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Surge of investments into the TPP upgrade program will fall on the plunge of cash flows caused by cease of DPM payments

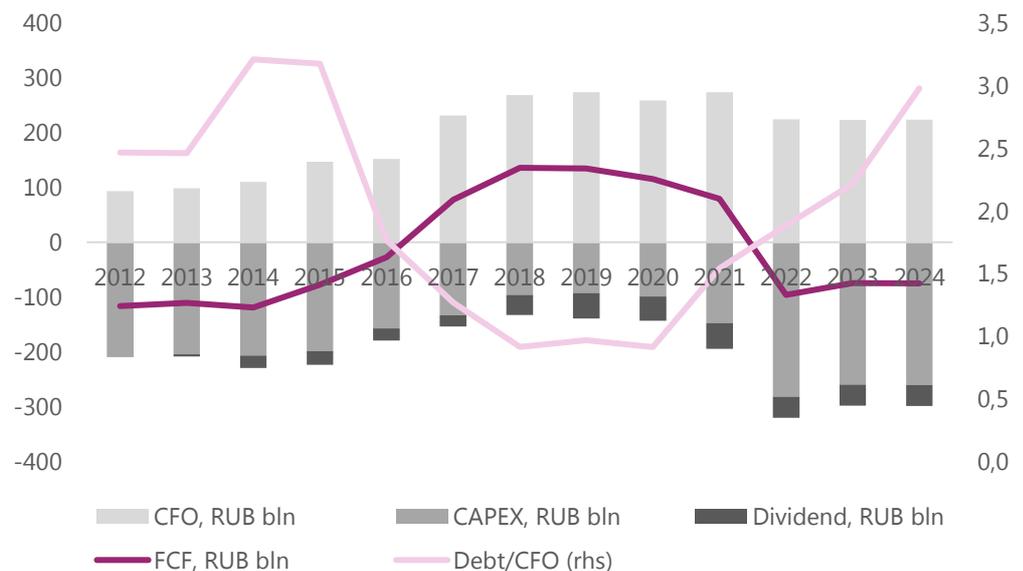
Russian power industry will return to debt market in the 2020s

Cash flows in the thermal generation sector of Russia

High leverage and long periods of negative cash flows are common for the global electric power industry due to high capital intensity and long lifespans of investment projects. In 2016, the Russian electricity sector showed positive free cash flow (FCF) (₽ 70 bln vs. -₽ 117 bln in 2012), for the first time since the RAO UES reform and the start of vast investments under the DPM program. This has occurred thanks to the thermal generation sector (OGCs and TGCs), while in other sectors ([power grid sector](#), [JSC RusHydro](#)), ACRA does not expect the FCF to go into the positive zone before 2019–2020.

In 2018–2020, the FCF in the thermal generation sector will reach the level of ₽ 150 bln per year and it is likely to be the best indicator among other Russian sectors (FCF of non-oil companies reached ₽ 100–130 bln in 2015–2016). This is caused by the completion of investment programs (the investments of the largest companies in the sector¹ fell to 5% of revenue in 2017) and the passing of the peak in DPM payments (special 10-year tariffs for new stations), which gave 86% of the cash flow from operations (CFO) in 2017.

Figure. FCF in thermal generation sector will remain positive until 2021



Source: ACRA estimates

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¹ The largest thermal generation companies include InterRAO, Gazpromenergoholding, T plus, Unipro, Enel Russia, TGC-2, Quadra.

For more information see ["10+10": Russian power sector anticipating new reforms to break investment pause](#) dated April 19, 2018.

Stable CFO to be generated by DPM payments in the thermal generation sector in 2018-2020 is unlikely to push up investments in this period, as the new mechanism for encouraging investments to upgrade TPPs was approved as late as in the summer of 2018, and the first tenders will be held at the end of 2018, with commissioning expected in 2022-2024. ACRA expects that the thermal generation sector will increase investments by 2-2.5 times in the beginning of the 2020s. And it is this period that the CFO from DPM payments will decrease, which will not be compensated by new payments for TPP upgrade projects. ACRA expects that, to implement the upgrade program, the sector will have to attract external financing, so that in 2024, the leverage may return to the level of 2014-2015, i.e. 3x/CFO. In the same period, the demand for debt financing will grow in the power grid sector as part of the announced Grids Digitalization Program.

The increase in cash flow expected in 2018-2020 can be used by the sector companies to repay their debts (in 2017, the sector's leverage slipped to 1x/CFO, while a half of the debt fell on "T plus" and "Quadra"), increase dividends, repurchase their own shares (in 2018, InterRAO has already spent ₹ 42 bln for this purpose), and mergers and acquisitions.

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