

Equity Update Transgaz: Investment-driven earnings growth discounted

Recommendation:  **Hold**

Target price: RON345.90

12 - months horizon

Current share price: RON341.50

* price as of 27/04/2023, 11:59 CEST

Sector: Energy

We reinitiate the coverage of Transgaz with a HOLD recommendation and a 12-month cum-dividend target price of RON 345.9. Although we see a slight dip in profitability in FY 23e, we are optimistic about a substantial improvement from 2024e onwards.



Investment-driven earnings growth discounted

We reinitiate the coverage of Transgaz with a HOLD recommendation and a 12m cum-dividend TP of RON 345.9 (RON 21.6 considering the new number of shares, 188.4 mn). On the one hand, we point to Transgaz positive factors, such as (i) strong business profile as a gas transmission network operator and concessionaire in Romania and (ii) expectation of regulatory continuity into the new regulatory period from October 2024. However, there are also negative factors to consider, such as the freeze on transmission tariffs for the gas year 2022-23, escalating investment ambitions, and contraction of its gas transit activity.

Outlook: Domestic transportation revenues are regulated using the revenue-cap methodology, which ensures a relatively stable stream of revenues, while covering an agreed cost base between the company and the regulator and providing for a defined level of return on the asset base. Regulated revenues generate most of the top line. We assumed domestic transport revenues to grow at a CAGR of 16% in 2023-25e. Regarding transit revenues, the activity is unregulated and limited to Gazprom Export Ltd (GPE) payment after the termination of the contract with GPE. In FY 23e we expect a slight downward trajectory in the EBITDA margin towards ca. 34% vs. 37% in 2022 driven by a freeze on transmission tariffs. We expect the EBITDA margin to recover from 2024e onwards, following an upward revision of transport tariffs.

Ambitious capex plan: Given the uncertainty over investment projects, as some of them are at an early stage of development, we should not be too optimistic regarding the commissioning of the projects in accordance with the deadline indicated in Transgaz's 10-year development plan, thus we believe some projects could be delayed.

Valuation: Our 12m TP of RON 345.9 per share is based on a DCF model. Considering the current share price of RON 341.5 our valuation implies 1.3% upside potential.

Co-Sponsored Research: RBI has entered into an agreement with the Bucharest Stock Exchange for producing financial research on Transgaz in exchange for a financial remuneration.

Equity Update: Transgaz

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Key financial data

HOLD	
Price 27.4.2023	341.5
Price target	345.9
Market cap.	794.8
(tot. shares, in EUR mn)	
Free float	42%
Free float in EUR mn	329.8
Avg. daily turnover	0.06
(12 m) in EUR mn	
Bloomberg	TGN RO
Reuters	TGN.BX



Income statement (RON mn)	12/2020	12/2021	12/2022	12/2023e	12/2024e	12/2025e
Consolidated sales	1,338.0	1,364.9	1,579.3	1,718.6	2,191.6	2,391.2
EBITDA	413.2	480.5	581.7	580.0	854.9	872.5
Adjusted EBITDA	413.2	480.5	581.7	580.0	854.9	872.5
EBITA	164.5	120.7	146.3	115.2	399.3	436.9
EBIT	164.5	120.7	146.3	115.2	399.3	436.9
Adjusted EBIT	164.5	120.7	146.3	115.2	399.3	436.9
Financial result	35.1	109.5	273.9	237.0	136.5	60.3
Earnings before taxes	199.6	230.2	420.2	352.2	535.8	497.2
Net profit before minorities	165.2	176.8	347.7	295.9	450.1	497.2
Net profit after minorities	165.2	175.4	342.9	292.7	445.3	492.7
Adjusted net profit	153.1	222.9	337.0	292.7	445.3	492.7
Cash flow statement (RON mn)						
Cash flow from the result	379.0	449.8	399.9	417.5	614.5	624.5
Change in working capital	-54.6	143.1	115.9	-26.2	-29.2	-1.8
Operating cash flow	324.4	592.9	515.9	391.3	585.3	622.7
Capex PPE and intangible assets	-1,493.6	-988.7	-617.0	-637.7	-1,168.2	-820.4
Investing cash flow	-1,241.1	-781.4	-483.4	-586.7	-1,074.7	-754.8
Financing cash flow	-1,100.6	-242.7	-139.4	-307.8	-615.2	509.3
Balance sheet (RON mn)						
Net working capital	289.7	109.8	131.9	158.1	187.3	189.1
Net interest-bearing debt	1,425.3	1,616.3	1,772.2	2,080.1	2,695.3	2,185.9
Capital employed	5,461.1	5,999.7	6,331.8	6,890.3	8,027.2	8,824.7
Market capitalisation	3,373.2	2,778.6	3,243.7	4,020.8	4,020.8	4,020.8
Enterprise value	3,434.3	2,699.9	2,957.5	3,751.5	4,172.5	3,503.2
Shareholders' equity	3,746.3	3,874.8	4,058.1	4,218.9	4,516.3	5,629.9
Minority interests	0.0	93.5	82.8	86.0	90.8	95.3
Total assets & liabilities	7,221.6	8,006.1	8,257.1	8,844.7	10,137.4	10,934.2
Margins & profitability						
EBITDA margin	30.9%	35.2%	36.8%	33.8%	39.0%	36.5%
EBITA margin	12.3%	8.8%	9.3%	6.7%	18.2%	18.3%
EBIT margin	12.3%	8.8%	9.3%	6.7%	18.2%	18.3%
Net margin	12.3%	12.9%	21.7%	17.0%	20.3%	20.6%
Return on assets	2.6%	2.5%	4.8%	3.8%	5.1%	5.5%
Return on equity	4.4%	4.6%	8.6%	7.1%	10.2%	9.7%
Return on capital employed	3.4%	3.3%	6.4%	4.9%	6.5%	6.9%
Financing (x)						
Net gearing	38.0%	40.7%	42.8%	48.3%	58.5%	38.2%
Capex / depreciation	6.0	2.7	1.4	1.4	2.6	1.9
Equity ratio	51.9%	49.6%	50.1%	48.7%	45.4%	52.4%
Per share data (RON)						
EPS reported	14.03	14.90	29.12	24.86	37.82	41.85
Earnings per share (adj.)	13.01	18.93	28.62	24.86	37.82	41.85
Operating cash flow per share	27.56	50.36	43.81	33.24	49.71	52.89
Book value per share	318.19	329.10	344.67	358.33	383.59	478.17
Dividend per share	8.14	14.82	11.20	12.56	19.11	17.74
Payout ratio	58.0%	99.5%	38.5%	50.5%	50.5%	42.4%
Valuation (x)						
PE reported	20.4	15.8	9.5	13.7	9.0	8.2
Adjusted PE ratio	22.0	12.5	9.6	13.7	9.0	8.2
Price cash flow	10.4	4.7	6.3	10.3	6.9	6.5
Price book value	0.9	0.7	0.8	1.0	0.9	0.7
Dividend yield	2.8%	6.3%	4.1%	3.7%	5.6%	5.2%
Free cash flow yield	-34.7%	-13.8%	-3.0%	-6.0%	-14.2%	-4.8%
EV/sales	2.6	2.0	1.9	2.2	1.9	1.5
EV/EBITDA	8.3	5.6	5.1	6.5	4.9	4.0
EV/EBIT	20.9	22.4	20.2	32.6	10.4	8.0
EV/operating cash flow	10.6	4.6	5.7	9.6	7.1	5.6

Source: Transgaz, RBI/Raiffeisen Research estimates

Investment case

Natural gas transmission is a natural and legal monopoly in Romania, with Transgaz being the only company that holds a licence for natural gas transmission. The core businesses of the company include the domestic transportation and international transit of natural gas. The natural gas transmission activity is based on the concession agreement for the pipelines, installations, equipment, and facilities related to the National Transport System (NTS) concluded with the National Agency for Mineral Resources (ANRM), the Romanian regulator, that is valid until 2032. The company is also responsible for the maintenance and operation of the Romanian national gas transportation system, acting as dispatcher, in charge of equilibrating and coordinating the flows of natural gas through the network.

The activity of international gas transmission takes place in the South-East of the country (Dobrogea), where the existing Romanian pipeline sector between Isaccea and Negru Voda is included in the Balkan corridor of international natural gas transmission from Russia to Bulgaria, Turkey, Greece and Macedonia.

The balancing segment includes expenses and revenue related to the NTS balancing activity, neutral in financial terms, and any profit or loss from this activity will be distributed to clients for whom domestic transmission services are provided. The tariffs related to the transmission and balancing contracts are approved by the National Energy Regulatory Authority (ANRE).

