GALT & TAGGART RESEARCH

Georgian Railway
The Worst is Behind

Georgia | Transportation
Georgian Railway
October 3, 2018

S&P / B+ / Outlook Negative
Fitch / B+ / Outlook Stable

GR released poor FY17 audited results. On the back of the continued decline in freight traffic volumes, the top line decreased 6.8% y/y to US$ 173.2mn, from an already low base. On the positive note, logistic service and freight car rental revenue, together accounting for 20.8% of total, were up 32.4% y/y to US$ 29.4mn and 13.5% y/y to US$ 6.7mn, respectively. Following the addition of four new passenger trains, passenger traffic revenue boosted, up 19.7% y/y to US$ 9.1mn. Ambiguity on Tbilisi Bypass Project translated into a US$ 152.2 impairment loss in 2017. As a result, FY17 net income was negative at US$ 141.2mn. Significant drop in EBITDA caused the net debt-to-EBITDA ratio to reach 4.9x, exceeding the Eurobond covenant of 3.5x. The outlook for GR's performance slightly improved in 2018, with 1H18 revenues increasing 3.9% y/y to US$ 80.4mn. The company retains sufficient cash buffers to incur essential capital expenditures in the medium term.

FY17 revenue was down 6.8% y/y to US$ 173.2mn, from the low base of US$ 185.9mn in 2016. Decrease in freight transportation revenue, down 15.3% y/y, was the main reason behind the decline. Freight handling and other revenue categories declined 10.6% y/y to US$ 20.0mn and 21.3% y/y to US$ 3.3mn, respectively. On the positive note, logistic service and freight car rental revenue, which account for 20.8% of total, were up 32.4% y/y to US$ 29.4mn and 13.5% y/y to US$ 6.7mn, respectively. Passenger traffic category increased for the second consecutive year with FY17 revenue up 19.7% y/y to US$ 9.1mn. In 1H18, the downward trend reversed with revenues increasing 3.9% y/y to US$ 80.4mn helped by the increased freight car rental and logistic service revenue categories.

Operating expenses (excluding impairment loss on PPE), which are mostly GEL-denominated, declined 3.7% y/y to US$ 148.0mn in 2017. The decrease is mostly attributed to GEL's 6.0% depreciation against US$ in 2017 vs 2016 (in GEL terms operating expenses increased 2.1% y/y). Reduction of the revenue, coupled with reduction in other income from continuing operations were the main reasons behind the 12.3% y/y decrease in adjusted EBITDA to US$ 72.3mn in 2017.

US$ 152.5mn impairment loss was recognized on Tbilisi Bypass Project reflecting ambiguity on the project. Considering the significant uncertainties related to the future of the project and the associated potential economic benefits, the carrying value of the project (GEL 397.3mn) was written down to its recoverable amount (GEL 14.7mn). This resulted in GEL 382.6mn or US$ 152.5mn impairment loss recognition, hitting the bottom line, which came in at US$ -141.2mn.

Main Line Modernization Project is the only ongoing capital project by Georgian Railway. A US$ 95.0mn is expected to be spent over 2018-21, while the project finalization is anticipated for end-2019. The company plans to finance the capital expenditures with its internal sources.

FY17 net debt-to-EBITDA ratio came in at 4.9x, exceeding the Eurobond covenant of 3.5x. According to the terms and conditions of the 2012 Eurobond prospectus, GR and any of its subsidiaries are not allowed to incur, directly or indirectly, any financial indebtedness if net debt-to-EBITDA ratio exceeds 3.5x. We expect the ratio to remain above the Eurobond covenant in the medium term which will limit GR's borrowing capacity under Eurobond covenants.

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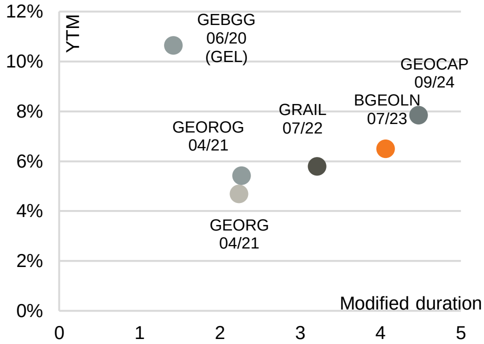
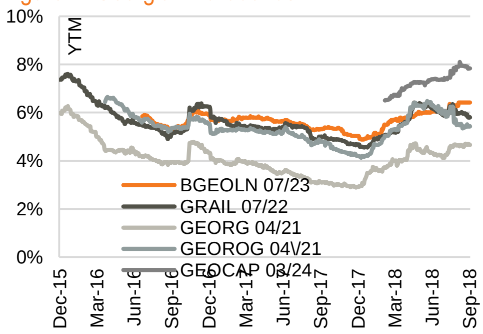
Figure 1: Georgian Eurobond universe



