

Utilities

TRANSELECTRICA

Still a defensive stock?

Buy (12m)

Price 23/03/2012 12m target
 RON 16.02 RON 20.6

Sector
 Weighting
Neutral

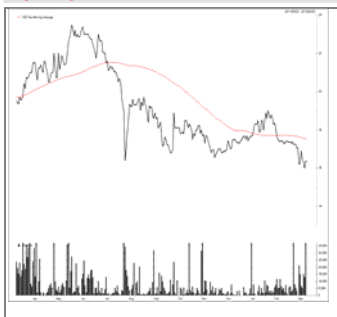
Market Share
100%

Last and TP Recommendation
BUY RON 22.4 (April 26, 2011)

Type of investment

Defensive ✓
 Dividend play ✓
 Regulatory risk ✓

1 year, price-volume



Source: Factset, BRD, GSG

▼ **Investment case** We reiterate our **Buy** recommendation for TEL share given the 28.8% discount from market price, but we lowered our 12M TP to **RON 20.6** from previously RON 22.4 despite of good 2011 results and ambitious three years CAPEX program of EUR 474m, almost double vs. the previous figures. While our main assumptions regarding power consumption and macro environment remained unchanged, we penalized the company's top line and especially the revenues from transmission activity by applying a discount to the values resulted from regulated revenue methodology. The historical data from 2009-2010 period showed a delay or just partial approval by ANRE of the tariff growth resulted from the methodology, while the tariffs for 2012 haven't been approved yet. We also take into account lower values for the CAPEX program than the ones recently announced by the company (please see valuation section below).

▼ **Catalysts for the share price** The most important price catalyst is the result of the current SPO. The success of the offer will bring several advantages: a more liquid stock with an almost doubled free float, the possibility to launch a subsequent IPO (which management proposed, but it was rejected by the majority shareholder), increased public awareness. On contrary the fail of the current SPO will have a negative influence of market price and probably determine pressure on sell side. On longer term the renegotiation with ANRE for the third regulatory period (2013-2017) should bring new insights regarding the company's perspectives. The 2011 proposed dividend was in line with market expectation and already included in price.

▼ **12m target price and methodology** The new target price is RON 20.6 based on a DCF two stages valuation method. The FCFF of the explicit period (2012 – 2020) were discounted using a variable WACC between 11.3% (2012) and declining down to 9.9% in 2020. For the second stage (mature growth period) we have used as terminal value 2020 RAB resulted from the application of the regulated revenue method. We cross checked our DCF valuation with a peers comparison using main European TSO-s, revealing that TEL shares are trading at significant discounts vs. peer group both for 2012 and 2013 forward market multipliers.

▼ **Alternative scenarios and risks to our valuation** We see as main risk the regulatory one, more specifically the late or partial approval by ANRE of the tariffs growth resulted from the regulatory methodology. On one side this impedes the company to realise the planned investments on time and on other side lowers the revenues predictability, which is the main feature of a defensive business such as regulated power transmission activity.

▼ **Next events** Presentation of IFRS 2011 financial statements during an analysts and investors meeting on March 29, 2012. Current SPO to end on March 27, 2012. OGSM called for April 24, 2012 in order to approve 2011 audited financial statements and dividend proposal.

www.transelectrica.ro

Share data

RIC RO TEL, Bloomberg TEL RO			
52-week range	16.4	– 23.49	
EV '12 (RONbn) - DCF	2.03		
Market cap. (RONbn)	1.17		
Free float (%)	12.81		
Performance (%)	1m	3m	12m
Ordinary shares	-7.7	-8.5	-17.8
Relative to BET	-6.6	-23.4	-7.1

Financial data (RON)

	12/10	12/11	12/12e	12/13e
Total Op. Revenues (m)	2,683	3,147	2,679	2,413
Net Profit (m)	104.0	137.8	179.6	171.6
CFO/share	6.8	7.5	6.3	6.7
EPS	1.4	1.9	2.4	2.3
BVPS	27.3	29.4	29.4	32.2
Dividend/share	0.12	1.10	0.72	0.74
Payout* (%)	8	59	29	32
Net debt/equity (%)	50	39	38	39

*based on IFRS net profit

Ratios*

	12/10	12/11	12/12e	12/13e
P/E (x)	11.3	8.5	6.5	6.8
Price/CFO (x)	2.4	2.1	2.5	2.4
EV/EBITDA (x)	4.8	4.0	3.9	3.9
EV/EBIT (x)	11.6	9.5	10.0	10.0
P/Sales (x)	0.4	0.5	0.5	0.5
Dividend yield (%)	0.7	6.9	4.5	4.6
Price/book value (x)	0.6	0.5	0.5	0.5
ROIC/WACC (x)	0.56	0.60	0.55	0.58