SWOT analysis

Strengths and opportunities

- Gas transmission is a natural and legal monopoly, Transgaz being the only licensed operator
- Regulated tariffs induce a stable revenue stream and an approved level of return on assets
- High pay-out ratio (minimum 50% payout ratio established by law)
- Strong net cash position representing around 54.6% of market cap at end of 2022
- Development of strategic projects which would ensure an adequate degree of interconnectivity with neighbouring countries, and also could generate an additional flow of revenues

Weaknesses and threats

- Dominant ownership of the state in the company (58.5%)
- Instability and unpredictability of the legislative environment and regulatory framework in the energy sector
- Risk of non-recognition of investments in the Regulated Assets Base (RAB) recognised by ANRE, necessary for determining transport tariffs
- Low possibility to obtain a higher profit than the regulated one, within a regulatory period
- Contraction of its gas transit activity

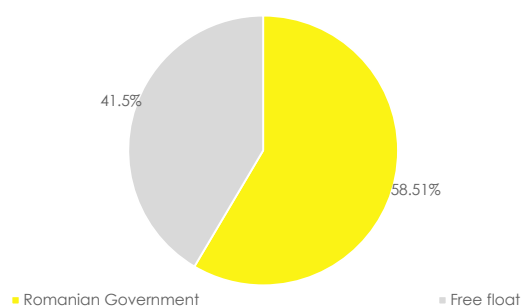
Share capital increase

On December 7, 2022, Transgaz announced that the OGMs & EGMs had approved an increase of share capital through the incorporation of reserves from the previous years' profit, in the amount of RON 1,766,076,600 and the issue of 176,607,660 new shares with a nominal value of RON 10 per share (resulting in 15 new free shares for 1 held). The payment date is set for May 4, 2023. According to the company increase in share liquidity could allow Transgaz to meet the individual liquidity criterion required for inclusion in the FTSE Russell indices.

Shareholders

The Romanian state is the majority shareholder, holding 58.5%, while the free float accounts for 41.5%. At the moment, NN Investment Partners hold a 7.38% stake in Transgaz and Allianz SE holds a 5.01% stake.

Shareholder structure on December 31, 2022



Source: Transgaz

Management

Transgaz has a one-tier management structure and is managed by a Board of Administration composed of five members. Members of the Board of Administration are elected by the General Meeting of Shareholders for a four-year term, with the possibility to renew the mandate.

Ion Sterian is the CEO of Transgaz. Mr. Sterian has been a member of the board since 2013, and in April 2021 he was re-elected as Executive Administrator and Director General. Previously he worked as Executive Director of the Technical Division's activity within the Autonomous Administration of State Protocol.

Petru Ion Vaduva is Non-Executive Administrator, and his tenure was also renewed for a four-year term in April 2021. At the same time, he is the CEO of Tiriac Holdings, which has interests in a variety of industries, including automotive, real estate, financial services and energy. Mr. Vaduva held the position of Transgaz's CEO in 2013-2017.

Nicolae Minea is Independent, Non-Executive Administrator, and his tenure was also renewed for a four-year term in April 2021. Previously he worked as President of the State Assets Management Authority of Romania.

Board of Administration structure

Name	Age	Position
Ion Sterian	63	Executive Administrator and Director-General
Petru Ion Vaduva	62	Non-Executive Administrator
Nicolae Minea	65	Independent, Non-Executive Administrator
Csaba Orosz	47	Non-Executive, Interim Administrator
Gheorghita Agafitei	41	Non-Executive, Interim Administrator

Source: Transgaz

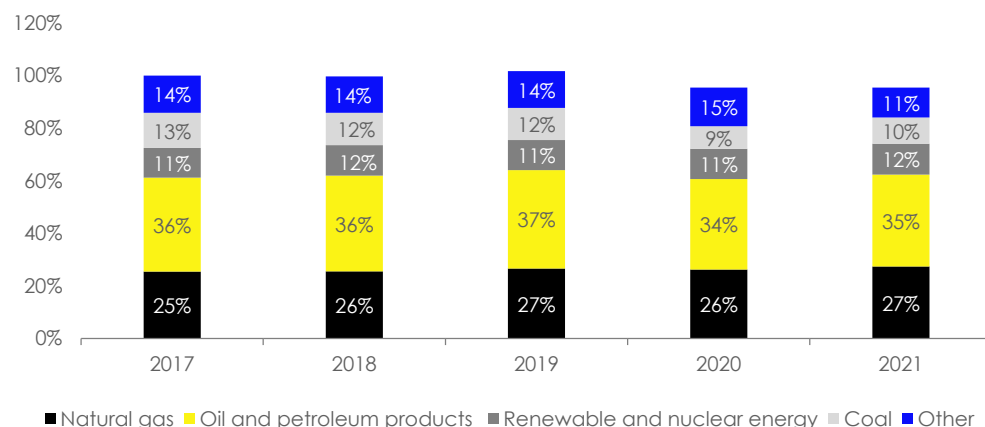
International Rating

On June 26, 2022, Fitch Ratings affirmed Transgaz's Long-Term Issuer Default Rating (IDR) at 'BBB-' with a Stable Outlook, supported on the one hand by its solid business profile expectation of regulatory continuity into the new regulatory period from October 2024. On the other hand, Fitch views the regulatory framework in Romania as less mature than in many Western European regimes, with considerable earnings and operating cash flows volatility.

Romanian gas market at a glance

Romania is one of the gas-rich countries in the CEE region, with proven gas reserves estimated at 77 bcm at the end of 2021. Over a few years, the share of gas in Romania's primary energy resources increased from 25.4% in 2019 to 27.4% in 2021.

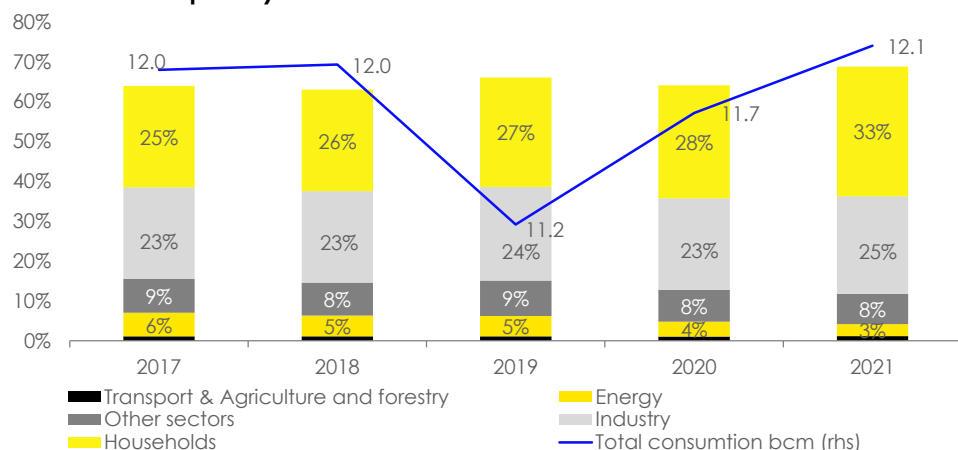
Structure of primary energy resources



Source: National Institute of Statistics of Romania, RBI/Raiffeisen Research estimates

The rise in gas consumption in Romania can be attributed to strong demand from households and increasing use of natural gas in industry.

Gas final consumption by sector

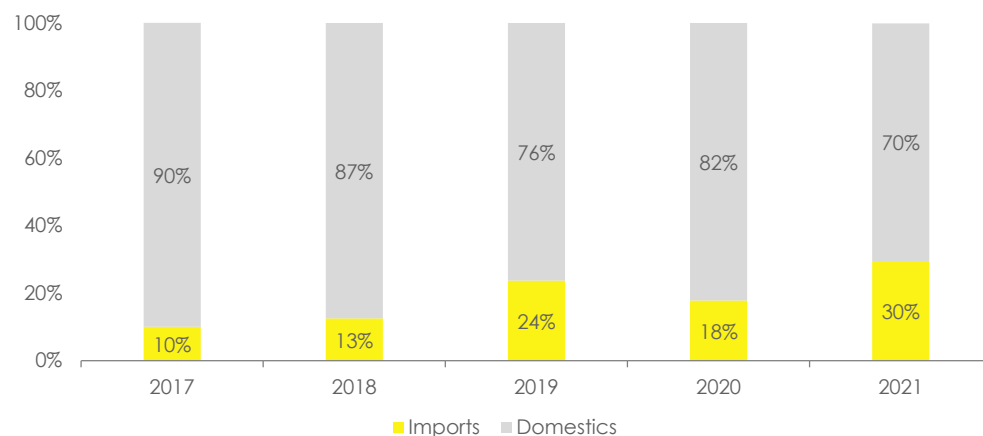


Source: National Institute of Statistics of Romania, RBI/Raiffeisen Research estimates

Although Romania has a relatively low dependence on gas imports, the current gas reserves are declining, as most gas fields are maturing. In this context there is a trend of shifting volumes from gas produced domestically to imported gas. Until the gas year 2015-2016, the capacity booking tariff for natural gas storage on import entry points was higher than on entry points from domestic production, giving the local production a

competitive advantage, but starting with the gas year 2016-2017, booking on both types of points (entry/exit) has been done at the same tariff.

