</b>	<b>163.4</b>	<b>44.8%</b>

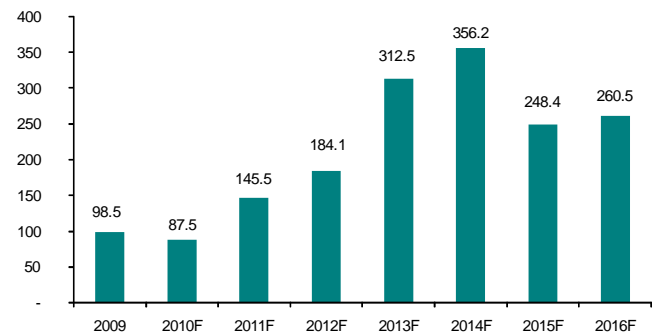
Source: KBC Securities estimates

### Transelectrica: Revenues breakdown (RON m)



Source: Transelectrica, KBC Securities estimates

### Transelectrica: EBIT forecast (RON m)



Source: Transelectrica, KBC Securities estimates

### Transelectrica: Changes in exchange rate forecasts

	2010F			2011F			2012F		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
€/RON (eop)	4.1	4.3	4.1%	3.9	4.2	7.2%	3.8	3.95	3.9%
US\$/RON (eop)	3.4	3.1	-10.8%	3.2	3.1	-2.5%	2.99	2.97	-0.7%

Source: Bloomberg

### Consensus versus KBC forecasts

(RON m)	2010F			2011F			2012F		
	Consensus	KBC	Difference (%)	Consensus	KBC	Difference (%)	Consensus	KBC	Difference (%)
Total revenues	2,693.5	2,735.8	1.6%	2,913.7	2,940.8	0.9%	2,952.3	3,171.7	7.4%
EBITDA	363.2	346.1	-4.7%	445.6	425.4	-4.5%	502.5	492.0	-2.1%
EBIT	94.0	87.4	-7.0%	160.6	145.5	-9.4%	197.0	184.1	-6.6%
Net result	50.3	25.0	-50.3%	105.5	98.8	-6.4%	101.0	163.4	61.7%

Source: KBC Securities estimates; Bloomberg

## Changes in forecasts and valuation

Transelectrica decided to postpone some expenses last year in order to meet its budgeted results and comply with obligations to reduce expenses which were imposed on all state-owned companies in Romania. This has prompted us to adjust our forecasts for the firm's operating profit downwards for 2010. At the same time we have revised our earnings forecasts upwards from 2011 to reflect the recovery in electricity consumption and better control of expenses. Despite the higher cost of capital induced by rising interest rates and a higher risk-free rate, our fair value is up 25% at RON 19.10 per share, which implies 6.1% upside. Our fair value estimate is calculated as the average result of our discounted cash flow model (DCF, RON 20.42 per share) and our dividend discount model (DDM, RON 17.79 per share). We upgrade our recommendation to Hold.

### Transelectrica: DCF summary

	RON m	%
Sum of FCF PVs (2010-2017)	152.4	6.3%
Sum of FCF PVs (2018-2044)	1,721.5	71.1%
PV of terminal value	547.1	22.6%
<b>Total enterprise value</b>	<b>2,421.0</b>	<b>100.0%</b>
Net debt	924.4	
Proceeds from sale of subsidiaries	0.0	
Value of equity	1,496.6	
Number of shares (m)	73.3	
<b>Fair value per share</b>	<b>20.4</b>	

Source: KBC Securities estimates

### Transelectrica: Dividend discount valuation

	RON m	%
Explicit forecast (2010-2017F)	366.2	28.1%
Fade (2018-2044F)	729.7	56.0%
Terminal value	208.3	16.0%
<b>Equity fair value</b>	<b>1,304.2</b>	<b>100.0%</b>
Number of shares (m)	73.3	
<b>Fair value per share (RON)</b>	<b>17.8</b>	