Source: Bloomberg

Figure 2: Georgian Eurobonds



Source: Bloomberg

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

	FY16	FY17	Change, y/y
Revenue	185,878	173,215	-6.8%
EBITDA	119,049	84,449	-29.1%
EBITDA margin	*64.05%*	*48.75%*	*-15.3pps*
Adjusted EBITDA	82,455	72,321	-12.3%
Adjusted EBITDA margin	*44.36%*	*41.75%*	*-261bps*
EBIT	74,148	40,719	-45.1%
EBIT margin	*39.89%*	*23.51%*	*-16.4pps*
Net income	27,517	-141,152	-612.9%
Net profit margin	*14.80%*	*-81.49%*	*-96.3pps*
Assets	1,218,711	1,104,173	-9.4%
Liabilities	614,481	623,944	1.5%
Equity	604,230	480,229	-20.5%

Source: Company data

US$-GEL	FY13	FY14	FY15	FY16	FY17
Period-end	1.74	1.86	2.39	2.65	2.59
Average	1.67	1.77	2.27	2.37	2.51

Source: NBG

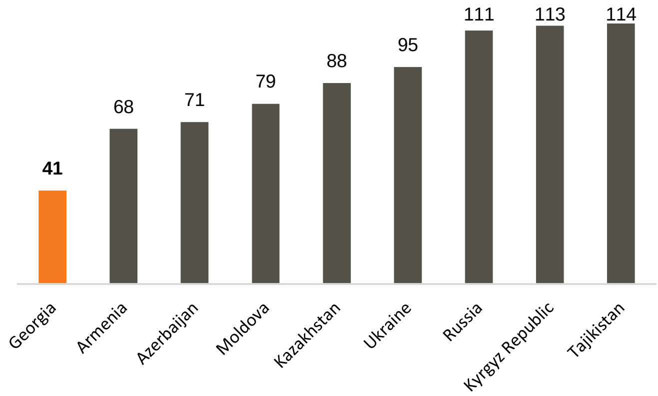
Georgian Railway prepares and publishes financial statements in GEL; translations into US$ are made by Galt & Taggart.

Georgia's transit potential

Due to Georgia's strategic location, it plays a crucial role in connecting resource-rich Central Asian countries with Europe. Continued investments in transit infrastructure by the public as well as private sector, enhances Georgia's potential to become a regional transit hub. Growing number of free trade agreements, granting Georgia to access to nearly 3.0bn customers without customs duties, is another factor incentivizing enhancement of trade infrastructure.

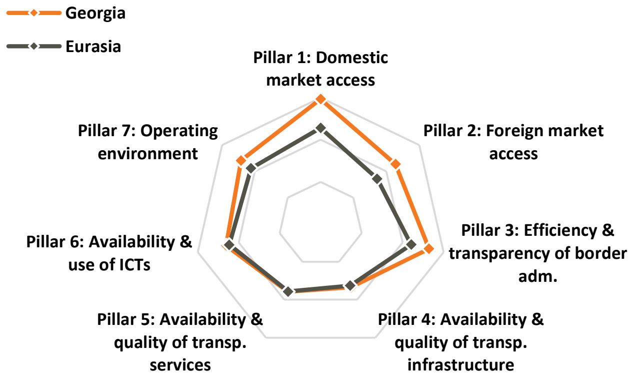
Georgia ranks 41st out of 136 countries in 2016 Global Enabling Trade index (ETI) as measured by World Economic Forum. Georgia leads the group in most of the ETI pillars, ranking 15th for market access, 39th for border administration and 33rd for operating environment. Despite significant investments and improvements in the past several years, Georgia's infrastructure appears to be a bottleneck to trade, where Georgia ranks 73th.