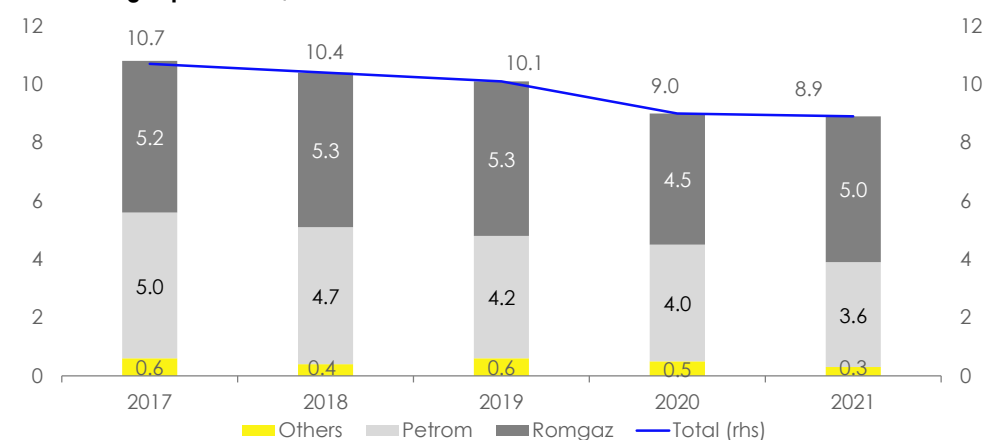
Romania's gas supply by source



Source: Transgaz, RBI/Raiffeisen Research estimates

Natural gas production exhibited a slightly negative trend over the past few years, decreasing by almost 17% in the period 2017-2021, reaching 8.9 bcm in 2021. The Romanian gas market is dominated by several large players, in many of which the government has a majority stake. The largest gas producer in 2021 was Romgaz (70% state-owned), with a 56.2% share, and it accounted for 5.0 bcm of gas production, followed by OMV Petrom (20.6% state-owned), with a 40.4% share in gas production and 3.6 bcm in 2021.

Romania's gas production, bcm



Source: OMV Petrom, Romgaz, Transgaz

The maturing of the country's gas fields could be mitigated by the implementation of Neptun Deep. The Neptun Deep exploration is split between OMV Petrom (50%) and Romgaz (50%). The FID might be taken in 1H 23 and would imply a start of gas production in 2027e (RBle). The project has a significant impact on the country, reducing dependence on imports or possibly even turning the country into a net exporter. More details about the project have been included in the "Transportation of natural gas from the Black Sea coast" section. Thus, Transgaz is willing to develop the natural gas transmission corridors that also ensure the necessary degree of interconnectivity at European level.

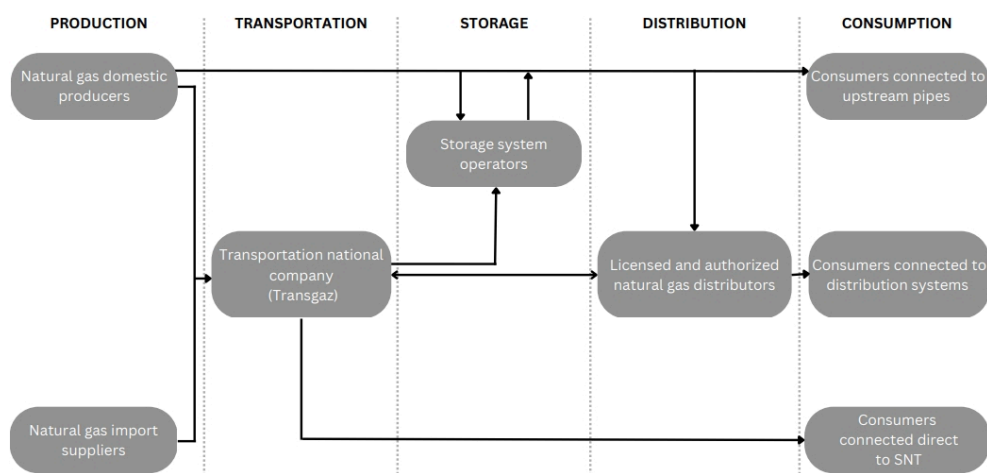
Market overview

The Romanian gas market has two components: the regulated market, that includes activities with a natural monopoly character, with supply established at regulated prices and under framework contracts approved by ANRE, and the competitive market, comprising the negotiated bilateral contracts of eligible consumers and natural gas suppliers.

The current structure of the natural gas market in Romania comprises:

- 1 operator of the National Transmission System - Tranzgaz;
- 10 natural gas producers: OMV Petrom SA, SNGN Romgaz SA, SC Amromco Energy SRL, SC Foraj Sonde SA, SC Raffles Energy SRL, Stratum Energy Romania LLC Wilmington Bucharest Branch, SC Hunt Oil SRL, SC Lotus Petrol SRL, SC Serinus Energy Romania, Dacian Petroleum SRL;
- 2 operators for underground storage: SNGN Romgaz through its Depogaz Ploiesti SRL subsidiary, SC Depomures SA;
- 30 natural gas distribution companies - the largest being SC Distrigaz Sud Retele SRL and SC Delgaz Grid;
- 154 licensed natural gas suppliers;
- External suppliers which bring natural gas from external sources to Romania: AIK Energy Austria GmbH, AIK Energy Hungary Kft, Axpo Solutions AG, Axpo Bulgaria EAD, Dexia Bulgaria, ERU Management Services, Engie Franta, Gazprom Schweiz AG, Gazprom Export LLC, Imex Oil Limited, MET Austria Energy Trade GmbH, MET Energy Trading Bulgaria EAD, Kolmar NL BV, MET International AG, MOL Commodity Trading Kft, Mytilineos, OMV Gas Marketing&Trading GmbH, RWE Supply&Trading GmbH, Uniper Global Commodities SE, Vitol Gas and Power B.V. and Wiee Hungary Kft.

Natural gas market structure



Source: Tranzgaz, RBI/Raiffeisen Research estimates

As of July 1, 2020, the gas market was fully liberalised, with gas supply since being carried out on a competitive basis. Each household customer must choose a supplier according to their specific needs and the competitive offers made available by them.

OMV Petrom and Romgaz are the main producers of natural gas, which also undertake supply operations. A small part of the natural gas produced by OMV Petrom is used in Upstream activity. The remaining volumes are placed on the market, to industrial end-

users as well as to wholesalers, either via bilateral contracts or on the centralised markets, while also partly delivered to internal consumers (such as the Brazi power plant). Romgaz is one of the largest natural gas producers in the CE and SEE and the main operator of gas storage facilities. Besides gas production, Romgaz owns and operates most of Romania's gas storages (ca. 3.0 bcm of working capacity).

Underground storage

Underground storage is mainly used for covering consumption peaks and fluctuating demand, operational recovery of functional parameters of the transmission system (pressures, flows) and controlling deliveries in extreme situations (source shutdowns, accidents, etc.). Romania's six storage facilities allow the storage of approx. 3.1 bcm/cycle. Five of these storage facilities are operated by Romgaz's subsidiary Depogaz Ploiesti, having a useful capacity of approx. 2.8 bcm/cycle. The other storage facility is operated by Depomures, having a total capacity of 0.3 bcm/cycle.

Due to changes in the European gas market and the liberalisation of the gas market, underground gas storage will take on new significance. In the new context, storage facilities can also be used to optimise gas prices. According to the Government of Romania Strategy (GOR), among the projects of interest promoted by Romania in the natural gas sector there are also investment projects aimed at increasing underground gas storage capacities, namely the projects promoted by the natural gas storage subsidiary Depogaz Ploiesti and Depomures: Bilciuresti underground gas storage unit and the Depomures natural gas storage depot.

