Georgian Railway
9M16 update

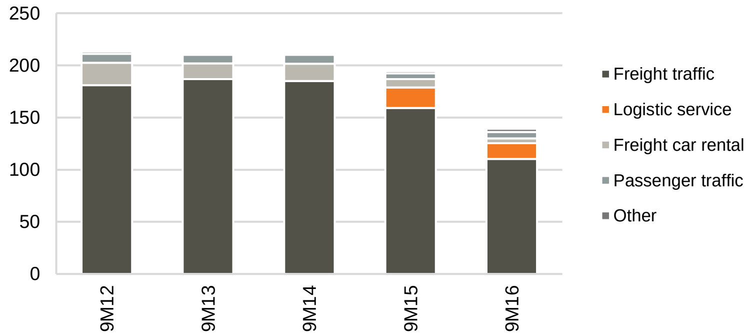
Georgia | Transportation
Georgian Railway
December 1, 2016

S&P / B+ / Stable
Fitch / BB-, Rating Watch Negative

GR released 9M16 unaudited results and Management Discussion and Analysis. Top line declined 28.5% y/y to US$ 139.0mn, largely due to lower oil products volumes. Operating expenses, mostly fixed in GEL, declined 8.7% y/y to US$ 116.5mn. Adjusted EBITDA declined 44.5% y/y to US$ 62.0mn, while the adjusted EBITDA margin shrank from 57.4% in 9M15 to 44.6% in 9M16. Appreciation of GEL vs. US$ between end-15 and 9M16 led to a non-cash FX gain, which propped up net income at US$ 56.0mn. The modernization project is underway, to be completed by late 2019. The bypass project is under review, with the final decision expected in Dec-16.

In 9M16, freight traffic and logistic service revenues declined 30.6% y/y to US$ 110.4mn and 24.7% y/y to US$ 15.0mn, respectively. GR reclassified the revenue generated by its freight forwarding subsidiaries under logistic service, a new revenue line. Freight car rental revenue fell 39.9% y/y to US$ 4.7mn, while passenger traffic revenue increased 9.5% y/y to US$ 6.2mn.

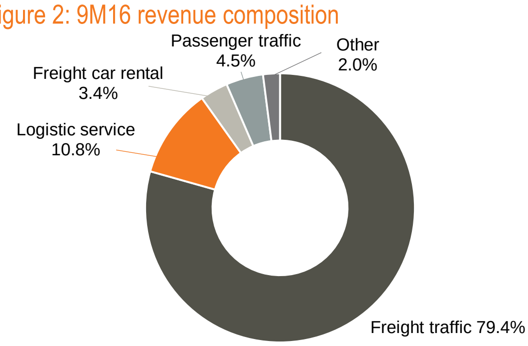
Figure 1: Revenue, US$ mn



Source: Company data

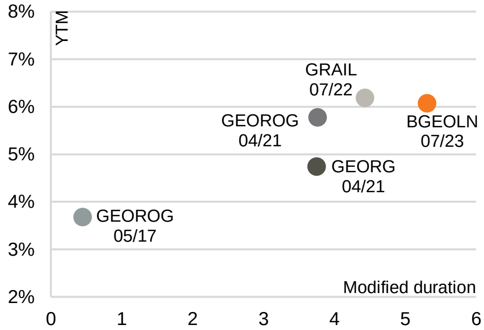
The main driver of the decrease in freight traffic was oil products transportation, down 42.1% y/y to US$ 33.1mn, due to lower volumes of heavy fuel from Kazakhstan and gasoil from Azerbaijan. Crude oil transportation revenue increased 20.2% y/y to US$ 9.1mn on the back of higher shipments from Turkmenistan. With the exception of sugar, all dry cargo categories posted significant declines. Ferrous metals and scrap dropped 36.4% y/y to US$ 7.4mn due to decreased transportation of pipes to Azerbaijan. Grain was down 46.7% y/y to US$ 4.4mn on the back of lower volumes of wheat transportation from Russia to Armenia. Sugar transportation revenue grew 14.2% y/y to US$ 7.3mn, thanks to increased shipments of cane sugar from Brazil to Azerbaijan and Armenia.

