



## Georgian Railway In a good shape for 2015

Georgia | Transportation  
Georgian Railway  
December 29, 2014

Georgian Railway reached a favorable agreement with the professional union of employees following the staff strike in late 2014. As a result, we have slightly revised our numbers and expect the employee benefits to grow 1.1% y/y in 2014. We also performed a sensitivity analysis on 2015 GR revenues in light of the regional economic weakness. As a result, we see no major impact on GR Eurobond covenants in 2015. Due to promising 9M14 performance (see our previous note) and new freight in oil products, we project a revenue growth of 3.3% y/y in GEL terms in 2014 and 3.4% y/y in 2015, on our conservative estimates. Top line will be slightly challenged by the volatile GEL (2.0% y/y higher) in 2015. However, GR's FX risk is partially mitigated through mostly US\$-denominated freight tariffs. In 2015, net income will increase 1.6% y/y to US\$ 62.4mn from US\$ 61.5mn in 2014. EBITDA is set to grow 1.7% y/y and reach US\$ 145.7mn in 2015 from US\$ 143.3mn in 2014. We expect net debt to EBITDA at 2.6x in 2015 vs. 2.7x in 2014, below the Eurobond covenant of 3.5x.

### Solid performance expected in FY15

We expect growth of revenues in 2015 at 3.4% y/y in GEL terms and at 1.4% y/y in US\$ terms, respectively, to reach US\$ 284.8mn (GEL 512.6mn) thanks to new agreements in freight of oil products. Due to revenue shift to a more profitable oil products segment, EBITDA and EBIT margins will both improve slightly in 2015 to reach 51.2% and 30.2% against 51.0% and 30.1% in 2014. Net profit margin will remain largely unchanged at 21.9%, in our view. Consolidation of freight forwarding subsidiaries (8.0% of total freight in 9M14 and 5.4% in 9M13) will further boost revenues in 2014 to reach US\$ 280.8mn (GEL 495.5mn), down 2.7% y/y in US\$ and up 3.3% in GEL terms, respectively, due to depreciated (6.1% higher y/y) GEL. In 2014, freight transportation will hold a lion's share of revenues at 87.2%, followed by car rental and passenger segments with 7.8% and 4.1% shares, respectively. Other revenue accounts for 0.9%.

### Employee benefits to increase 1.1% y/y in FY14

As a result of negotiations, GR and the professional union of employees reached an agreement regarding the staff strike which started in November. The latter seems to be mainly caused by miscommunication as most of the costs had already been budgeted. As a result, employee benefits will increase only by 1.1% y/y in FY14. The strike has caused a minor delay in cargo transportation. However, the delayed cargo is expected to be transported with an increased flow before the year-end.

Further, on the 9<sup>th</sup> of December, Fitch Ratings revised Georgian Railway's Outlook to Stable from Negative and affirmed its Long-term IDR (Issuer Default Rating) at 'BB-'. The Outlook revision mirrored GR's better-than-expected 9M14 performance and the commencement of freight forwarding services.

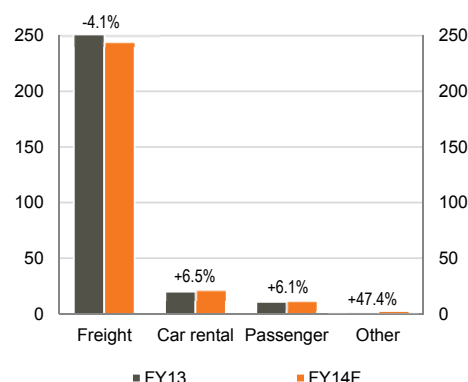
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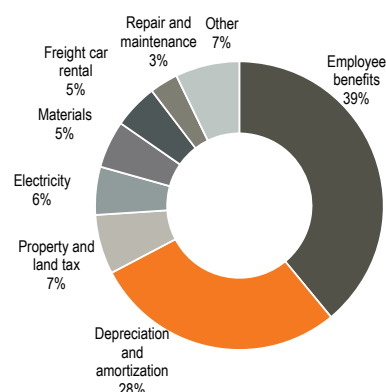
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Figure 1: Revenue breakdown, US\$ mn



Source: Company data, Galt & Taggart Research

Figure 2: FY14F operating cost breakdown



Source: Company data, Galt & Taggart Research

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

	FY14F	FY15F	Chg, y/y
Total revenue	280,830	284,753	1.4%
EBITDA	143,325	145,734	1.7%
EBITDA margin	51.0%	51.2%	0.14ppts
EBIT	84,637	85,875	1.5%
EBIT margin	30.1%	30.2%	0.02ppts
Net profit	61,498	62,449	1.6%
Net profit margin	21.9%	21.9%	0.03ppts
EBITDA coverage	8.3x	8.4x	
EBIT coverage	4.9x	5.0x	
Net debt to EBITDA	2.7x	2.6x	
Assets	1,669,091	1,700,734	1.9%
Equity	924,474	947,621	2.5%
Liabilities	744,617	753,407	1.2%