Underground storage capacity

Underground storage	Storage operator	Active capacity (TWh/cycle)
Balaceanca	Depogaz	0,545
Bilciuresti	Depogaz	14,214
Ghercesti	Depogaz	1,602
Sarmasel	Depogaz	9,522
Urziceni	Depogaz	3953
Targu Mures	Depomures	3,155

Source: Transgaz

Distribution and Supply

In terms of access to natural gas, approx. 44% of households in Romania are connected to the natural gas network. The gas distribution system consists of around 52,259 km of pipelines – 41,000 km of which are operated by the two major gas companies distributors, Delgaz Grid and Distrigaz Sud Networks, supplying around 3.6 mn consumers.

National Transmission System

The National Transmission System (NTS) covers the entire national territory and has a radial-ring structure. The gas transmission and transit capacity are provided through a network of pipelines and supply connections with diameters between 50 mm and 1,200 mm at pressures between 6 bar and 63 bar.

NTS infrastructure comprises:

- 14,209.55 km of main transmission pipelines and connections for natural gas supply, of which 183.5 km represent international natural gas transmission pipelines and 482 km represent the BRUA pipeline;
- 1,141 natural GMS (gas metering stations);
- 2 GMS for international transmission (Isaccea Tranzit 3, Negru Voda 3);

- 7 imported natural gas metering stations (Giurgiu, Mediesu Aurit, Isaccea I, Isaccea T1, Isaccea T2, Negru Voda T1, Negru Voda T2);
- 8 gas compressor stations (Sinca, Onesti, Silistea, Jupa, Podisor, Bibesti, Onesti M, Gheraesti);
- 1,045 cathodic protection stations (CPS);
- 59 valve stations/technological nodes;
- 1,026 odourisation stations.

Imports/exports of natural gas to/from Romania are achieved by seven cross-border interconnection points, as follows:

Cross-border interconnection points

Country	Interconnection pipeline	Total technical capacity
UKRAINE	Orlovka (UA) - Isaccea (RO) *	6,85 Sbcm/y at Pmin=35 ba
	LLC GAS TSO UA => Transgaz	
	Tekovo (UA) - Mediesu Aurit (RO) **	2,71 Sbcm/y at Pmin=47 bar
	LLC GAS TSO UA <=> Transgaz	
HUNGARY	Isaccea 1 (RO) - Orlovka 1 (UA)	6,85 Sbcm/y at import capacity at Pmin=46,5 bar
	Transgaz <=> LLC GAS TSO UA	4,12 Sbcm/y export capacity*** at Pmin=35,4 bar
HUNGARY	Szeged (HU) - Arad (RO) - Csanadpalota (HU)	2,63 Sbcm/y import capacity at Pmin=40 bar
	FGSZ <=> Transgaz	1,75 Sbcm/y export capacity at Pmin=40 bar
REPUBLIC OF MOLDOVA	Iasi (RO) - Ungheni (MO)	1,88 Sbcm/y export capacity at Pmin=39,5 bar
	Transgaz <=> Vestmoldtransgaz	0,73 Sbcm/y import capacity la Pmin=24 bar
BULGARIA	Giurgiu (RO) - Ruse (BG)	1,50 Sbcm/y export capacity at Pmin=40 bar
	Transgaz <=> Bulgartransgaz	0,92 Sbcm/y import capacity at Pmin=30 bar
	Kardam (BG) - Negru Voda 1 (RO)	6,36 Sbcm/y on export capacity **** at Pmin=31,5 bar
	Transgaz <=> Bulgartransgaz	5,31 Sbcm/y import capacity at Pmin=45 bar

* This interconnection point is not used since there is no interconnection agreement concluded. Gas imports from Ukraine are currently performed through Isaccea 1.

**For this point the Romanian TSO and the Ukrainian TSO are having discussions on the signature of a new Interconnection Agreement.

***Capacity is offered on an interruptible commercial basis as the Annex to the Interconnection Agreement on gas quality requirements has not been signed.

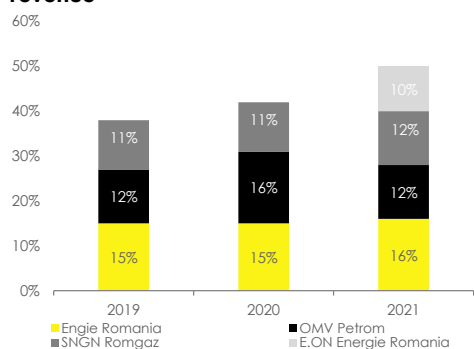
****Capacity conditioned by capacity booking at the Isaccea 1 IP in the UA-RO direction.

Source: Transgaz

Major customers

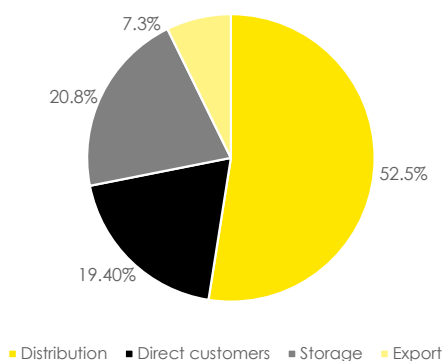
The main categories of customers are: distributors, suppliers and eligible consumers.

Domestic clients with over 10% of total revenue



Source: Transgaz

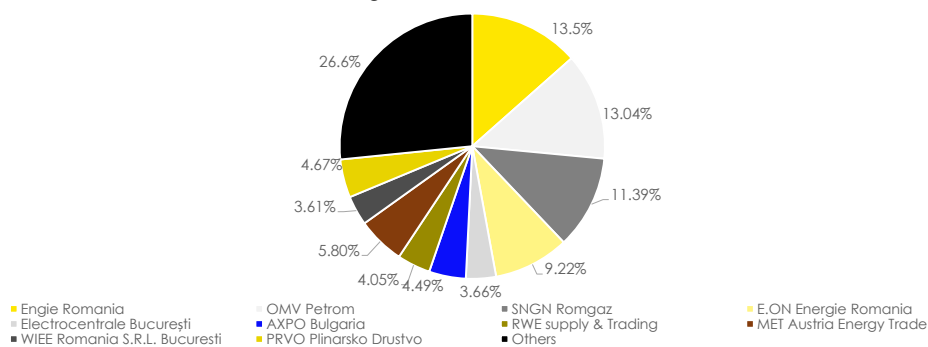
Quantity contracted by clients in 2022



Source: Transgaz

On the distribution side, the major operators are ENGIE Romania and E.ON Energie Romania. On the supply side, the major customers are Petrom and Romgaz.

The main network users (NU) of the gas transmission service in 2022



International gas transmission

The activity of international gas transmission takes place in the South-East of the country (Dobrogea), where the existing Romanian pipeline sector between Isaccea and Negru Voda is included in the Balkan corridor of international natural gas transmission from Russia to Bulgaria, Turkey, Greece and Macedonia.

Along the mentioned route, there are three interconnections (T1, T2, T3) with a similar international gas transmission system in Ukraine north of Isaccea and with a similar international gas transmission system in Bulgaria south of Negru Voda, respectively.

In the gas year 2019-20 the Isaccea 1 - Negru Voda 1 (T1) natural gas transmission pipeline was connected to the NTS in GMS (gas metering stations) Isaccea area, which enables the physical flow of gas from the T1 transmission pipeline to the NTS and vice versa. Thus Negru Voda became a point of interconnection to the NTS and the same tariff setting methodology applies to it both at the interconnection points with the EU Member States (Csanadpalota, Giurgiu Ruse) and at the domestic points of the NTS.

Regarding transmission through the T2 and T3 pipelines, the company has concluded an Agreement for the Termination of the Legacy Contract between Transgaz and GPE. Since January 2020, after the termination of legacy natural gas transmission contracts, there have been no physical flows on T2 and T3 pipelines. The T3 Isaccea 3-Negru Voda 3 gas transmission pipeline has not been connected to the NTS yet.

At the end of 2021, the T2 gas transmission pipeline Isaccea 2 - Negru Voda 2 was connected to the NTS, enabling physical gas flow from T2 to the NTS and vice versa. Moreover, the Isaccea 2 and Negru Voda 2 gas metering stations were upgraded to ensure bidirectional gas flow at the cross-border interconnection points Isaccea 2 with Ukraine and Negru Voda 2 with Bulgaria. After the completion of the works for the connection of the T2 pipeline to the NTS, Transgaz, together with the neighbouring TSOs, initiated actions (the conclusion of interconnection agreements) to ensure and offer bidirectional capacity at the interconnection points related to this pipeline.

Revenue Cap Methodology

Starting March 2019, a new pricing methodology – revenue cap - was introduced for the regulated segment of the natural gas market. ANRE regulation 41/2019 sets the basics for the calculation of tariffs for the supply, distribution, underground storage and transmission of natural gas. The revenue cap methodology was established to impose a linear trend to the revenues of operators and to ensure a certain revenue stream that covers the cost base approved by ANRE and provides the operator with a defined level of return on assets. The regulatory authority sets the transmission tariff for each year of the regulatory period, which does not correspond with a fiscal year.