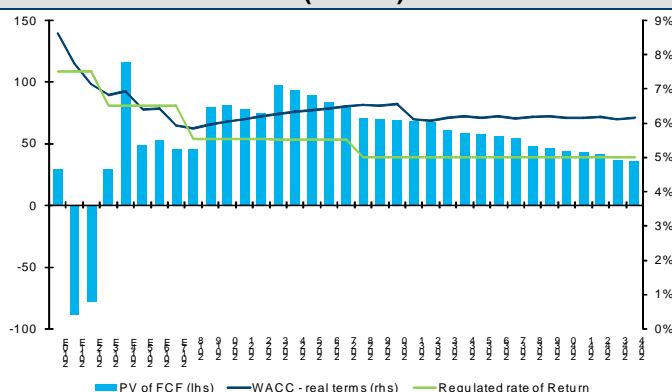
Source: KBC Securities estimates

### DCF valuation

	2010F	2011F	2012F	2013F	2014F	2015F	2016F	2017F	Avg. (2018-2044)
Turnover	2,736	2,941	3,172	3,443	3,672	3,731	3,875	4,034	5,954
Growth (%)	7.2%	7.5%	7.9%	8.6%	6.6%	1.6%	3.8%	4.1%	2.7%
EBIT	87	145	184	313	392	267	280	272	299
Growth (%)	-11.3%	66.3%	26.6%	69.8%	25.5%	-31.8%	4.7%	-2.7%	0.7%
Tax on EBIT	14	23	29	50	63	43	45	44	48
NOPLAT	73	122	155	263	329	225	235	229	251
Growth (%)	-11.3%	66.3%	26.6%	69.8%	25.5%	-31.8%	4.7%	-2.7%	0.7%
Depreciation	259	280	308	334	377	432	445	458	250
Capital expenditures	-386	-546	-533	-533	-497	-552	-565	-578	-500
Change in working capital	-85	-40	27	25	15	15	15	15	11
Free cash flow	31	-104	-98	39	195	90	101	94	227
Growth (%)	n.a.	n.a.	-6.0%	n.a.	401.9%	-53.7%	11.6%	-6.5%	4.0%

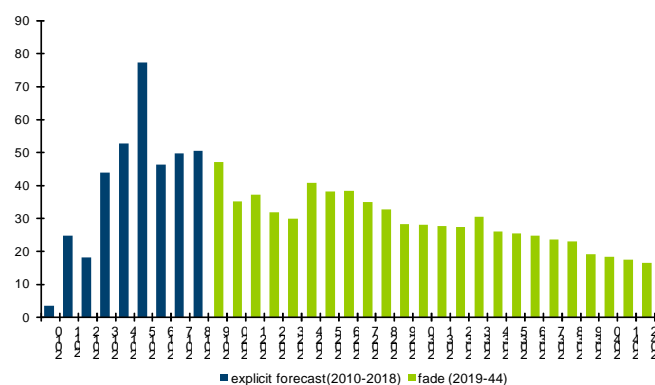
Source: KBC Securities

### NPV of future cash flows (RON m)



Source: KBC Securities estimates

### NPV of projected dividends (RON m)



Source: KBC Securities estimates

**Transelectrica: Multiple-based comparison**

	EV/EBITDA*			P/E*			P/Bk*		
	2010F	2011F	2012F	2010F	2011F	2012F	2010F	2011F	2012F
Elia	10.2	9.5	10.1	8.5	15.0	15.5	0.8	0.8	0.8
Terna	10.3	9.7	9.4	16.1	15.9	17.0	2.6	2.6	2.6
Snam Rete Gas	9.6	9.1	8.6	12.9	12.5	12.1	2.1	2.0	1.9
Red Electrica de Espana	n.a.	n.a.	n.a.	12.6	10.9	10.1	3.0	2.7	2.4
Enagas	8.4	7.7	7.1	11.0	10.2	9.7	2.1	1.9	1.8
Transgaz	5.1	5.2	5.0	11.1	11.1	10.8	1.0	1.0	1.0
<i>Average</i>	<b>8.7</b>	<b>8.2</b>	<b>8.0</b>	<b>12.0</b>	<b>12.6</b>	<b>12.5</b>	<b>1.9</b>	<b>1.8</b>	<b>1.7</b>
<b>Transelectrica</b>	7.3	6.6	6.0	52.7	13.4	8.1	0.7	0.7	0.6
<i>Premium/discount (%)</i>	-16.7%	-19.6%	-25.1%	339.4%	5.9%	-35.5%	-64.4%	-63.4%	-63.0%