*based on current price

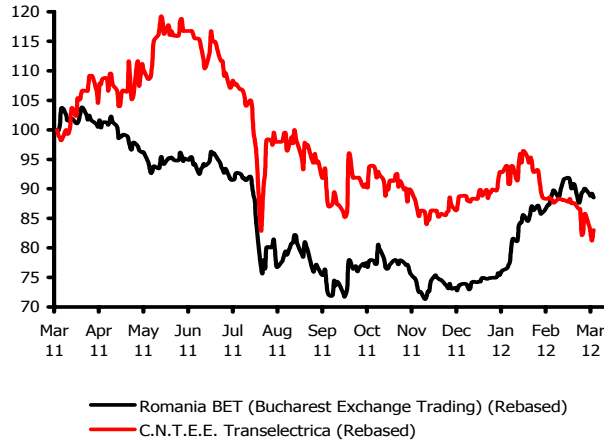
Laura Simion, CFA

(40) 21 301 44 61

laura.simion@brd.ro

Market performance

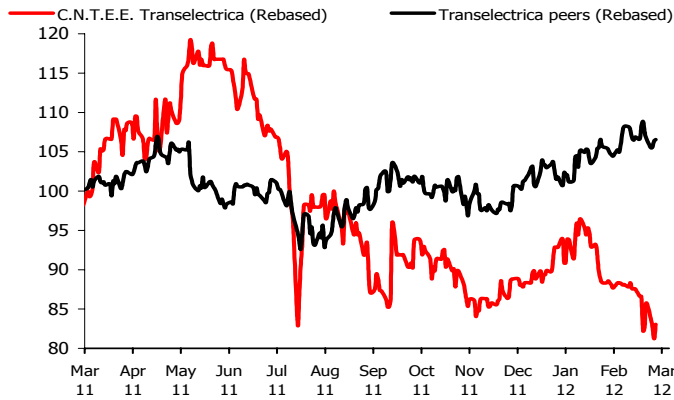
TEL vs. BET share price performance, rebased



TEL shares underperformed BET by 7.1% in the past 12 months. TEL shares also had a higher volatility than the index.

Source: FactSet, BRD GSG

TEL vs. peers share price performance, rebased, EUR denominated



TEL shares underperformed their peer group by 22% over the past 12 months. For a short period (May'11 – Jul'11) TEL price performance was above its peer group one.