This methodology regulates the means of the substantiation and establishment of the regulated revenue, the corrected regulated revenue and the regulated tariffs for the gas transmission activity conducted by a gas transmission system located on the territory of Romania. The provisions of this methodology do not apply to Isaccea 2 and 3 - Negru Voda 2 and 3 gas transmission pipelines, for which the establishment of regulated revenues and tariffs is based on the regulations approved by ANRE.

ANRE sets a yearly target revenue within a five-year framework, which is further translated into tariffs. The corrected regulated income and regulated tariffs for natural gas transmission activity applied in 2022 were related to the third year of the fourth regulatory period, meaning October 1, 2021 - September 30, 2022.

In 2022 ANRE froze the tariffs for internal transmission of natural gas, the application of the approved transmission tariffs for the gas year 2021-22 being extended until September 30, 2023.

The TSO (Transmission System Operator) regulated revenue is substantiated for the first year of the regulatory period and is adjusted/corrected during the following years based on the formulas relevant for the gas transmission activity.

Determination of regulated revenues

OPEX(i)	Operating expenses, fiscally deductible, the level and appropriateness of which could be controlled by management decisions or upon which the TSO may act directly to increase the efficiency of the activity for gas transmission service provision.
+	
CAPEX(i)	Costs recognised by ANRE in relation to the regulated depreciation and the return on the capital invested in tangible and intangible assets related to gas transmission activity.
+	
CPD(i)	Operating costs, fiscally deductible within the limit of the applicable legal provisions, related to gas transmission activity which are beyond the control of the TSO's management and which cannot be directly acted upon by the latter so as to increase the efficiency of gas transmission activity, recognised by ANRE during a year of the regulatory period.
=	
VR(i)	The revenue related to one year of the regulatory period which is recognised by ANRE in order for a TSO to cover justified costs as necessary for the conduct of gas transmission activity.

Source: ANRE regulation 41/2019

The authority and Transgaz agreed on the following determinants of transmission tariffs related to the third regulatory year, October 1, 2021-September 30, 2022, of the fourth regulatory period, that we used as a starting point to derive the allowed revenue in the following years:

- Opex at RON 736.1 mn
- Capex at RON 641.4 mn
- Pass through costs at RON 26.3 mn
- Regulated Revenue at RON 1,403.8 mn
- Differences at RON -366.4 mn
- Adjusted allowed revenues at RON 1,041.5 mn

- RAB at RON 5,351.7 mn
- Efficiency factor currently set at 1.5% per year

For each year of the regulated period Opex are adjusted using a specific formula which implies forecasting the calculation of operating costs related to the domestic transport of gas approved by the authority including salaries, maintenance, technological consumption costs, etc. and also takes into account inflation and an efficiency factor of 1.5% per year, which is meant to encourage operators to reduce the cost base.

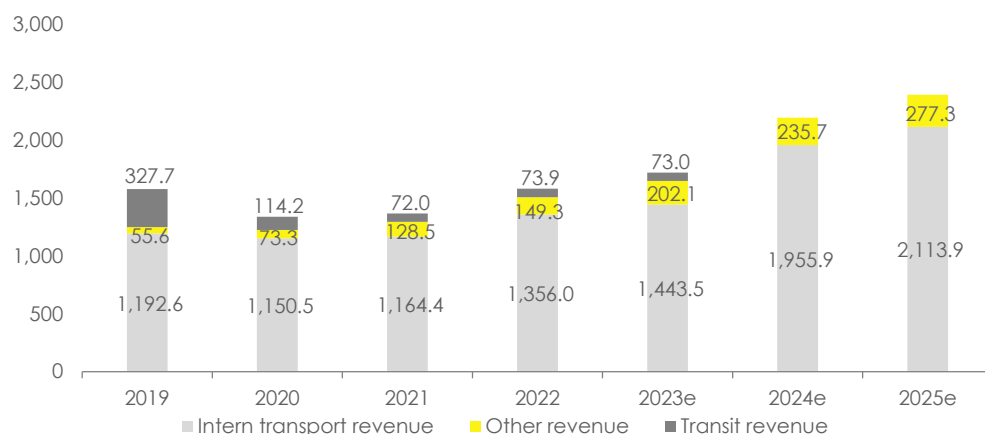
The CAPEX component related to the rate of return on invested capital is set at 6.39%. For the capital invested in tangible/intangible fixed assets put into operation during the fourth regulatory period, which constitutes objectives of the natural gas transmission system, a stimulus of 1% above the regulated rate of return is established, while for the investments made from own funds within projects that have attracted non-reimbursable European funds, a stimulus of 2% above the approved regulated rate of return on invested capital is established. ANRE can take into account the value of investment projects estimated to be carried out in each year of the regulatory period when establishing the regulated revenue.

Earnings forecast and financials

Domestic gas transportation is the major revenue generator and represented 86% of turnover in 2022. We forecast a moderate increase of domestic transport revenues of 6.4% yoy to RON 1,443.5 mn in 2023e, due to capping transport tariffs for the gas year 2022-23 at the level approved for the gas year 2021-22. Moving forward, we estimate an increase in domestic transport revenues of 35.5% yoy to RON 1,955.9 mn in 2024e, assuming an upward revision of transportation tariffs.

According to the company's R&E (Revenue and expenditure) budget, as the gas year 2022-23 is the last from a regulatory period, there would be adjustments related to regulated revenue for the gas year 2023-24 which are as followings: (i) Efficiency gains recorded by the company in the last year of the third regulatory period (RON -120.6 mn); (ii) additional income recorded in the years 2019-20, 2020-21, 2021-22 (RON -454.7 mn), (iii) unrealized revenue in the gas year 2022-23 as a result of tariff capping (RON 448.9 mn). Cumulated these adjustments have a low impact on regulated revenue, though.

Revenues before balancing and the construction activity, 2019-2025e (RON mn)



Source: Transgaz, RBI/Raiffeisen Research estimates

Transit revenue has suffered a decline since 2019, due to the termination agreement of the legacy contract between Transgaz and GPE (Gazprom Export Ltd), according to which GPE has to pay the remaining amount over a period of a maximum of three years (final year 2023). After this the T3 pipeline would be connected to NTS and same tariff

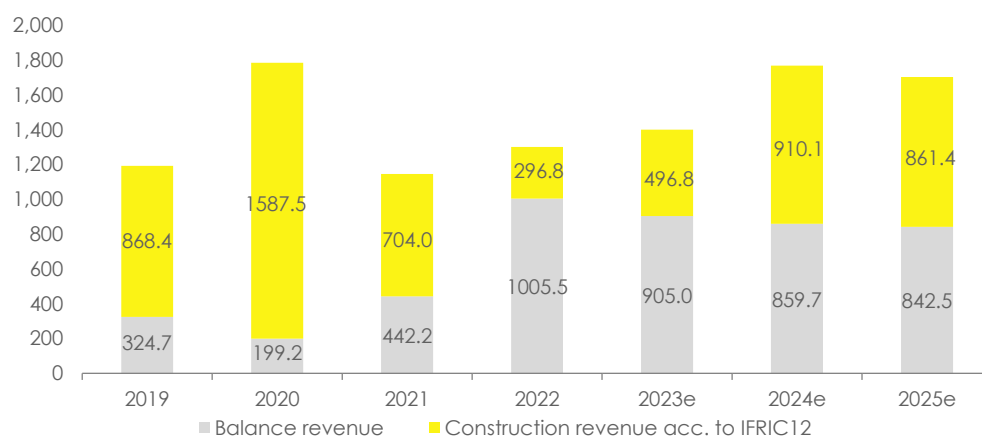
setting methodology would be applied. According to the company's R&E budget for 2023, there would not be reserved transportation capacity for international transport activity. Consequently, we assume that starting from 2024e the transit revenue will represent 0% of turnover.

Overall, we expect revenues before balancing and the construction activity to grow at a CAGR of 14.8% over the 2023-25e period, reaching RON 2,391.2 mn in FY 25e.

The company recorded revenues related balancing and construction activity, which are neutral in financial terms. The revenues from construction activity are related to the improvement of the transmission network, in exchange for which the intangible asset is registered. While the balancing segment includes revenue related to national transmission system balancing activity, any profit or loss from this activity will be distributed to clients for whom domestic transmission services are provided.

We expect revenue from the construction activity to develop in line with capex, estimated to rise at a CAGR of 42.6% to RON 861.4 mn in 2025e. Revenues from balancing activity, by contrast, are expected to decrease at a CAGR of 5.7% to RON 842.5 mn in 2025e, given the forecast of a decrease of the natural gas price.

