GALT & TAGGART RESEARCH

Georgian Railway
1H15 update

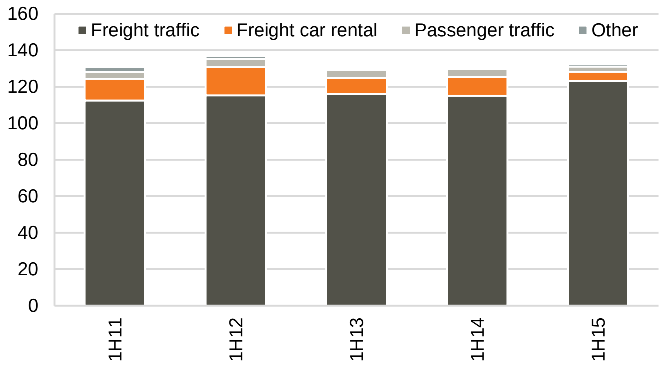
Georgia | Transportation
Georgian Railway
October 2, 2015

S&P BB- / Fitch BB-

GR released 1H15 unaudited results and Management Discussion and Analysis. Revenue increased 1.2% y/y on the back of a strong performance in freight transportation (up 6.5% y/y) and freight handling (up 10.4% y/y). Reduced operating expenses led to a 22.6% y/y increase in adjusted EBITDA to US$ 73.6mn. Significant weakening of GEL against US$ in 1H15 led to a substantial FX loss and pushed the bottom line into negative territory. We expect end-FY15 net debt-to-adjusted EBITDA to improve to 2.5x, well below the Eurobond covenant of 3.5x.

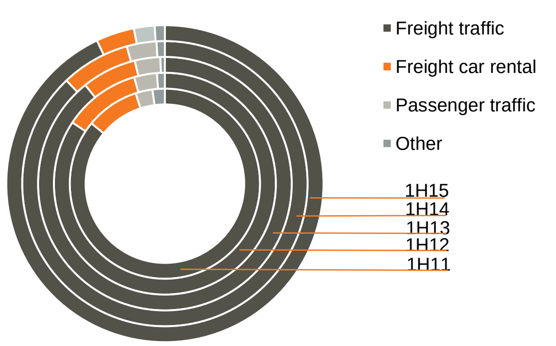
1H15 revenue increased 1.2% y/y due to solid growth in GR's core activities. Freight transportation and freight handling expanded 6.5% y/y and 10.4% y/y, respectively. Main drivers of the increase in freight transportation were oil products, ferrous metals and scrap, and grain, increasing 25.1% y/y, 43.0% y/y and 57.5% y/y, respectively. Other dry cargo categories posted y/y decreases; an exception was the 'other' category (the largest dry cargo category with a 14.5% share), which expanded 27.0% y/y. In line with our previous guidance, crude oil shipments dropped 32.0% y/y. A 49.5% y/y drop in freight car rental revenue resulted from an agreement with Azerbaijan Railways, according to which the corresponding freight car rental expense also decreased proportionately. Passenger traffic revenue decreased 36.4% y/y, but its share in the top line is only 2.1%. We believe GR has upside potential in oil products and dry cargo, in addition to the already fast-growing freight handling business.

Figure 1: Revenue, US$ mn



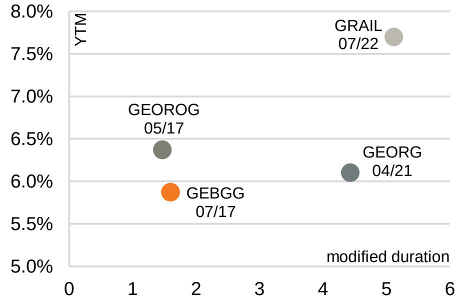
Source: Company data, Galt & Taggart Research

Figure 2: Revenue composition



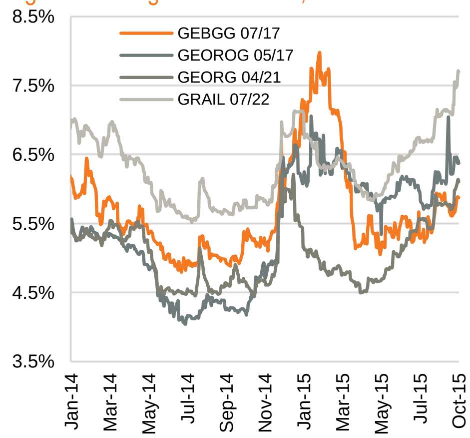
Source: Company data, Galt & Taggart Research