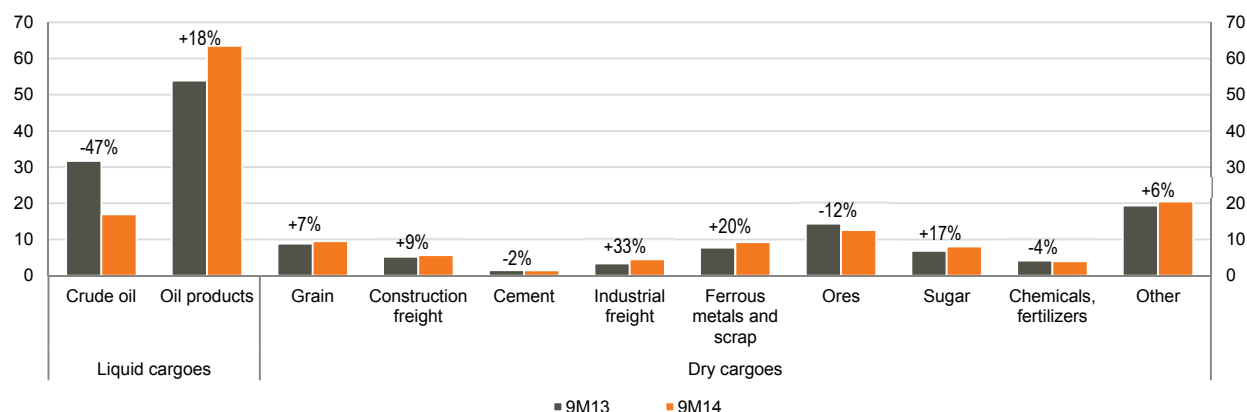
Source: Company data, Galt & Taggart Research



## Limited exposure to the regional economies

In the wake of the lower oil price environment and the regional economic weakness, GR's revenues remain diversified with operations mostly through advance payments. Further, 9M14 saw a significant growth of 18.1% y/y in transportation of oil products (40.8% of total freight traffic), stemming mainly from Azerbaijan and Kazakhstan.

Figure 3: Revenue breakdown, US\$ mn



Source: Company data

The prolonged regional economic weakness might eventually negatively affect GR's performance. However, we believe the most exposed are cyclical types of freight, including construction and industrial freights, as well as cement and other freight, together responsible for only 20.6% of the total. We do not expect oil products to decrease – especially in the short-term – as the adjustment of volumes, if any, takes time. We stress-tested three negative scenarios on GR's exposed freight types. As a result of the analysis, we expect no major concerns for 2015.

Table 2: FY15F key financials (US\$ '000) and margins and ratios

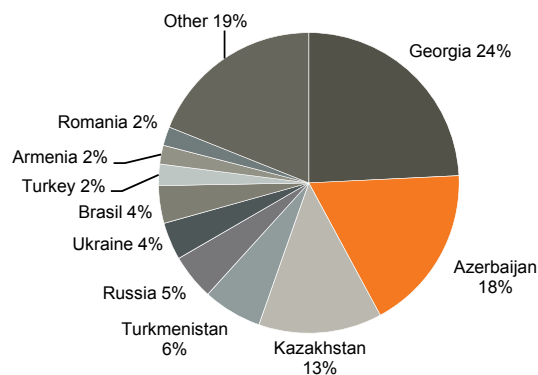
	Base scenario	Change in selected freight		
		-10%	-20%	-30%
Total revenue	284,753	280,471	276,189	271,907
Of that selected freight	42,821	38,539	34,256	29,974
EBITDA	145,734	141,452	137,170	132,887
EBITDA margin	51.2%	50.4%	49.7%	48.9%
EBIT	85,875	81,593	77,311	73,029
EBIT margin	30.2%	29.0%	28.0%	26.9%
Net profit	62,448	58,857	55,265	51,672
Net profit margin	21.9%	21.0%	20.0%	19.0%
EBITDA coverage	8.4x	8.2x	7.9x	7.7x
EBIT coverage	5.0x	4.7x	4.5x	4.2x
Net debt to EBITDA	2.6x	2.6x	2.7x	2.8x

Source: Company data, Galt & Taggart Research



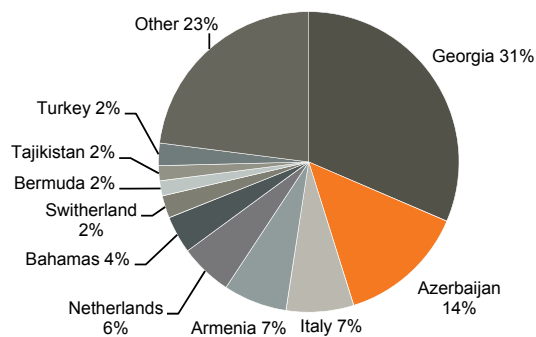
In 9M14, Azerbaijan, Kazakhstan and Turkmenistan originated 17.9% and 13.3% and 6.3% of the total freight transported by GR, respectively. In addition, Azerbaijan is the recipient of 13.7% of the freight. Russia and Ukraine together are the origins of 8.9% of the freight transported, while 9.0% of the GR's freight is sent either to or from Armenia. Given the diversification and the long-term scope of the business, GR seems to be well prepared for weaker regional environment in 2015.

**Figure 4: Origin of freight transported in 9M14**



Source: Company data

**Figure 5: Destination of freight in 9M14**



Source: Company data

## Settlement conditions

### Staff strike: settlement details

- One-time payment equivalent to 50% of the monthly salary will be paid as a special bonus;
- An improved health insurance package will be offered to GR's employees and their family members;
- Selected employees will receive additional training and education;
- Selected working facilities will be improved;
- Cash bonuses will be paid to some employees depending on the length of service and their performance;
- The payment of overtime compensation and its size is still pending the final settlement.



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