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Georgian Railway – 1H20 update

Refinancing risks mount for the upcoming bond maturity

Fixed Income Research | Georgia
Georgian Railway
October 15, 2020

Although COVID-19 related disruptions haven't significantly affected Georgian Railway's largest revenue category - freight transportation – other segments have come under significant pressure during the first half of 2020, particularly in 2Q20. After growing 7.4% y/y in 1Q20, GR's revenue dropped by 15.2% y/y in 2Q20. Revenue from passenger traffic, freight handling and freight car rental, which together accounted for 25% of 2019 revenue, almost halved in 2Q20. In contrast, freight transportation and logistics service segments turned out to be more resilient revenue streams for the company. GR generated US$ 37.0mn in adjusted EBITDA in 1H20, up 3.0% y/y. Weaker GEL has pushed up company's profitability margins as most of the revenue is USD denominated, while most of the operating expenses are incurred in GEL. GR is facing Eurobond maturity in 2022 and considering poor financial position of the company, securing financing at favorable terms might become difficult.

Despite the ongoing disruptions to global supply chains due to COVID-19 pandemic, transportation volumes going through Georgia have posted positive trends in 2020. Road transportation, which accounts for c. 70% of total freight going through Georgia, has increased marginally, up 1.1% to 19.1mn tons in 8M20, while freight transported by railway posted a strong 4.6% y/y growth in the same period.

Georgian Railway generated US$ 80.8mn in revenue in 1H20, which is 5.1% lower compared to the same period last year. Strong growth in revenue in 1Q20 (+7.4% y/y to US$ 42.0mn), mostly helped by robust performance in the first two months of the year, was not enough to offset the sharp decline in GR's 2Q20 revenue, which was down 15.2% y/y to US$ 39.0mn. Importantly, freight transportation, the largest revenue category, was down by a marginal 1.6% y/y to US$ 53.2mn in 1H20 as transportation volumes remained strong (discussed below).

Passenger traffic was the hardest hit segment, down 59.4% y/y to US$ 1.7mn in 1H20. Notably, most of the decline occurred during 2Q20, as passenger transportation was stopped by government during March-June 2020 due to COVID-19 (revenue plummeted to below US$ 0.2mn in 2Q20 vs. US$ 2.4mn in 2Q19).

Freight handing, which is the second largest revenue category for the company, was up 4.5%% y/y to US$ 11.6mn in 1H20, however the growth was entirely stemming from strong performance in the first quarter, when revenue more than doubled (to US$ 6.2mn). Freight handling revenue dropped 31.5% y/y in 2Q20. Freight car rental revenue category also experienced sharp decline in 2Q20 (- 63.2% y/y). On a positive note, logistics service revenue increased in both quarters of the year, with the revenue up 12.2% y/y to US$ 9.5mn in 1H20.

Weak GEL contributed to the improvement of the company's profitability margins. GR generated US$ 37.0mn in adjusted EBITDA in 1H20, up 3.0% y/y. As the company generates most of its revenue in USD, while most of the operating expenses are GEL denominated (GR's operating expenses were down 10.5% y/y in 1H20 in USD terms and up 0.5% y/y in GEL terms) the company's profitability margins improved in 1H20. Adjusted EBITDA margin came in at 45.8% in 1H20, compared to 42.2% in 1H19.

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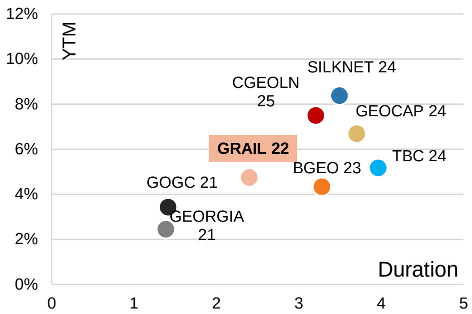
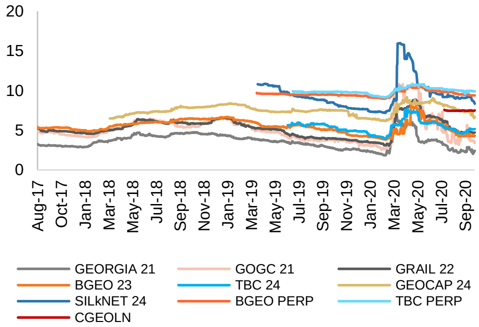
Figure 1: Georgian Eurobond universe



