

## Energo Pro Sales (4ES) Energo Pro Grid (2EG)



Privatization of the state owned stake (33%) of electricity distribution companies in Bulgaria which has initially started with EVN Bulgaria Electroprerazpredelenie's and EVN Bulgaria Electrosnabdiavane 's shares continues. Currently Energo- Pro Sales and Energo-Pro Grid securities (formerly E.ON Bulgaria Sales and E.ON Bulgaria Grid) are on the agenda.

In 2004 - 2005, E.ON acquired 67% of Varna Electricity Distribution Company and Gorna Or-yahovitsa Electricity Distribution Company. The deal accounted for BGN 275 million (140.7 million EUR). In late 2006 the company divided its activities and thus E.ON Bulgaria Grid and E.OH Bulgaria Sales separated. At the end of 2011 E.ON bought back the 8% stake from the European Bank for Reconstruction and Development (which it initially sold it in early 2006), while in June 2012 Energo-Pro bought E.ON's activity in Bulgaria. The deal price has not been announced. Currently, the companies are in 5-year regulatory period ending in 2013.

Energo-Pro Sales is the third largest electricity provider in the country and is operating in the Northeastern Bulgaria. The majority of the company's revenues are from households – 50%, followed by revenue from corporate customers – 20%. The company has a 30-year concession, which expires in 2039.

Energo-Pro Grid serves 1.2 electrometers in the country. Planned investments for the period 2011-2013 are worth BGN 218 million. The main purpose of those investments is to reduce the electricity losses. The company has managed to reduce its electricity losses to 14.8% for 2011 compared to 15.8% for 2010.

The main advantages of the companies are their stable and relatively predictable revenues.

The shares of the two companies are going to be offered for privatization through BSE on October 3. Mixed closed auction will be used. The minimum share price of each issue is defined as it follows:

- 495 330 shares of Energo-Pro Sales will be offered at the initial price of BGN 11.09 and the assigned ticker is 4ES. The total amount of the Government's stake will be at least BGN 5.5 million.
- The initial price of the 434 940 shares of Energo-Pro Grid is BGN 109.87 per share and has a ticker 2EG. The Government's stake is valued at the minimum amount of BGN 48 million.

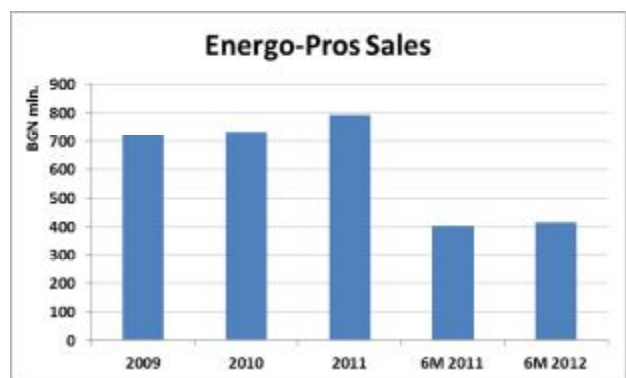
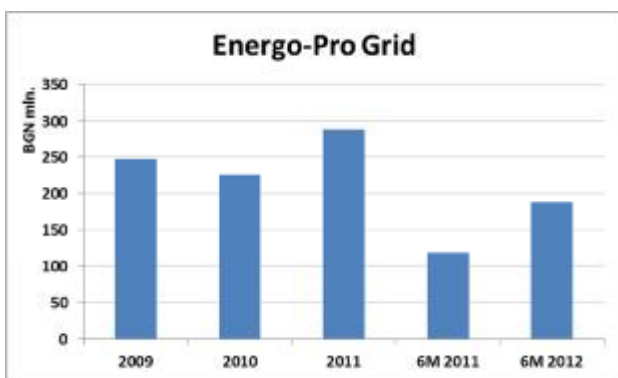
The auction will last 30 days or until the sale of all offered shares is completed. The securities have been already listed for trading on Bulgarian Stock Exchange's Privatization segment.