Figure 3: Georgian Eurobond universe



Source: Bloomberg, Galt & Taggart Research

Figure 4: Georgian Eurobonds, YTM



Source: Bloomberg, Galt & Taggart Research

Table 1: Key financials (US$ '000) and margins

	1H14	1H15	Change, y/y
Revenue	130,844.9	132,396.9	*1.2%*
EBITDA	60,025.2	74,834.1	*24.7%*
EBITDA margin	*45.9%*	*56.5%*	*1,065 bps*
Adjusted EBITDA	60,006.4	73,595.2	*22.6%*
Adjusted EBITDA margin	*45.9%*	*55.6%*	*973 bps*
EBIT	30,958.2	50,683.6	*63.7%*
EBIT margin	*23.7%*	*38.3%*	*1,462 bps*
Net income	19,492.8	-29,404.3	*n/m*
Net profit margin	*14.9%*	*n/m*	*n/m*
Assets	1,653,826.2	1,386,273.6	*-16.2%*
Equity	896,801.2	655,213.7	*-26.9%*
Liabilities	757,025.0	731,059.9	*-3.4%*

Source: Company data, Galt & Taggart Research

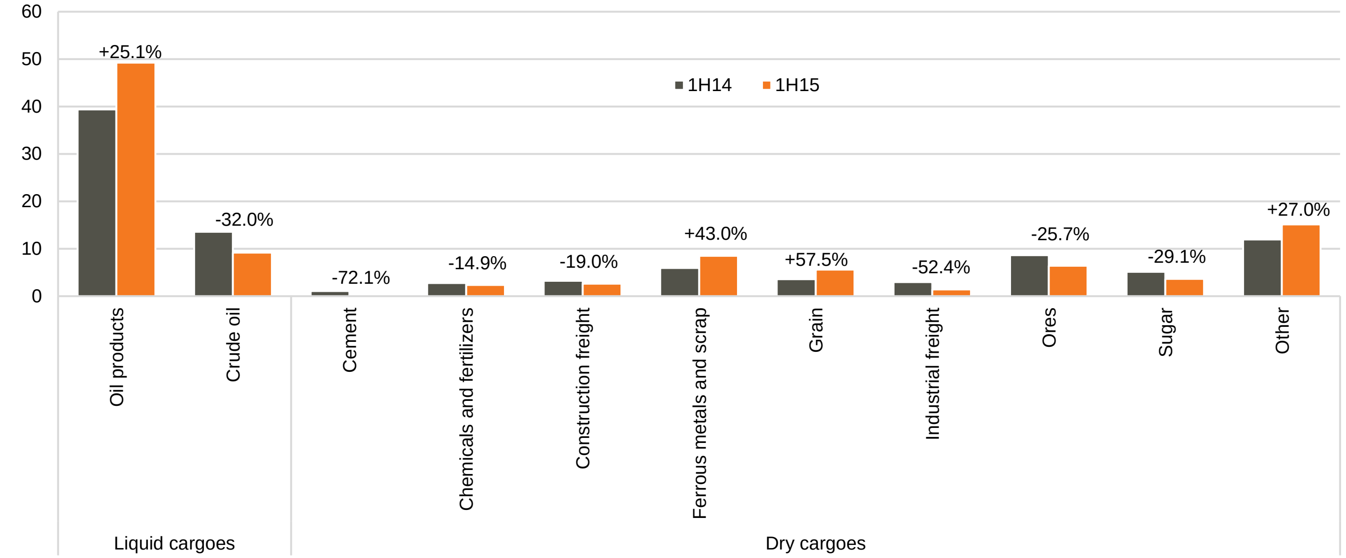
US$-GEL	1H11	1H12	1H13	1H14	1H15
Period-end	1.67	1.64	1.65	1.77	2.25
Average	1.71	1.65	1.65	1.76	2.18

Source: NBG, Galt & Taggart Research

Nino Papava
Head of Research | n.papava@gt.ge | +995 32 2401 111 ext. 4693

David Ninikelashvili
Senior Analyst | dninikelashvili@gt.ge | +995 32 2401 111 ext. 8137

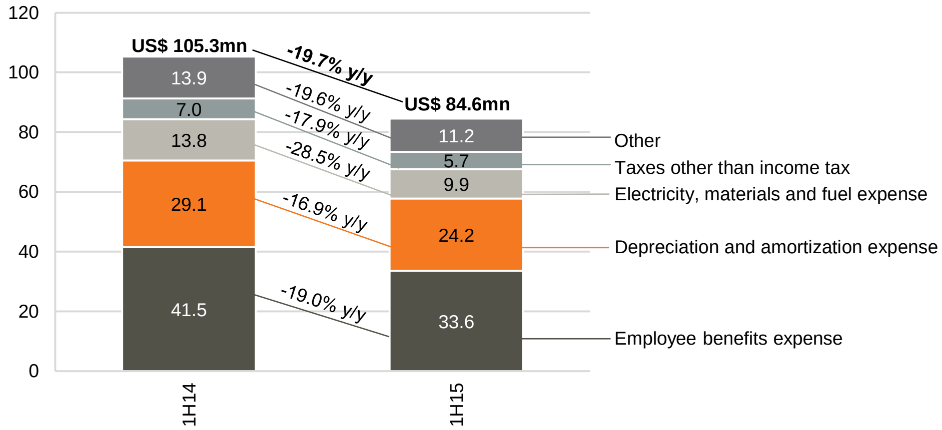
Figure 5: Freight transportation revenue, US$ mn