Source: Bloomberg

Figure 2: Georgian Eurobond universe



Source: Bloomberg , data as of October 14

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

	1H19	1H20	Change, y/y
Revenue	85,136	80,803	-5.09%
EBITDA	38,179	37,652	-1.38%
EBITDA margin	*44.84%*	*46.60%*	*1.76ppts*
Adjusted EBITDA	35,921	36,986	+2.96%
Adjusted EBITDA margin	*42.19%*	*45.77%*	*3.58ppts*
Net income	-15,318	-10,228	+33.23%
Net profit margin	*-17.99%*	*-12.66%*	*5.33ppts*
Assets	801,640	774,582	-3.38%
Liabilities	631,703	613,540	-2.88%
Equity	169,937	161,042	-5.23%
Net debt to EBITDA	**6.80x**	**5.92x**	

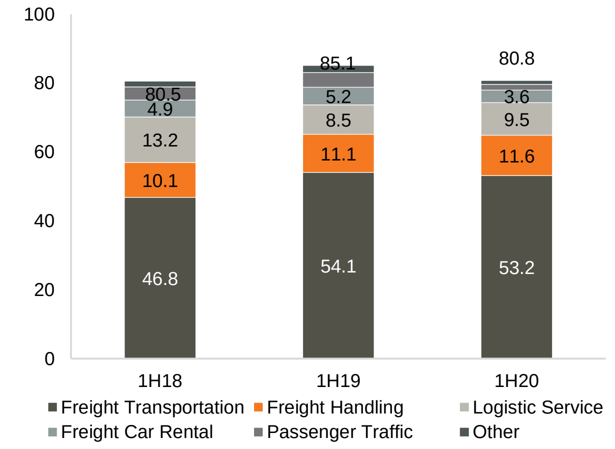
Note: Debt to EBITDA is calculated on last 12 months basis

Georgian Railway credit ratings

S&P Global Ratings
B+
Negative
Affirmed June-2020

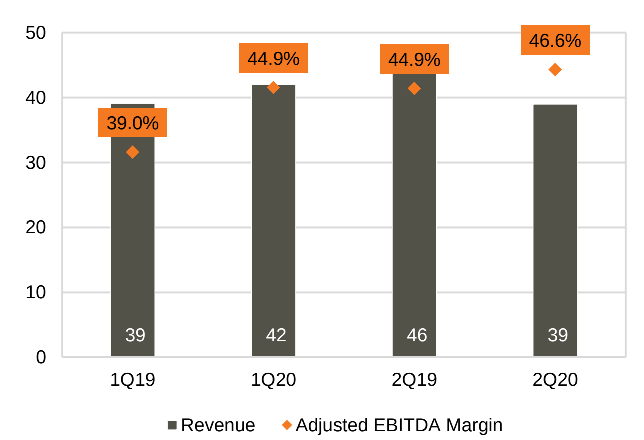
Fitch Ratings
BB-
Negative
Affirmed May-2020

Figure 3: Revenue, US$ mn



Source: Georgian Railway, Galt & Taggart Research

Figure 4: Quarterly revenue and adjusted EBITDA margin

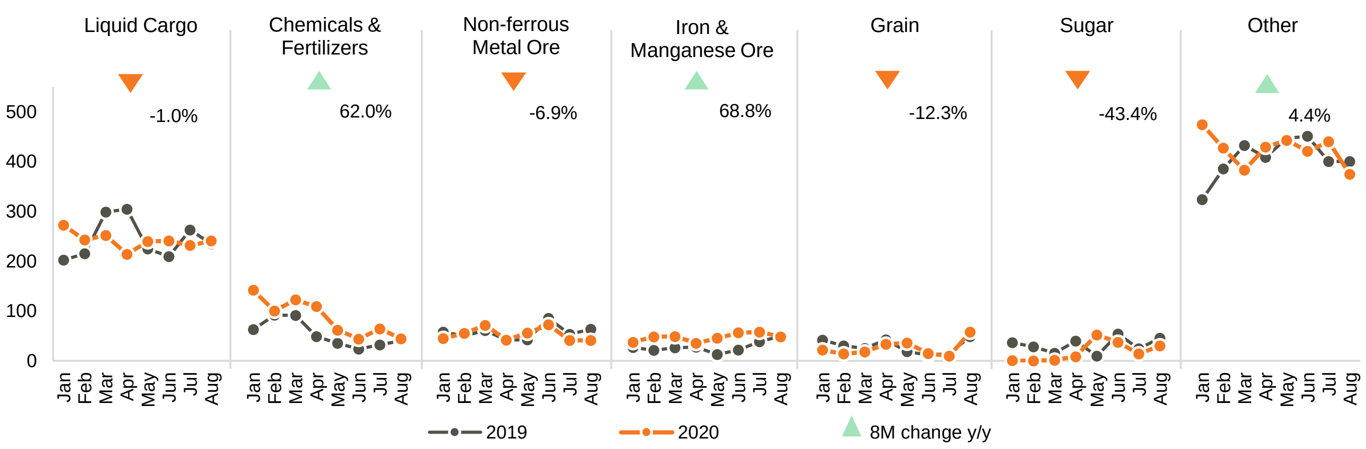


Source: Georgian Railway, Galt & Taggart Research

Freight transportation, which made up c. 66% of 1H20 revenue declined slightly, down 1.6% y/y to US$ 53.2mn in 1H20. However, this decline reflected reduced revenue per ton (due to changes in transportation and production mix), as transportation volumes went up 7.6% y/y in 1H20, entirely driven by dry cargo transportation volumes.