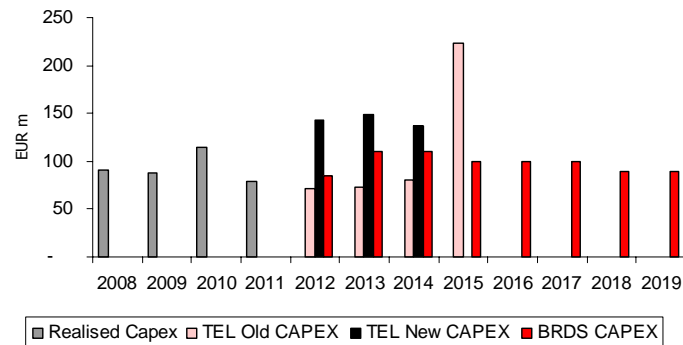
Source: FactSet, BRD GSG

Valuation

Target price calculation and fundamental valuation

- We value TEL shares based on a two stages DCF model with an explicit period of 9 years (2012-2020) and a second mature period.
- The energy transported in 2011 modestly increased by 1.47% yoy, while transport tariffs approved for 2011 were by 10.44% higher yoy. Also, starting with April, 1st, 2011 the cogeneration services are treated differently without being booked in the company's financial statements. Consequently, the tariff for system services decreased from RON 20.75/MWh to RON 10.21/MWh. We have maintained our long term CAGR of 2% for power consumption in 2012-2020 period. Transmission tariffs for 2012 – 2020 period were derived using the well known regulated revenue method but we have applied a discount of 20% on average as the tariffs approved by ANRE included only partially and/or with delay the growth resulted from the methodology. For 2012, we assumed a tariff change starting with end June. (The new tariff should have been approved in Jan'12).
- In 2011 the company booked a high level (RON 1.2bn) of market balancing revenues and related expenses (as this is a pass-through activity). In line with company's budget and guidance, we have maintained these revenues and expenses at significant levels for 2012-2013 and then normalized them towards the end of our explicit period. Although with no influence on profit these items overstates company's turnover and understates some ratios such as EBIT or net profit margin. On the expenses side we have maintained our main assumptions with a 2.1% technological consumption rate, annual RON 135m maintenance and repair expenses, while the expenses related to pass through activities were readjusted to corresponding revenues.
- The company's budget for 2012 points to operating revenues of RON 2.54bn vs. our estimate of RON 2.68bn. The main differences reside from the fact that our forecast are made on IFRS data which includes revenues from the consolidated subsidiaries as well as revenues from new system connections tax and from more conservative company's assumptions (1.8% consumption growth in 2012 vs. 2% BRD-GSGe and 0% yoy growth in transmission tariffs vs. 2.5% our forecast). Budgeted operating expenses stand at RON 2.46bn, slightly lower than our estimate of RON 2.475bn. For the first time the company's management published a multi-annual budget and released also estimates for 2013-2014 period. The starting point was 2012 detailed budget forecast, while the tariffs growth was conservatory approximated by the CPI forecasted by the National Forecasting Commission. Budget operating revenues of 2013 and 2014 amount to RON 2.62bn and RON 2.68bn, respectively vs. BRD-GSGe of RON 2.41bn and RON 2.4bn as we assumed a significant drop in market balancing revenues (RON 400m in 2014 vs. RON 765m in 2012 company's budget).
- Transelectrica also announced an ambitious CAPEX program for 2012-2014 period. Thus the company announced an investment program of EUR 474m for the next three years with an annual maximum of EUR 168m in 2013. Between 57% and 66% of the planned CAPEX should be financed through debt, between 54% and 60% from own sources and the rest from grants and new connections tax. In 2011, Transelectrica invested EUR 79m (94.3% of planned CAPEX). The new CAPEX for the next three years is more than doubled vs. the figures announced by the company in Nov'10 when the delay in new tariffs approval by ANRE made the management to be extremely conservative. Considering all that as well as the current gearing ratio of the company which stands at 35% for debt to employed capital as of end 2011, we included in our

DCF valuation lower CAPEX figures around EUR 110m for 2013-2014 period, EUR 100m for 2015-2017 period and EUR 90m for 2018-2020 period, respectively. The realized CAPEX for 2008-2011 period, as well as Transelectrica's old and new forecasts and our own estimates are depicted in the below graph:



DCF valuation and main assumptions

- We obtain an equity value of RON 1.44bn on the back of our DCF calculation. The 12M target price reaches RON 20.6, which implies a **BUY** recommendation considering the upside from current market price of RON 16, as of March 23, 2012.

Indicator (RONth)	2012e	2013e	2014e	2015e	2016e	2017e	2018e	2019e	2020e
EBIT	203,939	209,891	182,238	225,957	248,065	296,306	334,480	358,334	365,109
EBIT*(1-t)	171,309	176,308	153,080	189,804	208,375	248,897	280,964	301,000	306,692
+D&A expenses	318,657	331,253	349,595	334,210	344,872	347,588	360,984	374,533	385,336
- CAPEX	381,600	456,500	451,000	400,000	400,000	400,000	360,000	360,000	360,000
-Change in WC	(21,598)	7,684	(34,092)	30,522	(1,800)	(2,805)	(2,039)	(2,691)	(2,462)
FCFF	86,767	58,745	17,583	154,535	151,447	193,681	279,909	312,843	329,566
WACC	11.27%	10.57%	10.57%	10.57%	9.88%	9.88%	9.88%	9.88%	9.88%
Discounted FCFF	77,979	47,747	12,924	102,732	91,629	106,648	140,275	142,688	136,804
Present value of FCFFs ('12-'20e)	859,427								
Present Value of RAB	1,416,446								
Firm fair value	2,275,873								
(-) net debt (Dec'11)	(837,694)								
Equity value	1,438,179								
Fair value per share	19.6								
Target price 12M	20.6								
Closing Price as of 23/03/2012	16.02								
Upside/downside potential	28.8%								

Source: BRD GSG estimates

WACC assumptions

- As parameters for calculating the company's target WACC, we have maintained our previous estimates: a cost of equity that considers a premium which declines from 7.5% in 2011 to 6.5% in 2020 (Damodaran) and a risk-free rate between 7% and 6% over the 2011-2020 period. The diminishing levels for the risk-free rate are consistent with our macroeconomic view of long-term economic stability, as disinflation process consolidated in the last six months and National Bank of Romania continues to relax its monetary policy. The stock beta stands at 0.8. Consequently, we used a variable WACC for the explicit period between 11.3% and 9.9%.