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**Financial analysis**

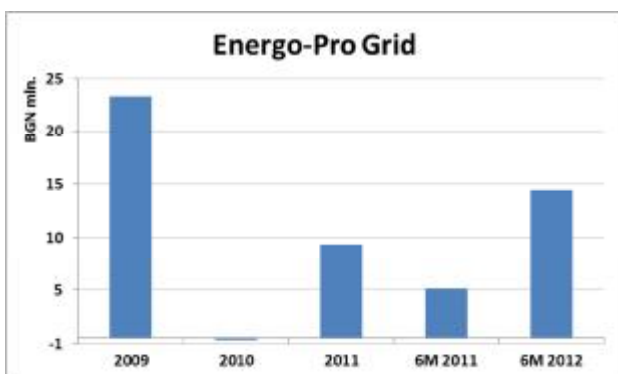
**Revenues**

The revenues of Energo-Pro Sales has increased by 8.4% in 2011 compared to the previous year, while this is fully reflecting the growth in electricity prices by 8.9%. The revenues from electricity remained 56% from the total revenues during the second quarter of 2012. Energo-Pro Grid revenues has increased by 28% for 2011 and have reached BGN 290 million at the year end. During the second quarter of 2012 the growth rate has accelerated to 58% compared to the same period a year ago. The increase was mainly due to regulation changes, after which the company began to invoice access and distribution costs, including renewable projects and energy from high-efficiency cogeneration. The company management has positive expectations for 2012, partly due to the increase of 2.5% in the quantity of distributed electricity.



**Financial results**

Both companies have reported an increase in the net profit for 2011 compared to a loss from the previous year. The main reason for this increase was due to regulator's decision affecting prices of transmission and access to a distributional network, which became effective since July 2010. The biggest risk that the company is facing is that it would not be able to control the level of electricity losses, which would affect financial results unfavorably. The appropriate technology costs approved by the regulator currently are 15%. Besides technical losses, however, there are the so called commercial losses, resulting from unauthorized access or improper reporting. For 2011, this kind of losses amounted between 4% and 6%. Energo-Pro Sales faces similar situation – a BGN 12 million profit, compared to a loss of BGN 0.2 million in 2010. The company's activity is highly dependent on the regulatory framework, revenues collection and energy supply continuity.



Valuation

Table 1  
Multiples  
comparison

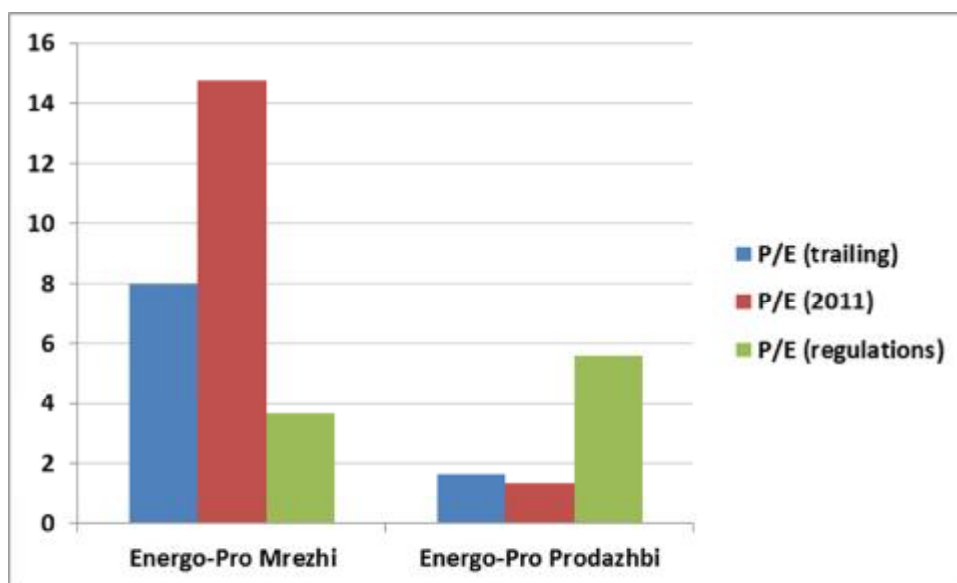
	Energo-Pro Grid	Energo-Pro Sales
Minimum Price	109.87	11.09
Number of Shares	1 318 000	1 501 000
Market Capitalization	144 808 660	16 646 090
Government Stake	47 786 858	5 493 210
Net Profit	18 117 000	9 973 000
P/E	7.99	1.67
Equity	332 476 000	38 738 000
P/B	0.44	0.43
Sales	358 642 000	803 494 000
P/S	0.40	0.02
RoE	5.45%	25.74%
RoA	3.82%	7.55%