Surprisingly, transportation volumes going through Georgia have mostly been unaffected by the pandemic related disruptions in global supply chains and reduced trade volumes among regional countries. In 8M20, GR transported c. 7.2mn tons of cargo, which is 4.6% higher y/y, mostly driven by increased dry cargo transportation (+ 6.8% y/y). Chemicals/fertilizers and ferrous metals, which together accounted for c. 15% of total dry cargo, were the driving force behind the growth, while sugar, grain, non-ferrous metals and oil products transportation declined in 8M20.

Figure 5: Freight transportation in Georgia by rail and product mix, '000 tons



Source: Georgian Railway

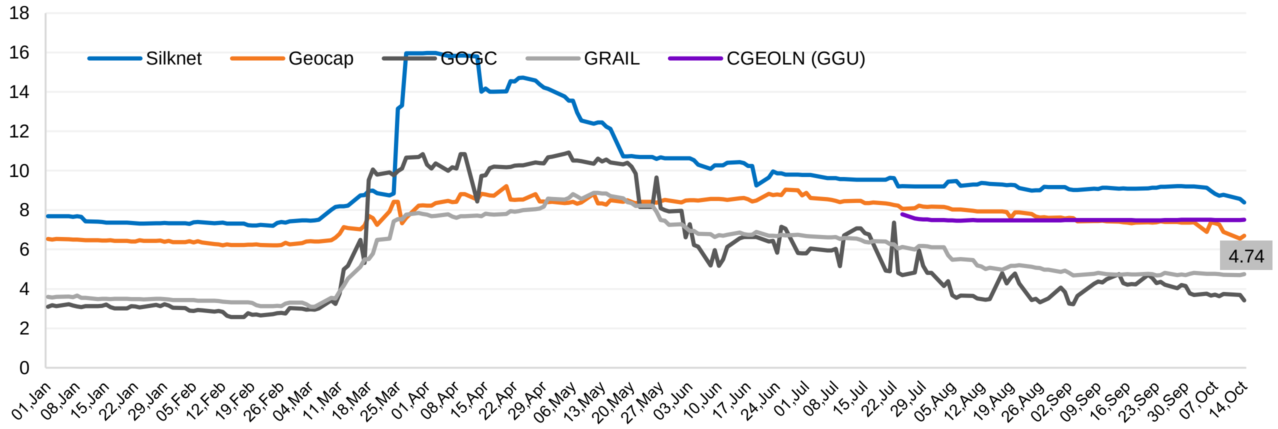
Due to GEL's significant - 6.5% - depreciation during the first half of 2020, GR recognized large FX loss (US$ 28mn), which **dragged the company's bottom line to a negative US$ 10mn in 1H20,** slightly less than the net loss incurred during 1H19 (-US$ 15mn).

After the significant hike in GR's yield due to the COVID-19 outbreak (peaked to 8.9% by mid-May), the yield started to decline in 2020 summer months, in line with other Georgian Eurobonds. **On October 14, yield on GRAIL 22 is stood at 4.7%, or 104.9% of par.** Notably, GRAIL 22 is trading at c. 229bps spread compared to GEORGIA 21 and c.132bps spread with another quasi government GOGC 21.

GR is facing the maturity of its US$ 500mn Eurobond in July 2022 and COVID-19 related disruptions in the financial markets have increased refinancing risks for the company. Notably, the company is currently working on different options to refinance the outstanding Eurobond:

- If the market sentiments become more favorable, the company **could tap international capital markets** within the next 12 months. However, taking into consideration the standalone financial health of the company and Eurobond covenant, which is above the previously agreed level (Net Debt-to-EBITDA came in at 5.92x as of 30 June, 2020 far above the Eurobond covenant of 3.5x), reaching reasonable terms for the new Eurobond could become difficult;
- GR **could try to negotiate a loan facility from large pool of IFIs** represented in Georgia. However, unlike GOGC, which has recently secured financing from EBRD to refinance its 2021 Eurobond, GR's standalone financial position is weaker and the scale of financing required is much larger (US$ 500mn for GR vs. US$ 250mn for GOGC).

Figure 6: YTM on selected Georgian Eurobonds



Source: Bloomberg, as of 14 October 2020

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