Indicator	2012e	2013e	2014e	2015e	2016e	2017e	2018e	2019e	2020e
LT Risk Free Rate	7.0%	6.5%	6.5%	6.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Equity Risk Premium	7.50%	7.00%	7.00%	7.00%	6.50%	6.50%	6.50%	6.50%	6.50%
Unlevered β	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Cost of Equity	22.4%	20.9%	20.9%	20.9%	19.3%	19.3%	19.3%	19.3%	19.3%
Cost of Debt (before tax)	7.6%	7.1%	7.1%	7.1%	6.7%	6.7%	6.7%	6.7%	6.7%
WACC	11.3%	10.6%	10.6%	10.6%	9.9%	9.9%	9.9%	9.9%	9.9%

Source: BRD GSG estimates

Sensitivity analysis

- We conducted a sensitivity analysis on our valuation results. The sensitivity of the target price as a function of WACC is showed in the table below. Thus, a 50bps decrease in WACC leads to an increase in our 12M TP of 5.7% and a 50bps increase in WACC leads to a decrease of 17.7% in TP, which reveals a high correlation with the parameters included in WACC calculation.

	WACC-1%	WACC-0.5%	WACC	WACC+0.5%	WACC+1%
Cumulated PV of FCFF (RON th)	842,972	882,832	859,427	769,847	747,302
PV of RAB (RON th)	1,428,791	1,475,587	1,416,446	1,251,045	1,197,331
Equity value (RON per share)	19.56	20.75	19.62	16.14	15.10
12m target price, RON	20.57	21.82	20.63	16.97	15.88
Upside/Downside	28.4%	36.2%	28.8%	6.0%	-0.9%

Source: BRD-GSG estimates

Peers comparison

We used for relative valuation a group of European TSO-s (transport system operators): Elia (Belgium), National Grid (UK), Red Electrica (Spain) and Terna (Italy). Same as the prices graph, the market multiples for 2011 showed that Transelectrica was traded at significant discounts vs. its peers, especially in terms of EV/EBITDA (-58%), which is the most appropriate for relative analysis as it is not influenced by local tax regime and company's financing and investment strategy. The forward EV/EBITDA reveals a decreasing discount of 48% in 2012 and of 43% in 2013. Part of the discount between Transelectrica and its European peers is explained by low operative performance, regulatory risk (approved tariffs don't respect regulated revenue method) and market risks (low free float and liquidity). However, we consider the current market valuation of TEL stock is under its potential which enforces our Buy recommendation.

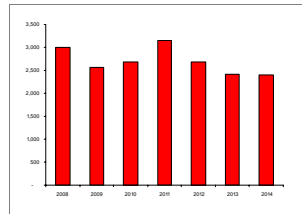
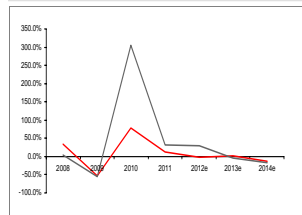
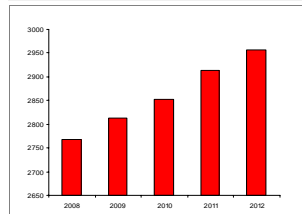
Company	Price* (EUR)	Mcap (EUR m)	P/E			EV/EBITDA			EV/EBIT			ROE
			11	12e	13e	11	12e	13e	11	12e	13e	11
Elia	31.70	1,913	13.9 x	14.3 x	12.9 x	9.7 x	9.6 x	9.1 x	14.1 x	10.4 x	14.6 x	6.73%
National Grid	7.64	27,254	12.9 x	11.7 x	11.6 x	8.9 x	8.7 x	8.8 x	12.2 x	13.7 x	11.5 x	na
Red Electrica	36.54	4,943	10.7 x	9.5 x	8.8 x	7.5 x	7.6 x	7.1 x	10.9 x	12.1 x	10.8 x	25.39%
Terna	3.00	6,038	15.4 x	14.5 x	13.9 x	8.4 x	9.0 x	8.9 x	12.4 x		13.1 x	14.03%
average			13.2 x	12.5 x	11.8 x	8.6 x	8.7 x	8.5 x	12.4 x	12.5 x	12.1 x	15.4%
Transelectrica	3.74	517	8.7 x	8.2 x	7.8 x	4.0 x	4.5 x	4.9 x	9.6 x	12.4 x	14.0 x	6.4%
Discount/ Premium			-34%	-34%	-34%	-54%	-48%	-43%	-23%	-1%	16%	-58%