Figure 2: 9M16 revenue composition



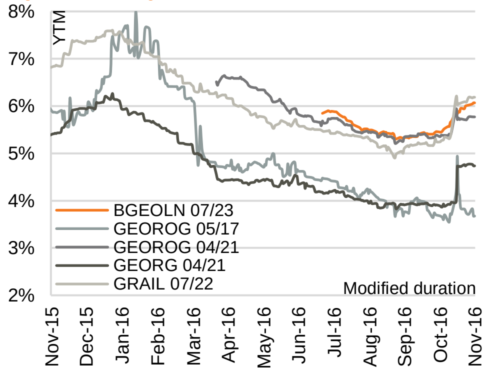
Source: Company data

Figure 3: Georgian Eurobond universe



Source: Bloomberg

Figure 4: Georgian Eurobonds



Source: Bloomberg

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

	9M15	9M16	Change, y/y
Revenue	194,467.3	139,026.2	-28.5%
EBITDA	111,666.2	95,419.3	-14.5%
EBITDA margin	*57.4%*	*68.6%*	*+1,121 bps*
Adjusted EBITDA	111,674.3	62,007.6	-44.5%
Adjusted EBITDA margin	*57.4%*	*44.6%*	*-1,282 bps*
EBIT	75,588.7	62,035.1	-17.9%
EBIT margin	*38.9%*	*44.6%*	*+575 bps*
Net income	(40,933.6)	56,030.4	n/m
Net profit margin	*n/m*	*40.3%*	*n/m*
Assets	1,275,218.8	1,361,510.9	6.8%
Equity	607,419.0	687,491.5	13.2%
Liabilities	667,799.8	674,019.4	0.9%

Source: Company data

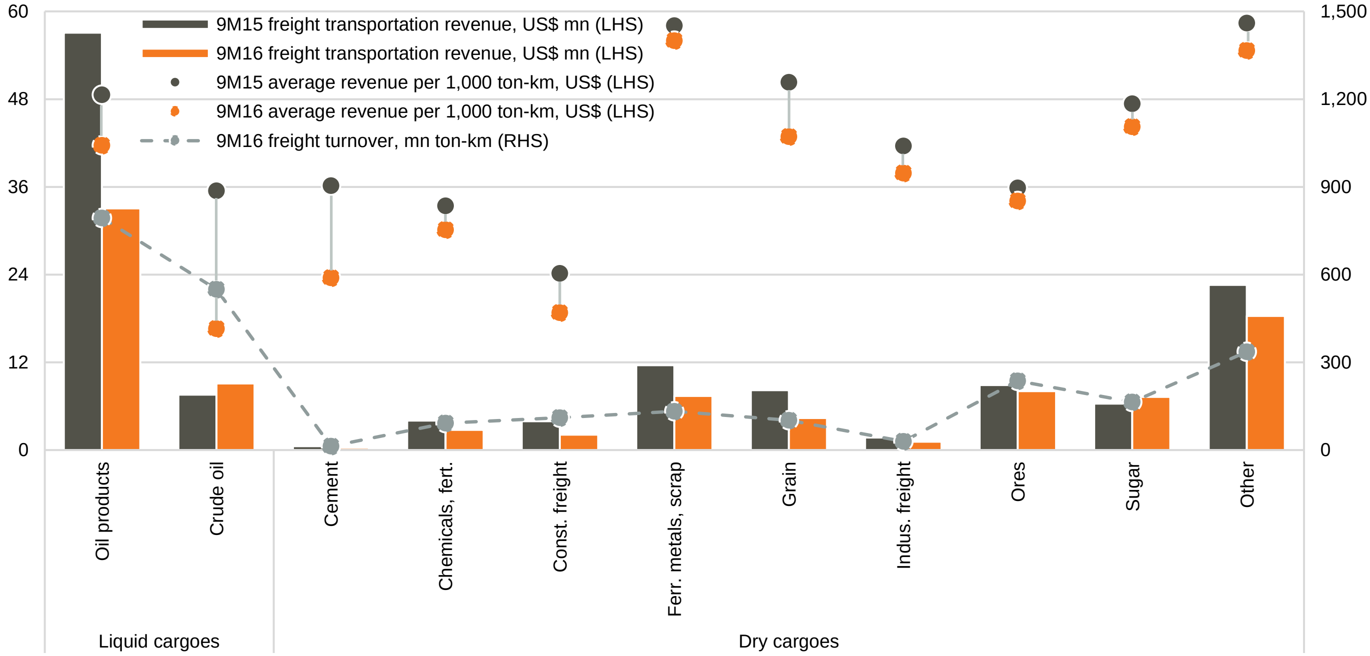
US$-GEL	9M12	9M13	9M14	9M15	9M16
Period-end	1.66	1.66	1.75	2.38	2.33
Average	1.65	1.66	1.75	2.23	2.32