Source: Energo-Pro  
Calculations: ELANA Trading

The table is presenting the multiples of both companies, calculated by the minimum price of the offering. Data are including the results for the first half of the year. The management announced that the new pricing of electricity had negative impact on the financial performance of the companies during July and August. The net profit of Energo-Pro Sales is substantially above the return on capital that is set by the energy regulator for the period. The regulator is determining the return of 12% based on WACC, regardless of the capital structure of individual companies. This is why both companies of Energo-Pro have different price-to-earnings ratio, whereas the price-to-book ratios were set to be equal for the purpose of the privatization.

Comparison according to price-to-earnings ratios

Graph 5  
Comparison  
by P/E



Calculations: ELANA Trading

The graph is representing the price-to-earnings ratio according to the results for 2011 and for the last reporting 12 months. It is also including the calculated P/E if the return on capital of 12% is achieved by the companies. The market value of the two companies is calculated at the minimum price for the auc-

tion. Energo-Pro Grid improved its results during the first half of 2012. If the implemented by the regulations RoC of 12% is achieved, the P/E ratio of Energo-Pro Grid should be below 4. However, the company's profitability is well below the 12% level. The profit of Energo-Pro Sales is exceeding the regulated level, thus creating artificially low P/E ratio at the expense of Energo-Pro Grid's profitability.

### Comparison to peer group

We are comparing the two subsidiaries of Energo-Pro to the largest companies of the sector worldwide. This comparison has the purpose to be a starting point for the valuation and the recommendation of the stocks. We don't consider the comparison to peer group as good concept for the fair price of the two stocks due to the division of functions in the process of electricity distribution. The divergence in the current RoC of both subsidiaries to the regulations is also a reason for significant difference between the current prices and the intrinsic values. The multiples for comparison are price-to-earnings, price-to-book and price-to-sales.

**Table 2**  
**Comparison**  
**to the sector**

Energo-Pro Grid			
Mutiples	P/E	P/B	P/S
Median	13.85	1.30	0.93
Market Capitalization	250 832 238	332 476 000	358 642 000
Price	190.31	252.26	272.11
Weight	50%	40%	10%
Minimum Price		109.87	
Fair Price		223.27	
Premium (Discount) to Current Price		103.21%	

Source: Bloomberg  
Calculations: ELANA Trading

**Table 3**  
**Comparison**  
**to the sector**

Energo-Pro Sales			
Mutiples	P/E	P/B	P/S
Median	13.85	1.30	0.93
Market Capitalization	138 077 491	50 209 871	751 037 894
Price	91.99	33.45	500.36
Weight	20%	80%	0%
Minimum Price		11.09	
Fair Price		45.16	
Premium (Discount) to Current Price		307.20%	

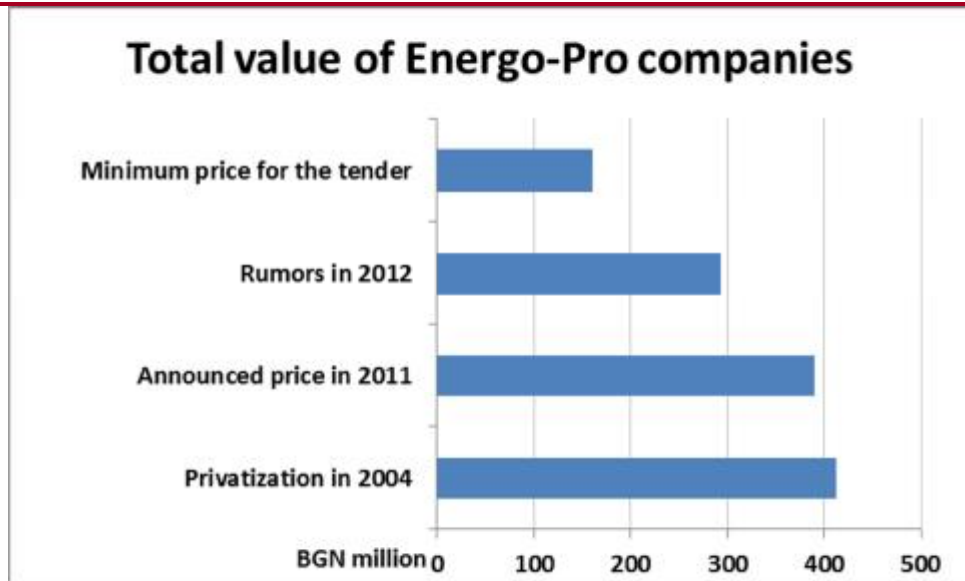
Source: Bloomberg  
Calculations: ELANA Trading