Construction and balance revenues, 2019-2025e (RON mn)



Source: Transgaz, RBI/Raiffeisen Research estimates

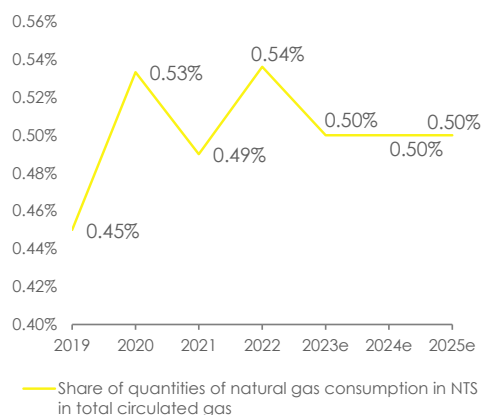
Cost structure

Transgaz cost structure is expected to be dominated by personnel-related expenses, reaching RON 546.6 mn in 2023e, which could increase by 9.6% annually in 2023-25e, to RON 652.4 mn in 2025e (vs. RON 495.1 mn in 2022), considering the indexation to inflation and other expenditures related to salaries and benefits to employees.

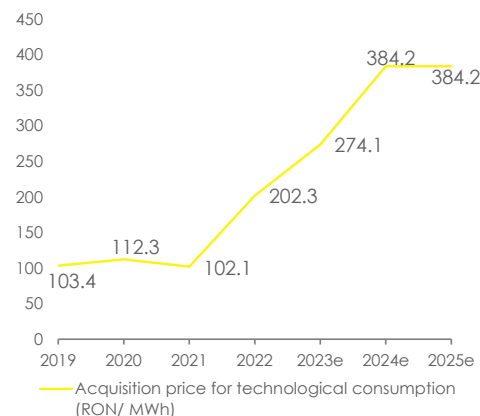
We estimate gas, materials and consumables used to reach RON 237.6 mn in 2023e, 86% of the amount is attributable to the component related to transmission system's TC (technological consumption).

We estimate that the transmission system's TC will increase by 34.7% yoy given the increase of the acquisition price for technological consumption (202.3 RON/MWh in 2022 vs. 274.1 RON/MWh in 2023). Over the 2019-22 period the percentage of technological consumption in the total volume of gas circulated through NTS (including storage) varied between 0.45% and 0.54% in 2022. We assume that starting from 2023e the share of quantities of natural gas consumption in NTS in total circulated gas will stand at 0.50%. The decline came as a result of investments made in network rehabilitation and the maintenance works performed.

Share of quantities of natural gas consumption in NTS in total circulated gas



Acquisition price for technological consumption (RON/ MWh)

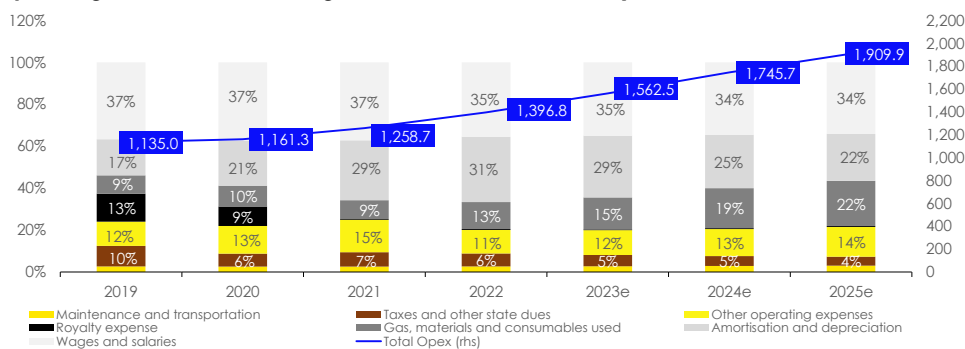


Source: Transgaz, RBI/Raiffeisen Research estimates

Source: Transgaz, RBI/Raiffeisen Research estimates

We estimate the amortisation and depreciation expenses to represent a higher portion in total operating expenses (average share of amortisation and depreciation in opex of 13.4% in 2023-25e vs. 12% 2019-22) due to the company's investment strategy ambitions.

Operating cost before balancing and the construction activity

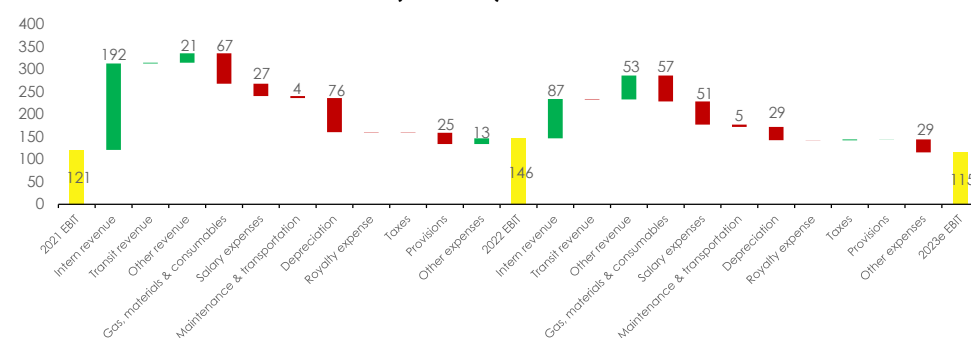


Source: Transgaz, RBI/Raiffeisen Research estimates

Profitability

In FY 23e we expect a slight downward trajectory in the EBITDA margin towards 33.8% vs. 36.8% in 2022 due to the freeze of transmission tariffs. We expect the EBITDA margin to recover from 2024e onwards, following an upward revision of tariffs, reaching 39.0% and 36.5% in 2024e and 2025e, respectively. Also, we forecast EBIT to amount to RON 115.2 mn in 2022e, increasing at a CAGR of almost 44% in 2022-25e and reaching RON 436.9 mn in 2025e. Net income for 2023e should come in at RON 295.9 mn. We forecast net income to increase at a CAGR of 6.4% in the period 2022-25e, reaching RON 417.7 mn in 2025e.

EBIT evolution between 2021-2023e (RON mn)



Source: Transgaz, RBI/Raiffeisen Research estimates

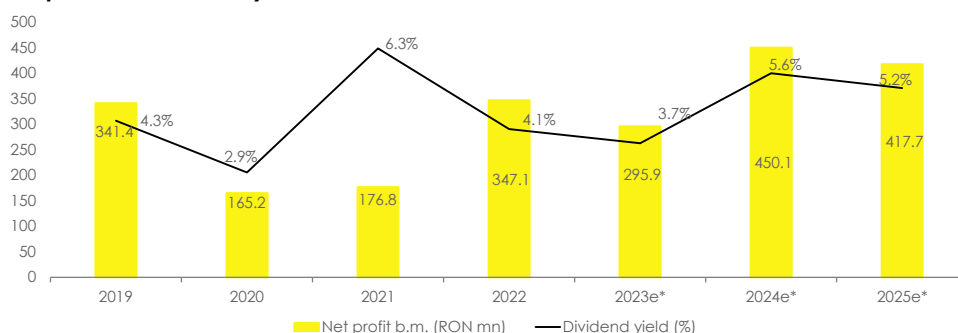
Dividend policy

As a state-owned company, Transgaz must adhere to a dividend pay-out ratio of a minimum of 50% applied to net profit. At the same time, at the beginning of the year the Romanian Government presented a memorandum which provides a new measure to the dividend pay-out ratio for companies in which the state holds stakes. The dividend pay-out ratio established by law rose from 50% to 90%. However, there are companies exempted from this general rule, which are indicted under specific regulations and in justified cases, the Government can approve the mandate of state representatives to decide on the distribution of a share of less than 90% of net profit.

For 2022 Transgaz's AGM approved to pay out a dividend of RON 11.2 per share (considering the current number of shares, 11.8 mn), which implies a pay-out ratio of 50% from distributable profit of RON 265.5, determined after the deduction of the sums related to the destinations determined based on legislative acts specifically provided by Government. In terms of pay-out ratio from consolidated profit the company has a pay-out ratio of 38.0%. The payment date is set starting from July 19, 2023. Transgaz will hold its AGM on April 26, 2023, where among other shareholders are requested to approve the proposed 2022 dividend.

Considering companies ambitious investment program we believe that Transgaz will continue to distribute to its shareholders dividends with pay-out ratios of 50% in the following years, thus being excluded from the new dividend pay-out ratio measures.