Source: NBG

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

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

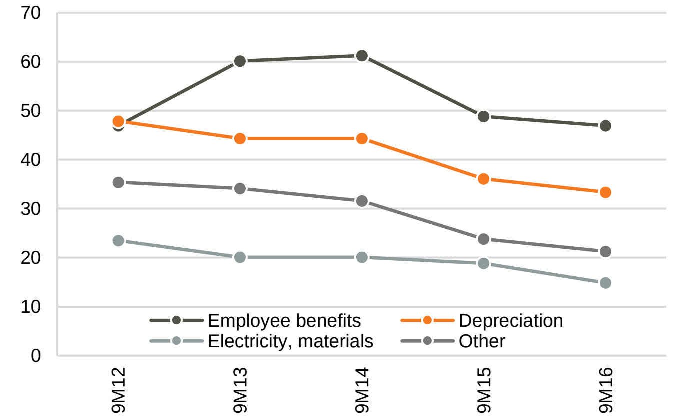
Figure 5: Freight transportation dynamics



Source: Company data

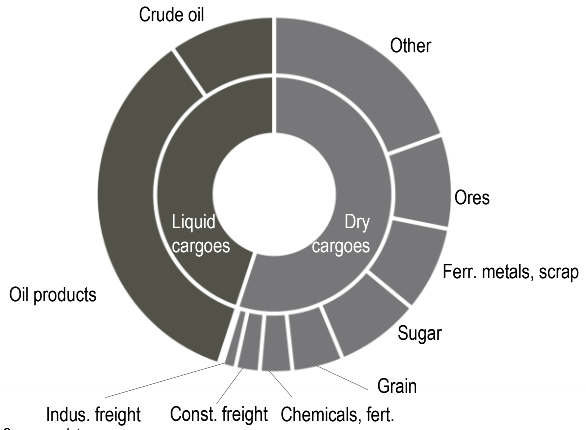
9M16 operating expenses, mostly fixed and GEL-denominated, declined 8.7% y/y to US$ 116.5mn. Electricity, materials, fuel and repair expense posted the largest decline, in both absolute and percentage terms, down 21.3% y/y to US$ 14.9mn. Materials expense was down 26.9% y/y due to decreased rail car utilization level, while electricity expense increased 7.2% y/y on the back of a 40.0% higher electricity tariff set by the regulator in August 2015. Repair and maintenance dropped 51.0% y/y to US$ 2.1mn. The other expenses category declined 10.5% y/y to US$ 21.3mn, largely due to the elimination of wagon rent expense[1] (US$ 1.5mn in 9M15). Employee benefits expense, the largest operating expense with a 40.3% share, declined 3.9% y/y to US$ 47.0mn.

Figure 6: Operating expenses, US$ mn



Source: Company data

Figure 7: 9M16 freight traffic revenue composition, US$ mn



Source: Company data

9M16 adjusted EBITDA decreased 44.5% y/y to US$ 62.0mn (excluding a US$ 33.4mn one-off, non-cash gain on sale of land to the state). The adjusted EBITDA margin shrank from 57.4% in 9M15 to 44.6% in 9M16. Strengthening of GEL against

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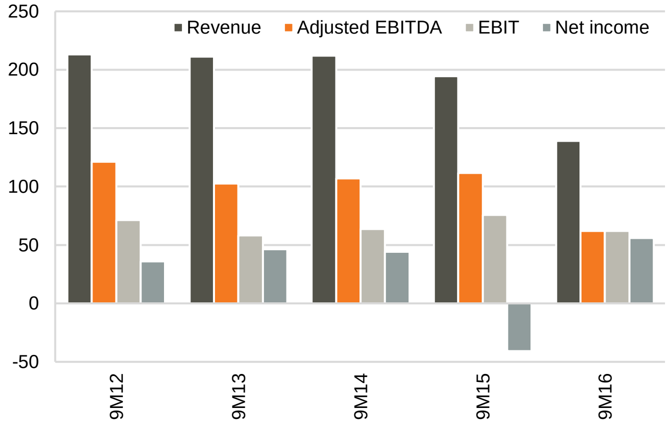
[1] In 2012, based on the expectation of increased volumes of liquid cargo transportation, GR entered into an agreement to rent 425 tank cars. The contract expired in April 2015 and GR did not renew the contract, as the corridor has a sufficient quantity of tank cars to handle both current and expected volumes.