Figure 3: Global Enabling Trade index, 2016



Source: World Economic Forum

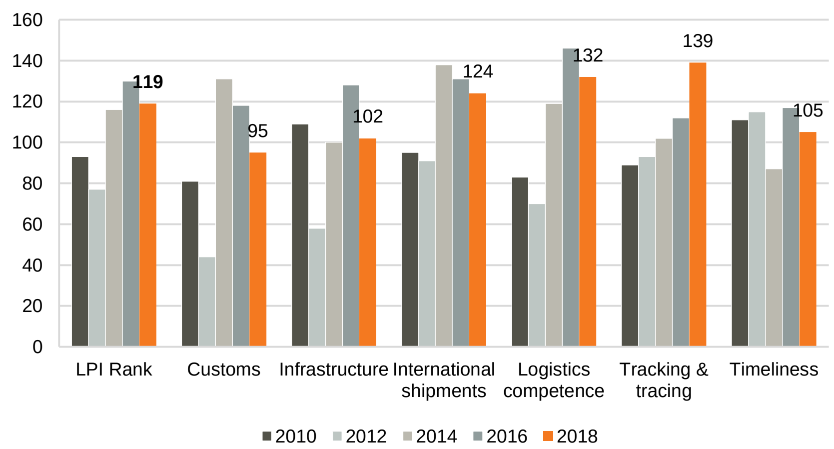
Figure 4: Georgia vs Eurasia



Source: World Economic Forum

Georgia improved its ranking in the 2018 World Bank's Logistics Performance Index (LPI), however is still behind many regional countries. Currently Georgia is ranked 119 out of 160 countries compared to 130 in 2016. Georgia's 2018 score has improved in almost all categories however the country ranks below that of Turkey (47), Romania (48), Bulgaria (52), Iran (64), Ukraine (66), Kazakhstan (71), Russia (75) and Armenia (92).

Figure 5: Global Enabling Trade index for Georgia

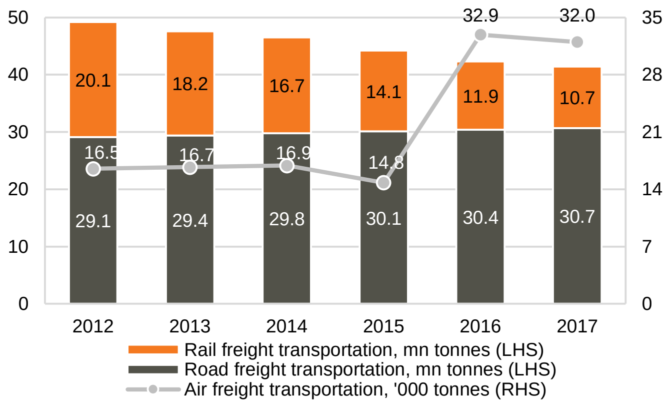


Source: World Bank

Cargo flows going through Georgia have decreased substantially over 2012-2017, with 15.7% less cargo transported through the corridor in 2017 vs in 2012. The decrease was solely driven by the reduced volumes of rail freight transportation, while freight volumes transported by road have been relatively stable over the same period.

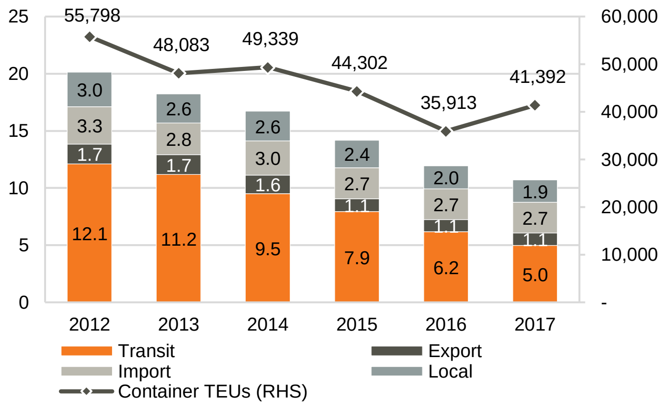
Despite reduced rail transportation volumes as other transportation schemes gained, it still holds a 25.8% of total freight as of 2017 (standing at 40.8% in 2012). The Caucasus rail corridor is mainly used to transport bulk commodity products including: liquid cargoes comprised of oil and oil products, and dry cargos - largely comprised of ores, grain and construction freight. Substantial part of the rail freight is transit cargos, accounting for 46.5% of total cargo flows in 2017. Crude oil and oil products are the major transit categories, accounting for 47.0% and 7.9% in total transit, respectively.