Net profit and dividend yield estimates



*Based on previous closing price; No. of shares 11.8 mn

Source: Transgaz, RBI/Raiffeisen Research estimates

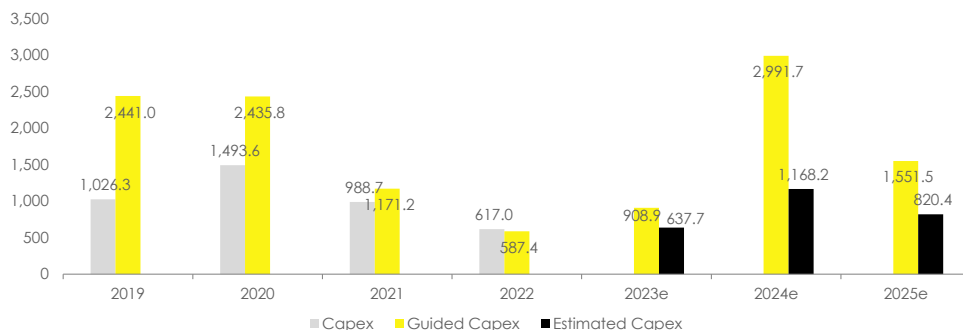
Investment strategy

Investment activity is mainly directed towards the modernisation and development of the NTS in order to improve efficiency and to increase its capacity, to develop new consumption areas. Transgaz elaborated the National Gas TYNDP (10-year National Gas Development Plan) for the period 2022-31, which proposes an extensive investment programme for the strategic development and infrastructure in Romania. Transgaz's TYNDP includes: (i) projects dedicated to the development of the NTS, some of the key projects being the connection of the Black Sea to the NTS as well as the BRUA pipeline (phase II, III) and (ii) projects dedicated to the development of the natural gas storage system, some of the key projects being modernisation of the gas storage system infrastructure-Bilciuresti, increasing the underground natural gas storage capacity of the Ghercesti storage facility.

As for the investment plan, we reckon with an ambitious capex strategy of the company, which amounts for EUR 3.4 bn between 2022-2031e. Out of this we can distinguish three types of projects: (i) FID-projects for which the final investment decision has been taken, representing 16% of the total amount of the investment plan; (ii) A Non FID-projects in an advanced stage of development, representing 4% of the total amount of the investment

plan; (iii) LA Non FID-projects at an early stage of development, representing 80% of the total amount of the investment plan. Although our capex estimates are slightly different from Transgaz's, we believe the investment project would require more projects to be commissioned. Our capex estimates take into account the realisation of projects with FID status in the coming years, while for A Non-FID and LA Non-FID projects, we believe that they would have a low degree of achievement and be postponed until a later period.

Annual capex plan vs. Guided & Estimated capex, RON mn



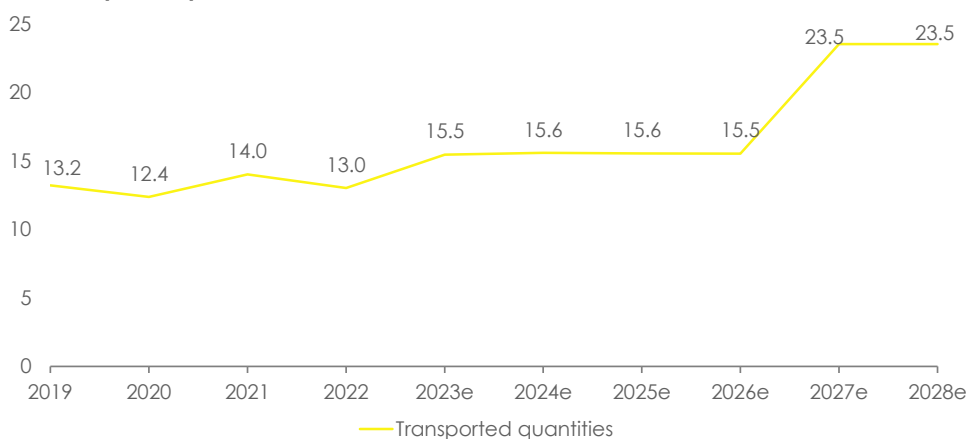
Source: Transgaz, RBI/Raiffeisen Research estimates

Transportation of natural gas from the Black Sea coast

One of the priority investment projects for Transgaz is the development of the Southern Transport Corridor for the transportation of natural gas from the Black Sea coast. The main objective of this investment is to construct a telescopic natural gas transport pipeline from Tuzla to Podisor, with a length of 308.3 km, which will connect the natural gas resources available on the Black Sea coast to the BRUA corridor, thus enabling the transportation of natural gas to Bulgaria and Hungary through the existing interconnections Giurgiu-Ruse (with Bulgaria) and Nadlac-Szeged (with Hungary). This pipeline will connect with the T1 natural gas transport pipeline and it is set to be operational by 2026.

In March 2023, there was a successful completion of the incremental capacity booking procedure for the future Tuzla-Podisor pipeline. Consequently, OMV Petrom and Romgaz have signed gas transportation contracts with Transgaz for the gas that will be extracted from the Neptun Deep perimeter. The Neptun Deep exploration is split between OMV Petrom (50%) and Romgaz (50%) and the FID might be taken in H1 23. Assuming a positive FID we take into account the project's impact in the current report. We reckon that the start of gas production would be in 2027e and would imply a plateau annual production of 8 bcm, which consequently would be injected in the NTS.

Total transported quantities (bcm)



Source: Transgaz, RBI/Raiffeisen Research estimates

Peer group comparison

We are showing the peer group for comparison purposes, using EV/EBITDA multiples, given the large variation of the selected companies in terms of market capitalisation, geographical location, and taxation. On the one hand, we have selected European players operating in the electricity transmission, gas, and crude oil transportation sectors. On the other hand, from the regional peers, we have selected Conpet, as we see it as a decent proxy for comparison.

To allow for a fair comparison, we would like to underline that one of the main differences between Transgaz and its European players is that the regulatory framework in Romania is less mature than in many Western European regimes, with considerable earnings and operating cash flows volatility. The difference between Transgaz and Conpet first of all refers to the nature of the regulated business, as it relies on a "revenue cap" methodology, while in the case of Conpet, profitability is judged on costs, rather than the RAB.

We are showing FY 23e, FY 24e, and FY 25e multiples and taking the median of EV/EBITDA multiples for the regional peers and for the regional peers. It is worth mentioning that the comparative analysis reveals that Transgaz is trading at a discount of 10-33% to its regional peers, while in comparison with Conpet, Transgaz is trading at a premium.

Peer multiples

Ticker	Country	Mcap mn EUR	EV/EBITDA		
			2023e	2024e	2025e
Gas transmission					
SRG IM	Italy	16,811.0	12.4	11.2	10.5
FLUX BB	Belgium	2,079.8	6.7	6.6	6.6
ENG SM	Spain	645.4	11.0	11.8	12.3
Crude oil transmission					
COTE RO	Romania	138.0	4.1	3.7	3.6
Electricity transmission					
REE SM	Spain	8,865.6	9.0	10.1	9.8
TRN IM	Italy	15,617.6	11.5	10.5	10.1
ELIA AV	Belgium	9,108.6	11.9	6.9	10.0
Median integrated regional			11.2	10.3	10.0
TGN RO			10.1	6.9	6.7
Premium / (discount) Conpet			147%	86%	87%
Premium / (discount) regional			-10%	-33%	-33%

Source: Bloomberg, RBI/Raiffeisen Research estimates

Peer description

Ticker	Business Description
SRG IM	Snam SpA is engaged in the management of natural gas services. The Company is diversified into four operating segments: transportation, regasification, storage and distribution.
FLUX BB	Fluxys Belgium SA is the operator of natural gas transport networks and transit grids and storage infrastructure. The Company's principal activities include the provision of gas transportation services; transmission system connections; gas storage services; border-to-border gas transmission services, and services for hub gas trading.
ENG SM	Enagas SA is primarily engaged in gas transportation. The Company's activities are divided into three business segments: Infrastructure, Technical management and Unregulated activities. The Infrastructure division is structured into three areas: Gas transport; Regasification and Storage.
COTE RO	Conpet SA is primarily engaged in pipeline transportation. The Company is active in the pipeline transportation of crude oil and its derivatives, including gasoline, condensate and liquid ethane, to refineries in Romania and other clients.
REE SM	Red Electrica Corporacion focuses on the management of the Spanish high-voltage transmission grid as well as is responsible for its development, maintenance and improvement of the network's installations.
TRN IM	Terna - Rete Elettrica Nazionale SpA transmits electricity over the high-voltage and extra-high voltage grid in Italy. Through subsidiaries, the Company owns a substantial share of the national electricity transmission grid.
ELIA AV	Elia Group SA operates as an electricity transmission company. The Company supplies and distributes electricity over high-voltage levels, as well as offers consulting services. Elia Group serves customers in Belgium and Germany.