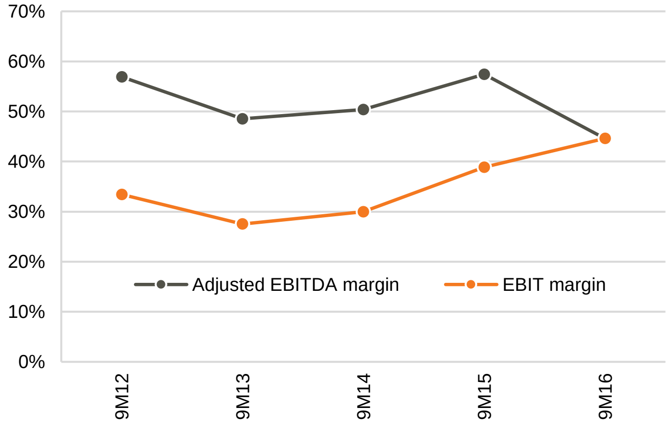
US$ between end-15 and 9M16 led to a non-cash FX gain of US$ 12.1mn, which propped up net income at US$ 56.0mn.

Figure 8: Income statement highlights, US$ mn



Source: Company data

Figure 9: Profitability margins

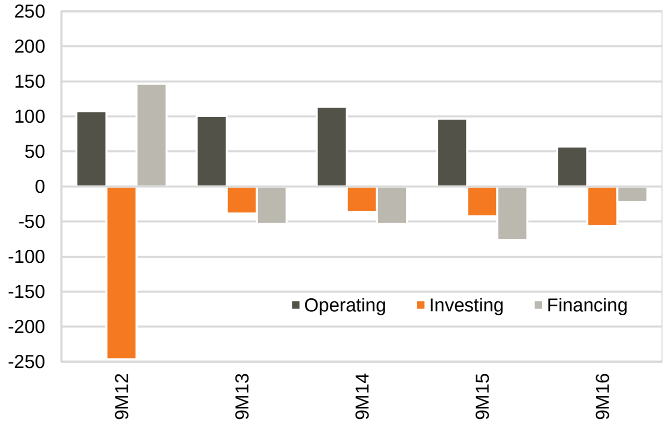


Source: Company data

Operating cash declined 41.1% y/y to US$ 57.0mn on the back of lower cash receipts (-24.3% y/y) in 9M16. Investing outflows on long-term assets, mostly related to the modernization project and new passenger trains, were at US$ 66.2mn (+36.4% y/y). On the financing side, in May-16, GR granted a new, 7-year, US$ 6.0mn loan to the Partnership Fund (a Georgian state-owned investment fund and 100% owner of GR), while the US$ 16.0mn loan granted to Georgian Energy Development Fund (a state-owned entity promoting the development of renewable energy sources) in Dec-15 was repaid in full over Jun-16 and Jul-16. In Jul-16, GR borrowed US$ 23.0mn from Credit Suisse for the purchase of new passenger trains. In 3Q16, a US$ 8.5mn loan was granted to a liquid cargo terminal operator on the Black Sea, which GR took under management.

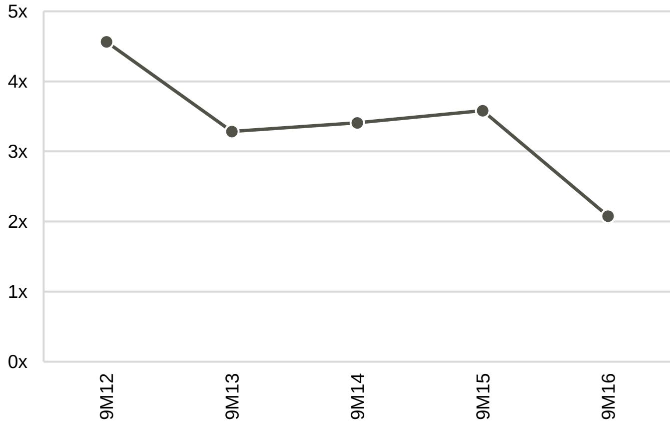
The adjusted EBITDA coverage ratio deteriorated from 3.6x in 9M15 to 2.1x in 9M16. Notably, interest expense was down 4.2% y/y in 9M16, as in Aug-15, GR redeemed the outstanding portion (US$ 27.5mn) of the Eurobond maturing in 2015.

Figure 10: Cash flows, US$ mn



Source: Company data

Figure 11: Adjusted EBITDA coverage ratio



Source: Company data

GR has recently published its 2015 annual report. A report with our detailed projections will follow shortly.

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Head of Investment 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

Senior Analyst
David Ninikelashvili | dninikelashvili@gt.ge

Analyst
David Kutidze | dkutidze@gt.ge

Analyst
Kakhaber Samkurashvili | ksamkurashvili@gt.ge

Analyst
Ioseb Kumsishvili | ikumsishvili@gt.ge

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