Source: Company data, Galt & Taggart Research

1H15 operating expenses decreased 19.7% y/y to US$ 84.6mn (US$ 105.3mn in 1H14), as they are mostly GEL-denominated. A lower utilization rate of rolling stock also played its role. Freight car rental expense decreased due to the aforementioned agreement between Georgian and Azerbaijan railways, according to which both sides were exempted from freight car rental payments during the first eight days of each month, from December 2014 through February 2015.

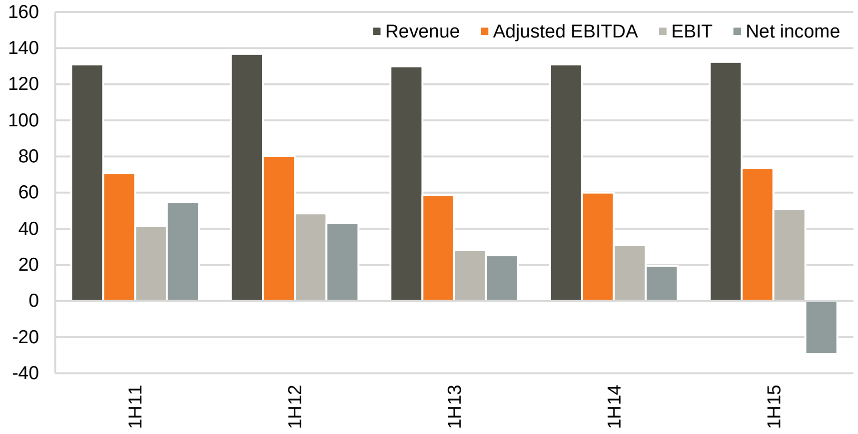
Figure 6: Operating expenses, US$ mn



Source: Company data, Galt & Taggart Research

1H15 adjusted EBITDA increased 22.6% y/y (up 2.3% y/y in 1H14) and accounted for US$ 73.6mn (US$ 60.0 in 1H14). EBIT grew 63.7% y/y to US$ 50.7mn. In the same vein, adjusted EBITDA and EBIT margins widened to 55.6% and 38.3% from 45.9% and 23.7% in 1H14, respectively. Significant weakening of GEL against US$ in 1H15 led to a substantial FX loss and pushed the bottom line into negative territory. Notably, the FX loss is an unrealized non-cash charge and not a cause for concern.

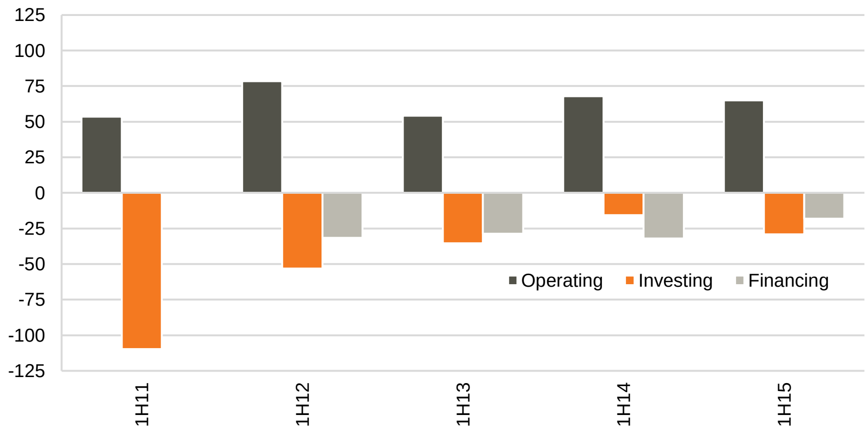
Figure 7: Revenue, adjusted EBITDA, EBIT and net income (US$ mn)



Source: Company data, Galt & Taggart Research

1H15 operating cash was at US$ 65.0mn (US$ 68.0mn in 1H14), down 4.4% y/y (up 25.4% in 1H14). The decrease was mainly caused by a relatively large cash outflow on property tax. In 1H14, a large VAT surplus was used to cover a significant portion of property tax payable which was not the case this year. Investing outflows accelerated in 1H15 mainly due to the Modernization project.