Source: Factset, BRD-GSG, prices as of March 22, 2012

Utilities (Romania)

Price 23/03/2012

12m target

TRANSELECTRICA
BUY
RON 16.02
RON 20.6
Operating revenues

Net profit and EBIT growth

RAB for 2nd reg. period (2008-2012)

Major shareholders (%)

METBE	73.69
Proprietatea Fund	13.5
Others	12.81

Valuation* (RON m)	2008	2009	2010	2011	2012e	2013e	2014e
Average nb of shares (diluted)	73.30	73.30	73.30	73.30	73.30	73.30	73.30
Share price (eop)	16.02	16.02	16.02	16.02	16.02	16.02	16.02
EV	2127	2161	2181	2012	2034.2	2094.6	2223.9
P/E (x)	20.3	45.8	11.3	8.5	6.5	6.8	8.2
Price/CFO (x)	3.3	2.7	2.4	2.1	2.5	2.4	2.8
EV/EBITDA (x)	4.6	6.0	4.8	4.0	3.9	3.9	4.2
EV/EBIT (x)	9.5	20.4	11.6	9.5	10.0	10.0	12.2
Price/book value (x)	0.6	0.6	0.6	0.5	0.5	0.5	0.5
P/S(x)	0.4	0.5	0.5	0.4	0.5	0.5	0.5
Dividend yield	2.2%	0.4%	0.7%	6.9%	4.5%	4.6%	4.9%
Per share data (RON)							
EPS	0.8	0.3	1.4	1.9	2.4	2.3	1.9
CFO	4.9	6.0	6.8	7.5	6.3	6.7	5.7
Book value	26.4	26.0	27.3	29.4	30.5	32.2	33.4
Dividend	0.35	0.07	0.12	1.10	0.72	0.74	0.79
Income statement (RON m)							
Transport revenues	1045.7	939.8	968.1	1110.0	1126.7	1189.0	1263.0
System revenues	1090.3	1076.1	1163.9	784.1	668.0	635.4	666.0
Total Operating revenues	2995.4	2559.0	2683.2	3147.5	2679.1	2412.9	2407.2
EBITDA	465.1	363.1	455.6	501.9	522.6	541.1	531.8
Depreciation, depletion and amort.	-240.6	-257.1	-267.1	-291.0	-318.7	-331.3	-349.6
EBIT	224.5	106.0	188.4	211.0	203.9	209.9	182.2
Net financial income/expense	-29.5	-25.1	-25.1	-22.3	-20.9	-18.7	-24.3
	-126.2	-62.7	-33.9	-13.6	33.0	15.9	14.5
EBT	70.0	19.5	130.2	177.3	213.8	204.3	169.8
Corporate tax	-12.2	6.1	-26.2	-39.5	-34.2	-32.7	-27.2
Reported net income	57.7	25.6	104.0	137.8	179.6	171.6	142.6
Cash flow statement (RON m)							
Net income	57.7	25.6	104.0	137.8	179.6	171.6	142.6
Depreciation, depletion and amort.	240.6	257.1	267.1	291.0	318.7	331.3	349.6
Change in working capital	64.6	4.5	28.2	69.7	-21.6	7.7	-34.1
Cash flow from operating activities	355.5	441.5	498.3	549.4	461.6	490.6	418.1
Cash flow from investing activities	-395.8	-338.9	-480.5	-349.4	-383.1	-458.4	-453.3
Cash flow from financing activities	62.5	-123.2	9.5	-42.4	26.0	-78.7	-86.1
Total CF	22.3	-20.7	27.3	157.6	104.4	-46.5	-121.2
Balance sheet (RON m)							
Total long-term assets	2905.0	3005.7	3215.0	3298.5	3363.0	3490.1	3593.8
of which tangible	2454.6	2428.3	2681.0	2745.9	2754.4	2825.8	2962.1
Working capital	173.4	164.7	111.4	49.3	70.9	63.2	97.3
Total interest bearing debt	1176.9	1150.2	1166.6	1160.2	1286.8	1300.7	1308.7
Shareholders' equity	1934.6	1904.8	2003.0	2157.2	2238.3	2357.3	2445.8
Net debt	-953	-987	-1006	-838	-860	-920	-1050
Accounting ratios							
ROIC	7.6%	3.7%	6.3%	6.8%	6.2%	6.2%	5.3%
ROE	3.0%	1.3%	5.2%	6.4%	8.0%	7.3%	5.8%
Sales growth (%)	25.6%	-14.6%	4.9%	17.3%	-14.9%	-9.9%	-0.2%
EBITDA margin	15.5%	14.2%	17.0%	15.9%	19.5%	22.4%	22.1%
EBIT margin	7.5%	4.1%	7.0%	6.7%	7.6%	8.7%	7.6%
Net income margin	1.9%	1.0%	3.9%	4.4%	6.7%	7.1%	5.9%
Net debt/equity	49.2%	51.8%	50.2%	38.8%	38.4%	39.0%	42.9%
Interest cover	3.73	2.50	6.33	6.39	5.31	5.21	4.28
Payout ratio	44%	20%	8%	59%	29%	32%	40%