Source: Reuters, RBI/Raiffeisen Research

Valuation

Our DCF model returns a 12m cum-dividend TP of RON 345.9 per share (or RON 21.6 considering the new number of shares of 188.4 mn). We remind that starting from May 4, 2023, the share capital will increase to RON 1,883.8 mn with a nominal value of RON 10 per share. Our price is calculated based on the current number of shares of 11.8 mn.

We value Transgaz using a Discounted Cash Flows model, as we believe it is the most adequate valuation method in the case of Transgaz: it better captures the intrinsic qualities of the company, like the intense capital investment plan following to be developed in the coming years and most importantly the particularities of the revenue cap methodology.

For the WACC computation we employ a risk-free rate around 7.6% for the explicit period, fluctuating from 7.45% to 8.0% and a rate of 6.5% in perpetuity, as we believe that the current macroeconomic conditions will improve. We use beta of 0.7, ERP of 7%, a target capital structure of 69.9-58.0% of equity in the explicit period and 66.0% in perpetuity and pre-tax cost of debt of around 3.9% for the explicit period and 3.0% in perpetuity. Consequently, the WACC ranges between 9.6% and 8.5% in the explicit period and amounts to 8.4% in perpetuity.

We employ a terminal growth rate of 1.5% considering on the one hand the maturing of the country's gas fields and the associated decline in output, and on the other hand we take into consideration the company's commitment to a shift in energy sources from traditional fossil fuels to green ones in the long term.

DCF Model

FCF projection (RON mn)	2023e	2024e	2025e	2026e	2027e	2028e	TV CF	
Consolidated sales	1718.6	2191.6	2391.2	2749.9	4069.9	5290.8	7138.9	
EBITDA	580.0	854.9	872.5	998.3	1546.6	1957.6	2141.7	
EBITA	115.2	399.3	436.9	480.9	756.5	898.9	499.7	
Taxes paid on EBITA	-18.4	-63.9	-69.9	-76.9	-121.0	-143.8	-80.0	
NOPLAT	96.8	335.4	367.0	404.0	635.4	755.0	419.8	
Adj. NOPLAT	96.8	335.4	367.0	404.0	635.4	755.0	419.8	
Depreciation of PPE & intangibles	464.8	455.5	435.6	517.4	790.1	1058.8	1642.0	
Gross investment in PPE & intangibles	-637.7	-1168.2	-820.4	-870.2	-1179.5	-1392.5	-1832.1	
Change in working capital	-26.2	-29.2	-1.8	21.3	-27.6	-51.3	-5.4	
NWC/Sales	9.2%	8.5%	7.9%	6.1%	4.8%	4.7%	5.0%	
Change in LT provisions other than tax	1.9	1.4	1.3	1.3	1.3	1.3	1.0	
Net acquisitions & disposals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Free cash flow to firm	-100.4	-404.9	-18.3	73.7	219.7	371.3	225.3	
Adj. free cash flow to firm	-100.4	-404.9	-18.3	73.7	219.7	371.3	225.3	
EV DCF, mid-year assumption	3257.1	3670.9						
+MV of non-operating assets eop	2141.2	2435.3						
-MV of net debt eop	1772.2	2080.1						
-MV of minorities eop	82.8	86.0						
Adjustments to EV eop	0.0	0.0						
Faire value of equity	3543.3	3940.2						
Shares outstanding (mn)	11.8	11.8						
Fair value per share (in RON)	300.9	334.7						
Value drivers	2023e	2024e	2025e	2026e	2027e	2028e	TV CF	
Consolidated sales yoy	8.8%	27.5%	9.1%	15.0%	48.0%	30.0%	1.5%	
EBITDA margin	33.8%	39.0%	36.5%	36.3%	38.0%	37.0%	30.0%	
Rate of taxes paid	-16.0%	-16.0%	-16.0%	-16.0%	-16.0%	-16.0%	-16.0%	
Working capital/sales	9.2%	8.5%	7.9%	6.1%	4.8%	4.7%	5.0%	
CAPEX/Depreciation	1.4	2.6	1.9	1.7	1.5	1.3	1.1	
Free cash flow margin	-5.8%	-18.5%	-0.8%	2.7%	5.4%	7.0%	3.2%	
WACC	2023e	2024e	2025e	2026e	2027e	2028e	TV CF	
Target capital structure (at MV)	69.9%	66.4%	60.4%	58.0%	58.0%	58.0%	66.0%	
Debt to equity ratio (at MV)	43.1%	50.6%	65.5%	72.4%	72.4%	72.4%	51.5%	
Risk free rate (local)	7.5%	7.4%	7.5%	7.5%	7.9%	8.0%	6.5%	
Equity market premium	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	
Levered beta	0.7	0.7	0.7	0.7	0.7	0.7	0.7	
Cost of equity	12.4%	12.3%	12.4%	12.4%	12.8%	12.9%	11.4%	
Cost of debt	3.2%	3.2%	3.2%	3.2%	3.4%	3.4%	2.5%	
Tax rate	-16.0%	-16.0%	-16.0%	-16.0%	-16.0%	-16.0%	-16.0%	
WACC	9.6%	9.2%	8.8%	8.5%	8.8%	8.9%	8.4%	
Growth sensitivity (RON)			Terminal growth rate					
WACC		0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%
	6.9%	371.6	384.2	398.9	416.3	437.3	463.0	495.5
	7.4%	348.4	358.8	370.9	385.1	401.8	422.0	446.9
	7.9%	327.6	336.4	346.5	358.1	371.8	387.9	407.4
	8.4%	309.0	316.5	324.9	334.7	345.9	359.0	374.6
	8.9%	292.2	298.6	305.8	313.9	323.3	334.1	346.8
	9.4%	276.9	282.4	288.5	295.5	303.3	312.4	322.8
	9.9%	262.9	267.6	272.9	278.9	285.6	293.2	301.9
Margin sensitivity (RON)			FCF margin TV					
WACC		1.7%	2.2%	2.7%	3.2%	3.7%	4.2%	4.7%
	6.9%	323.8	354.7	385.5	416.3	447.1	477.9	508.7
	7.4%	303.9	331.0	358.0	385.1	412.1	439.1	466.2
	7.9%	286.4	310.3	334.2	358.1	382.0	406.0	429.9
	8.4%	270.9	292.1	313.4	334.7	355.9	377.2	398.5
	8.9%	256.9	275.9	294.9	313.9	333.0	352.0	371.0
	9.4%	244.2	261.3	278.4	295.5	312.6	329.7	346.8
	9.9%	232.6	248.0	263.4	278.9	294.3	309.7	325.2

Source: RBI/Raiffeisen Research estimates

Appendix 1: Glossary

Abbreviation	Description
A Non FID	projects in an advanced stage of development
ANRE	National Energy Regulatory Authority
ANRM	National Agency for Mineral Resources
bcm	billion cubic meters
BOA	Board of administration
BRUA	BULGARIA-ROMANIA-HUNGARY-AUSTRIA
CPS	Cathodic protection stations
FID	Final investment decision
GMS	Gas metering stations
GOR	Government of Romania
GPE	Gazprom Export Ltd
IDR	Issuer default rating
LA Non FID	projects at an early stage of development
MWh	megawatt-hour
NTS	National transport system
NU	Network users
R&E	Revenue and expenditure budget
RAB	Regulated Asset Base
RRR	Regulated rate of invested capital return
TC	Tehnologic Consumption
tcm	trillion cubic meters
TSO	Transmission system operator
TWh	terawatt-hour
TYNDP	10-year National Gas Development Plan

Source: RBI/Raiffeisen Research estimates

Disclosure

Transgaz

3. RBI or one of its affiliated legal entities is a market maker or specialist or a designated sponsor or stabilisation manager or liquidity provider in financial instruments of the issuer.

Risk notifications and explanations

Warnings:

- Figures on performance refer to the past. Past performance is not a reliable indicator for future results and the development of a financial instrument, a financial index or a securities service. This is particularly true in cases when the financial instrument, financial index or securities service has been offered for less than 12 months. In particular, this very short comparison period is not a reliable indicator for future results.
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Transgaz Rating History as of 04/26/2023



Conpet Rating History as of 04/26/2023



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	Column A	Column B
Investment recommendation	Basis: All recommendations for all financial instruments (last 12 months)	Basis: Recommendations for financial instruments of all issuers, for which special services were rendered in the last 12 months
Buy recommendations	59.5%	59.5%
Hold recommendations	25.8%	22.5%
Sell recommendations	14.8%	17.9%

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