We give different weight on each multiple in both companies. Equity and profitability are the most important factors, whereas P/B is mainly used for the comparable valuation of Energo-Pro Sales. In both cases we have substantially higher stock values.

### Comparison to majority stake deals

We are comparing the minimum value at the privatization of the two companies to the deals for the majority stake of 67% in the past. All calculations are based on the total value of Energo-Pro subsidiaries.

*Graph 6  
Comparison  
to majority  
stake deals*

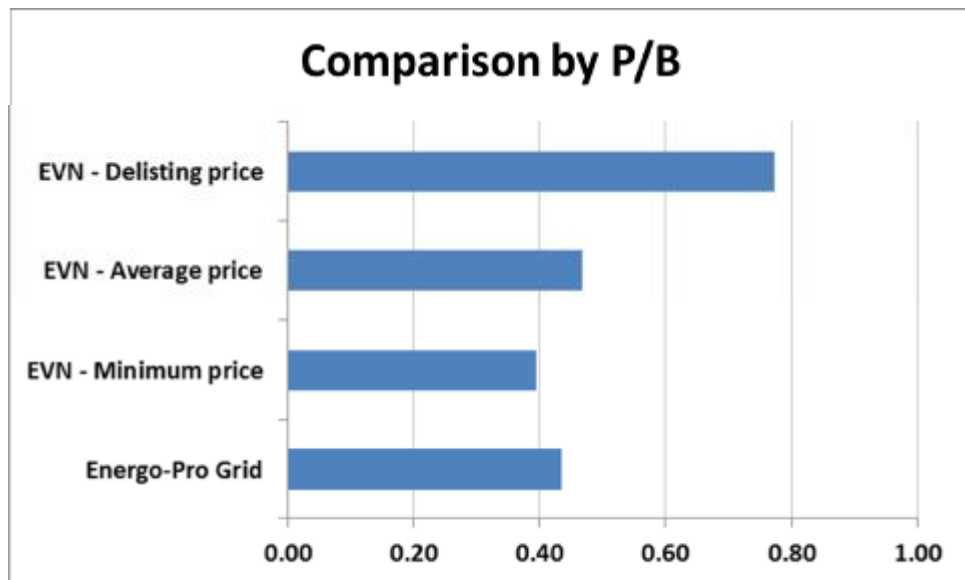


Calculations: ELANA Trading

The privatization in 2004 was for 67% of the capital of the regional distribution company and totaled EUR 140.7 million, which roughly corresponds to BGN 400 million for both companies. We are adding also the information in media for the recent sale of the same stake from E.ON to Energo-Pro. First information at the beginning of last year was for EUR 133 million. However, the deal was concluded in June and rumors were for price in the range of EUR 95-105 million. The decrease in value since 2004 is due to the global crisis that revalued assets and risks but the subsidiaries of Energo-Pro did not achieve the RoC according to regulations. The maximum return on equity was 7% during the last three years.

**Comparison to the privatization of EVN Electrorazpredelenie**

*Graph 7  
Comparison  
by P/B*



Calculations: ELANA Trading

The graph is comparing the P/B ratios of Energo-Pro Grid and the levels of EVN Electrorazpredelenie during the privatization and the recent delisting of the company from the stock-exchange. P/B of Energo-Pro Grid is close to the privatization value and is almost twice lower than the level at which the company was delisted.