*Valuation ratios for past years are based on current price

BRD-GSG – Research		+40 21 301 6850	research@brd.ro
Florian LIBOCOR	Chief Economist Head of Research	+40 21 301 6869	florian.libocor@brd.ro
Carmen LIPARĂ	Head of Financial Markets Research	+40 21 301 4370	carmen.lipara@brd.ro
Monica CROITORU	Economist	+40 21 301 6858	monica.croitoru@brd.ro
Laura SIMION, CFA	Equity Analyst	+40 21 301 4461	laura.simion@brd.ro
Roxana HULEA	Economist	+40 21 301 4472	roxana.hulea@brd.ro

BRD-GSG rating system (March 2012)

Premium List

Selected from stocks expected to outperform the market by over 25%.

Buy

Expected to outperform the market by at least 10%.

Hold

Expected to perform in line with the market +/-10%.

Sell

Expected to underperform the market by at least 10%.

Assumptions

12 month time horizon and flat market over forecast period.

IMPORTANT DISCLAIMER

Disclaimer. This publication is issued in Romania by or through BRD – Groupe Société Générale (BRD - GSG), which is regulated by the Romanian Securities and Exchange Commission and National Bank of Romania. The information herein is not intended to be an offer to buy or sell, or a solicitation of an offer to buy or sell any securities. Investments in emerging markets can involve significant risks, such as uncertainty of dividends, of benefits or of profits, market, foreign exchange, legal, credit, tax and other risks and are not suitable for all investors. The information contained herein, including any expression of opinion, has been obtained from or is based upon sources believed to be reliable, but is not guaranteed as to accuracy or completeness although BRD - GSG believes it to be accurate, clear, fair and not misleading at the time of publication. BRD - GSG, and its affiliated companies, may from time to time to deal in, profit from the trading of, hold or act as market-makers or act as advisers, brokers or in relation to the securities, or derivatives thereof, of persons, firms or entities mentioned in this document or be represented on the board of such persons, firms or entities. Employees of BRD - GSG, and its affiliated companies, or individuals connected to them, may from time to time have a positioning or be to holding any of the investments or related investments mentioned in this document. BRD - GSG, and its affiliated companies, are under no obligation to disclose or take account of this document when advising or dealing with or for their customers and may have acted upon or made use of the information in this document prior to its publication. The views of BRD -GSG reflected in this document may change without notice. To the maximum extent possible at law, BRD - GSG does not accept any liability whatsoever arising from the use of the material or information contained herein. This research document is not intended for use by/or targeted to private customers. In case customers obtain a copy of this report, they should not base their investment decisions solely on this document, but must search for independent financial advice.

Important notice: The circumstances in which materials provided by BRD - GSG have been produced are in such manner (for example because of reporting or remuneration structures or the physical location of the author of the material) that it is not appropriate to characterise it the materials as independent investment research as referred to in European MIFID directive and that it should be treated as a marketing material even if it contains a research recommendation. However, it must be made clear that all publications issued by BRD – GSG will be accurate, clear, fair, and not misleading.

This publication is also not subject to any prohibition or dealing ahead of the dissemination of investment research.

Analyst Certification: Each author of this research report hereby certifies that (i) the views expressed in the research report accurately reflect his or her personal views about any and all of the subject securities or issuers and (ii) no part of his or her compensation was, is, or will be related, directly or indirectly, to the specific recommendations or views expressed in this report.

Copyright BRD-Groupe Societe Generale 2012. All rights reserved. Nobody can reproduce, redistribute or pass on to any other person or publish in whole or in part for any purpose this publication.