Figure 8: Cash flows, US$ mn



Source: Company data, Galt & Taggart Research

Disclaimer

This document is strictly confidential and has been prepared by JSC Galt & Taggart ("Galt & Taggart"), a member of JSC Bank of Georgia group ('Group") solely for informational purposes and independently of the respective companies mentioned herein. This document does not constitute or form part of, and should not be construed as, an offer or solicitation or invitation of an offer to buy, sell or subscribe for any securities or assets and nothing contained herein shall form the basis of any contract or commitment whatsoever or shall be considered as a recommendation to take any such actions.

Galt & Taggart is authorized to perform professional activities on the Georgian market. The distribution of this document in certain jurisdictions may be restricted by law. Persons into whose possession this document comes are required by Galt & Taggart to inform themselves about and to observe any and all restrictions applicable to them. This document is not directed to, or intended for distribution, directly or indirectly, to, or use by, any person or entity that is a citizen or resident located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would require any registration or licensing within such jurisdiction.

Investments (or any short-term transactions) in emerging markets involve significant risk and volatility and may not be suitable for everyone. The recipients of this document must make their own investment decisions as they believe appropriate based on their specific objectives and financial situation. When doing so, such recipients should be sure to make their own assessment of the risks inherent in emerging market investments, including potential political and economic instability, other political risks including without limitation changes to laws and tariffs, and nationalization of assets, and currency exchange risk.

No representation, warranty or undertaking, express or implied, is or will be made by Galt & Taggart or any other member of the Group or their respective directors, employees, affiliates, advisers or agents or any other person as to, and no reliance should be placed on, the fairness, accuracy, completeness or correctness of this document and the information contained herein (and whether any information has been omitted from this document) and no reliance should be placed on it. This document should not be considered as a complete description of the markets, industries and/or companies referred to herein. Nothing contained in this document is, is to be construed as, or shall be relied on as legal, investment, business or tax advice, whether relating to the past or the future, by Galt & Taggart any other member of the Group or any of their respective directors, employees, affiliates, advisers or agents in any respect. Recipients are required to make their own independent investigation and appraisal of the matters discussed herein. Any investment decision should be made at the investor's sole discretion. To the extent permitted by law, Galt & Taggart, any other member of the Group and their respective directors, employees, affiliates, advisers and agents disclaim all liability whatsoever (in negligence or otherwise) for any loss or damages however arising, directly or indirectly, from any use of this document or its contents or otherwise arising in connection with this document, or for any act, or failure to act, by any party, on the basis of this document.

The information in this document is subject to verification, completion and change without notice and Galt & Taggart is not under any obligation to update or keep current the information contained herein. The delivery of this document shall not, under any circumstances, create any implication that there has been no change in the information since the date hereof or the date upon which this document has been most recently updated, or that the information contained in this document is correct as at any time subsequent to the date on which it is supplied or, if different, the date indicated in the document containing the same. No representation or warranty, expressed or implied, is made by Galt & Taggart or any other member of the Group, or any of their respective directors, employees, affiliates, advisers or agents with respect to the accuracy or completeness of such information.

The information provided and opinions expressed in this document are based on the information available as of the issue date and are solely those of Galt & Taggart as part of its internal research coverage. Opinions, forecasts and estimates contained herein are based on information obtained from third party sources believed to be reliable and in good faith, and may change without notice. Third party publications, studies and surveys generally state that the data contained therein have been obtained from sources believed to be reliable, but that there is no guarantee of the accuracy or completeness of such data. Accordingly, undue reliance should not be placed on any such data contained in this document. Neither Galt & Taggart, any other member of the Group, nor their respective directors, employees, affiliates, advisors or agents make any representation or warranty, express or implied, of this document's usefulness in predicting the future performance, or in estimating the current or future value, of any security or asset.

Galt & Taggart does, and seeks to do, and any other member of the Group may or seek to do business with companies covered in its research. As a result, investors should be aware of a potential conflict of interest that may affect the objectivity of the information contained in this document.

This document is confidential to clients of Galt & Taggart. Unauthorized copying, distribution, publication or retransmission of all or any part of this document by any medium or in any form for any purpose is strictly prohibited.

The recipients of this document are responsible for protecting against viruses and other destructive items. Receipt of the electronic transmission is at risk of the recipient and it is his/her responsibility to take precautions to ensure that it is free from viruses and other items of a destructive nature.

Head of Research
Nino Papava | n.papava@gt.ge

Economist
Eva Bochorishvili | evabochorishvili@gt.ge

Economist
Alim Hasanov | ahasanov@gt.ge

Senior Associate
Giorgi Iremashvili | giremashvili@gt.ge

Analyst
David Kutidze | dkutidze@gt.ge

Senior Analyst
David Ninikelashvili | dninikelashvili@gt.ge

Analyst
Tamara Kurdadze| tamarkurdadze@gt.ge

Address: 79 D. Agmashenebeli Avenue, Tbilisi 0102, Georgia
Tel: + (995) 32 2401 111
Email: research@gt.ge