Source: KBC Securities, Bloomberg

\*Priced at 11 November 2010 closing prices

## Financial data – Transelectrica

<b>INCOME STATEMENT (RON m)</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
Transmission services revenues	888.3	1,045.7	846.0	924.0	1,028.4	1,164.5
System services revenues	1,379.4	1,844.8	1,520.0	1,684.9	1,781.1	1,872.4
<b>Total operating revenues</b>	<b>2,384.4</b>	<b>2,988.1</b>	<b>2,551.6</b>	<b>2,735.8</b>	<b>2,940.8</b>	<b>3,171.7</b>
Operating costs	2,019.2	2,530.3	2,195.9	2,389.6	2,515.4	2,679.6
<b>EBITDA</b>	<b>365.3</b>	<b>457.7</b>	<b>355.7</b>	<b>346.2</b>	<b>425.4</b>	<b>492.1</b>
Depreciation	189.3	240.6	257.1	258.7	280.0	307.9
<b>EBIT</b>	<b>175.9</b>	<b>217.2</b>	<b>98.5</b>	<b>87.5</b>	<b>145.5</b>	<b>184.1</b>
Net interest	-29.2	-15.1	-23.9	-32.9	-54.6	-65.2
Other financial result	-51.4	-135.5	-62.4	-23.5	16.5	67.2
Pre-tax profit	90.6	62.6	12.1	31.0	107.3	186.1
Taxes	27.7	12.2	6.1	6.0	8.6	22.7
<b>Net profit</b>	<b>63.0</b>	<b>50.4</b>	<b>18.3</b>	<b>25.0</b>	<b>98.8</b>	<b>163.4</b>
<b>BALANCE SHEET (RON m)</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
<b>Current assets</b>	<b>927.5</b>	<b>1,115.4</b>	<b>838.8</b>	<b>950.6</b>	<b>997.7</b>	<b>1,157.4</b>
Cash and equivalents	198.1	224.2	163.4	112.5	57.9	186.1
Trade debtors	689.7	848.3	633.9	798.0	897.2	926.1
Inventories	39.7	42.9	41.5	40.2	42.5	45.2
<b>Fixed assets</b>	<b>2749.8</b>	<b>2,905.0</b>	<b>3,005.7</b>	<b>3,133.3</b>	<b>3,399.5</b>	<b>3,624.6</b>
Tangible assets	2707.8	3,266.5	2,969.6	3,090.8	3,355.5	3,579.0
Goodwill and other intangible assets	36.3	33.1	30.4	33.1	33.1	33.1
Financial assets	5.7	5.7	5.7	9.4	10.9	12.5
<b>Total assets</b>	<b>3677.3</b>	<b>4,020.4</b>	<b>3,844.5</b>	<b>4,083.9</b>	<b>4,397.2</b>	<b>4,782.0</b>
<b>Current liabilities</b>	<b>650.0</b>	<b>893.0</b>	<b>725.0</b>	<b>802.4</b>	<b>854.7</b>	<b>913.7</b>
Interest-bearing borrowings	141.7	165.7	140.6	149.4	159.1	169.9
Accounts payable	508.3	727.4	584.4	653.0	695.7	743.8
<b>Long-term liabilities</b>	<b>1116.6</b>	<b>1,192.8</b>	<b>1,215.5</b>	<b>1,374.1</b>	<b>1,585.6</b>	<b>1,829.7</b>
Interest-bearing borrowings	947.4	1,011.3	947.2	1,192.5	1,404.0	1,648.1
Provisions for liabilities and other	146.6	161.3	230.9	161.3	161.3	161.3
Minorities	0.0	-1.0	0.0	0.0	0.0	0.0
Shareholders' equity	1910.6	1,934.6	1,905.0	1,907.5	1,956.9	2,038.6
<b>Total liabilities and shareholders' equity</b>	<b>3677.2</b>	<b>4,020.4</b>	<b>3,845.5</b>	<b>4,083.9</b>	<b>4,397.2</b>	<b>4,782.0</b>
<b>CASH FLOW STATEMENT (RON m)</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
<b>Cash flow from operations</b>	<b>60.7</b>	<b>362.9</b>	<b>417.9</b>	<b>119.9</b>	<b>319.8</b>	<b>487.9</b>
Net profit	63.0	50.4	18.3	25.0	98.8	163.4
Depreciation	189.3	240.6	257.1	258.7	280.0	307.9
Change in working capital, incl.:	-176.0	57.3	72.9	-94.2	-58.9	16.5
change in receivables	6.7	-158.6	214.4	-164.1	-99.2	-28.9
change in inventories	-10.0	-3.2	1.4	1.4	-2.4	-2.7
change in payables	-172.8	219.1	-142.9	68.5	42.7	48.1
Other	-15.6	14.7	69.6	-69.6	0.0	0.0
<b>Cash flow from investment</b>	<b>-557.4</b>	<b>-395.8</b>	<b>-357.9</b>	<b>-386.3</b>	<b>-546.2</b>	<b>-533.0</b>
Additions to PPE, net	-566.0	-395.8	-357.9	-386.3	-546.2	-533.0
Acquisitions, net	0.0	0.0	0.0	0.0	0.0	0.0
Other	8.6	0.0	0.0	0.0	0.0	0.0
<b>Cash flow from financing</b>	<b>342.7</b>	<b>61.5</b>	<b>-136.9</b>	<b>231.6</b>	<b>171.8</b>	<b>173.3</b>
Change in debt / incr. in marketable securities	147.3	87.9	-89.1	254.1	221.2	254.9
New equity	221.8	0.0	0.0	0.0	0.0	0.0
Dividends	-26.4	-26.4	-47.8	-22.5	-49.4	-81.7
Other	0.0	0.0	0.0	0.0	0.0	0.0
Net change in cash and equivalents	-154.0	28.6	-76.9	-34.8	-54.5	128.1
Cash at beginning of period	352.1	198.1	212.2	163.4	112.5	57.9
Cash at end of period	198.1	224.2	163.4	112.5	57.9	186.1