Figure 6: Freight transportation by modes, mn tons



Source: Ministry of Economy

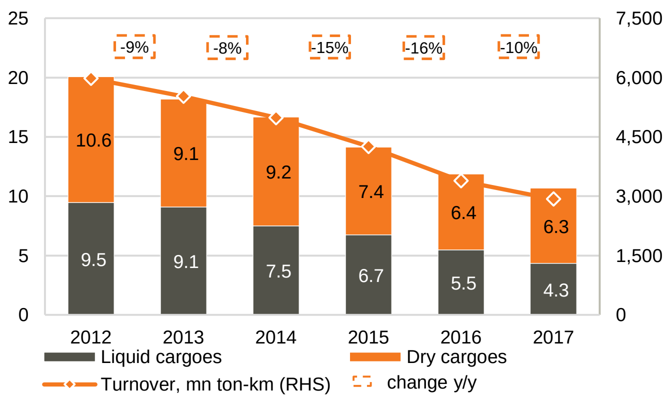
Figure 7: Rail cargo by type, mn tons



Source: Georgian Railway

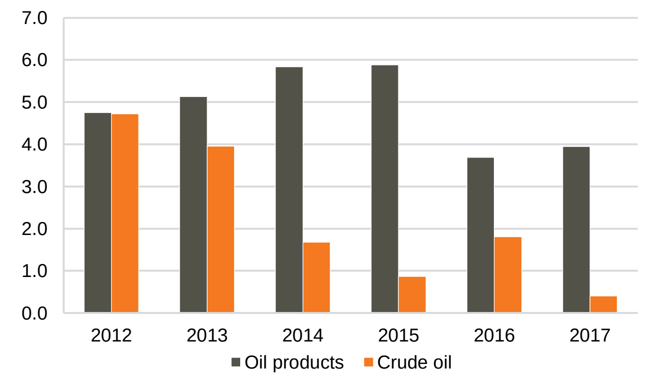
Liquid cargo transportation by rail, combining crude oil and oil products, more than halved over 2012-2017. Crude oil transportation dropped almost 12.0x over the same period to 0.4 tons in 2017, as the competition from the pipelines has intensified in the last couple of years. As for oil product transportation facing no competition from pipelines, the decrease was not as severe.

Figure 8: Rail cargo by type, mn tonnes



Source: Georgian Railway

Figure 9: Liquid cargo transportation, mn tons



Source: Georgian Railway

Crude oil transportation was one of the major rail freight categories, accounting for over 20% of the total in 2012-13. The crude oil shipments used to originate from Kazakhstan (76.3% of total in 2012-13), however the CPC pipeline expansion caused crude oil going through Georgia to drop significantly (down to 3.7% of total cargo in

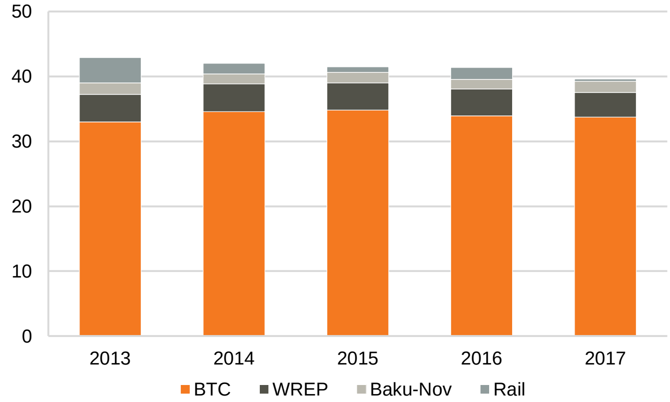
2017 from 23.5% in 2012). With the drop of Kazakh oil transportation, GR started transporting crude oil from Turkmenistan (77% of total crude oil shipments in 2016) along with the high grade Azeri-light oil. In 2017, crude oil transportation from Turkmenistan reduced as well down 77.9% y/y, as volumes transported to Italy from Turkmenistan have dropped.

Box 1: Crude oil transportation from the Caspian region

Georgia hosts two major crude oil pipelines:

- The Baku-Tbilisi-Ceyhan (BTC) - the main pipeline used to transport Azeri Light crude oil from the Sangachal Terminal in the Caspian Sea to Turkey. The pipeline has the capacity to transport 1,2mn barrels per day, however in the past couple of years the pipeline has been running with spare capacity (c. 40%).
- The Western Route Export Pipeline (WREP) - transporting Azeri crude oil from Baku to the Supsa terminal, the pipeline's capacity is c. 5.0mn tons.