### Recommendation

The privatization of Energo-Pro Subsidiaries has the advantage to follow the deals of EVN Bulgaria, where the majority owner acquired most of the shares at the beginning of the offering. Prices were low and the majority shareholder easily acquired most of them. The market had little participation and most investors were bidding around the minimum prices. This time investors' interest will be much higher due to two main reasons:

- The minimum prices are also low and will not drive back long-term investors or domestic speculators. The comparison by P/B showed enough room for capital gains. However, the management announced that financial results are worsening during the third quarter.
- The delisting of the two subsidiaries of EVN in Bulgaria was at much higher price than the average during the current privatization. This will attract the market attention to the new auction with the expectations of repeat. Short-term capital will look for the participation of the majority owner.

The total volume of both issues is very large for the ability of the Bulgarian stock market to absorb the supply only with the recourses of local portfolio investors. The sell will be very difficult or even impossible without the participation of the majority owner or other large player in the energy sector in Bulgaria. It is possible that demand of such scale will not appear during the first day of the offer.

Our recommendation to investors will be to participate in the auction with market orders with the presumption of large demand. In case of absence of large bids, the risks of buying at high prices are low as most demand will be at the minimum prices or close. Investors could place limit orders but the large offers could outbid them.

In terms of the structure of investments we recommend to buy mostly shares of Energo-Pro Grid as Energo-Pro Sales will have more volatile financial results and the issue will be less liquid.

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**Energo-Pro Grid**

<i>BGN `000</i>	2009	2010	2011	6M 2011	6M 2012
Revenues	246 527	225 926	289 222	118 856	188 276
Costs, including depreciation	193 886	186 199	254 876	100 642	158 843
Gross profit	52 641	39 727	34 346	18 214	29 433
Sales costs	27 121	38 410	23 834	13 038	15 309
EBITDA	63 113	41 291	52 877	25 979	36 197
Operating profit	25 520	1 317	10 512	5 176	14 124
Financial income/(expenses)	-113	-1 505	-862	-572	-218
Profit before tax	25 407	-188	9 650	4 604	13 906
Net profit	22 852	-183	8 815	4 604	13 906

<i>BGN `000</i>	2009	2010	2011	6M 2011	6M 2012
PP&E	360 953	387 846	410 657	384 023	409 911
Non-current assets	360 990	387 918	410 673	384 043	410 042
Receivables	49 456	58 102	55 434	56 240	28 699
Cash	2 192	1 098	117	223	12 250
Current assets	62 442	70 108	63 971	67 798	51 214
Total assets	423 432	458 026	474 644	451 841	461 256
Equity	314 674	308 764	318 570	313 367	332 476
Provisions	21 141	20 428	19 448	20 282	18 880
Deferred income	43 841	54 200	58 540	53 860	63 392
Non-current liabilities	71 609	80 298	83 329	79 999	88 007
Payables	19 629	42 615	47 025	16 522	31 455
Short-term debt	8 511	16 917	15 719	30 842	10
Current liabilities	37 149	68 964	72 745	58 475	40 773

**Energo-Pro Sales**

<i>BGN `000</i>	2009	2010	2011	6M 2011	6M 2012
Revenues	719 446	730 748	792 037	404 247	415 704
Electricity	399 362	408 313	444 815	221 664	233 948
Others	320 084	322 435	347 222	182 583	181 756
Costs, including depreciation	699 699	703 943	753 523	387 164	399 005
Gross profit	19 747	26 805	38 514	17 083	16 699
Sales costs	18 564	26 522	24 816	12 711	13 869
EBITDA	1 334	408	13 837	4 448	2 869
Operating profit	1 183	283	13 698	4 372	2 830
Financial income/(expenses)	587	-503	-137	-53	-286
Profit before tax	1 770	-220	13 561	4 319	2 544
Net profit	1 852	-204	12 211	4 319	2 081

<i>BGN '000</i>	2009	2010	2011	6M 2011	6M 2012
Non-current assets	6 954	6 485	5 058	6 473	4 974
Receivables	111 066	105 806	125 319	93 775	96 279
Cash	10 839	1 660	1 801	2 862	1 308
Current assets	126 340	107 467	127 121	96 637	97 862
Total assets	133 294	113 952	132 179	103 110	102 836
Equity	24 641	24 421	36 657	28 740	38 738
Non-current liabilities	33	63	43	65	50
Payables	74 495	79 536	76 705	73 366	47 222
Short-term debt	34 043	9 010	15 510	0	15 011
Current liabilities	108 620	89 468	95 479	74 305	64 048



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