Source: Transelectrica, KBC Securities

<b>PER SHARE DATA (RON)</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
Shares outstanding (m)	73.3	73.3	73.3	73.3	73.3	73.3
EBITDA per share	5.0	6.2	4.9	4.7	5.8	6.7
EBIT per share	2.4	3.0	1.3	1.2	2.0	2.5
Published EPS	0.9	0.7	0.2	0.3	1.3	2.2
Net dividend	1.5	0.4	0.3	0.1	0.7	1.1
NBV per share	26.1	26.4	26.0	26.0	26.7	27.8
<b>PERFORMANCE CRITERIA</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
Sales growth	-4.8%	25.3%	-14.6%	7.2%	7.5%	7.9%
EBITDA margin	15.3%	15.3%	13.9%	12.7%	14.5%	15.5%
EBIT margin	7.4%	7.3%	3.9%	3.2%	4.9%	5.8%
EPS annual growth	-78.6%	-20.0%	-63.8%	37.1%	294.8%	65.4%
CFPS annual growth	-87.4%	498.2%	15.2%	-71.3%	166.7%	52.6%
Pay-out ratio	41.9%	43.7%	20.1%	197.4%	82.7%	36.5%
Effective tax rate	30.5%	19.5%	50.7%	19.3%	8.0%	12.2%
Effective interest rate	4.6%	4.9%	3.7%	3.2%	3.8%	3.9%
EPS CAGR 3Y historic	-34.5%	-64.2%	-60.4%	-26.5%	25.2%	107.6%
CFPS CAGR 3Y historic	n.a.	11.9%	-13.2%	97.7%	-11.9%	16.7%
Total asset turnover	64.8%	74.3%	66.4%	67.0%	66.9%	66.3%
Total debt / total assets	29.6%	29.3%	28.3%	32.9%	35.5%	38.0%
Net financial debt / equity	46.6%	49.2%	48.5%	64.5%	76.9%	80.1%
Return on equity	3.5%	2.6%	1.0%	1.3%	5.1%	8.2%
<b>VALUATION DATA*</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010F</b>	<b>2011F</b>	<b>2012F</b>
Financial year high (RON )	49.3	39.3	14.7	21.9	21.9	21.9
Financial year low (RON )	30.3	10.9	8.6	11.5	11.5	11.5
Reference market capitalization (RON m)	1,319.5	1,319.5	1,319.5	1,319.5	1,319.5	1,319.5
Enterprise value (RON m)	1,961.6	1,939.7	2,198.9	2,513.3	2,816.0	2,964.9
PER high (x)	57.4	57.2	59.0	64.2	16.2	9.8
PER low (x)	35.3	15.9	34.3	33.7	8.5	5.2
PER reference (x)	21.0	26.2	72.3	52.7	13.4	8.1
P/CF (x)	21.8	3.6	3.2	11.0	4.1	2.7
P/Book value (x)	0.7	0.7	0.7	0.7	0.7	0.6
Gross dividend yield (%)	8.2%	2.0%	1.7%	0.3%	3.7%	6.2%
EV/EBITDA (x)	5.4	4.2	6.2	7.3	6.6	6.0

Source: Transelectrica, KBC Securities

\*Historic valuation data are based on historic prices

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