Figure 10: Crude oil transportation from Azerbaijan, mn tons

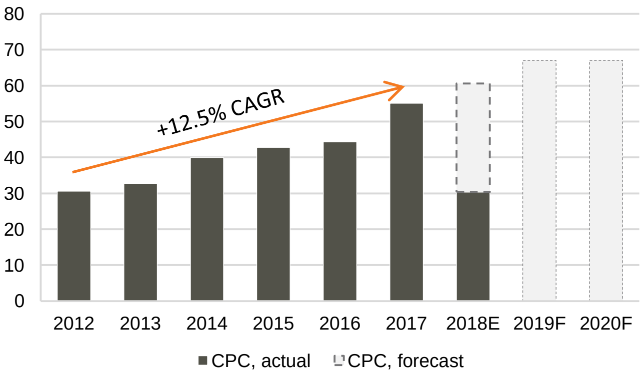


Source: State Statistical Committee of Azerbaijan

In addition, there are two major crude oil pipelines from the Caspian Sea bypassing Georgia:

- The Caspian Pipeline Consortium (CPC) – one of the largest crude oil pipelines from Kazakhstan connecting to Novorossiysk in Russia. Pipeline expansion in 2014, increased its capacity from 37mn tons to nearly 67mn tons per annum.
- The Northern Route Export Pipeline (NREP or Baku–Novorossiysk pipeline) – transporting crude oil from Sangachal Terminal near Baku to the Novorossiysk terminal at the Black Sea coast in Russia, the pipeline's capacity is c. 5.0mn tons.

Figure 11: CPC pipeline throughput, mn tons

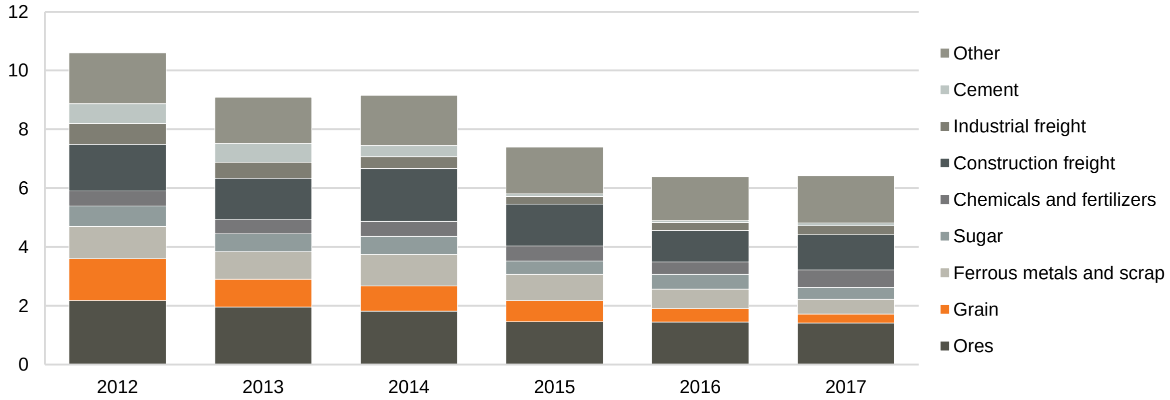


Source: Caspian Pipeline Consortium, Galt & Taggart Research

Dry cargo volumes are more cyclical in nature, depending on the general economic environment in Georgia as well as in the region. Major dry cargo categories are ore products and construction freight, accounting for 22.4% and 19.0% of total dry cargo volumes in 2017, respectively.

Over 2012-17, dry cargo transportation volumes were down 40.4%, driven by the reduction in almost all freight categories. Ore products, grain and ferrous metals were hit the most down 34.7%, 78.9% and 54.8% respectively compared to 2012.

Figure 12: Dry cargo transportation, mn tons

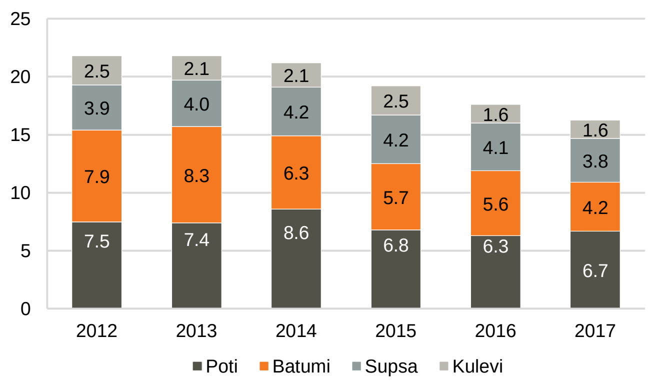


Source: Georgian Railway

On the back of the decreased cargo flows going through Georgia, turnover in Georgian sea ports has also plummeted. Over 2012-2017 cargo handled in Batumi (-46.6%) and Kulevi (-37.1%) decreased substantially, while in Poti (-10.9%) and Supsa (-2.8%) the decrease was moderate.

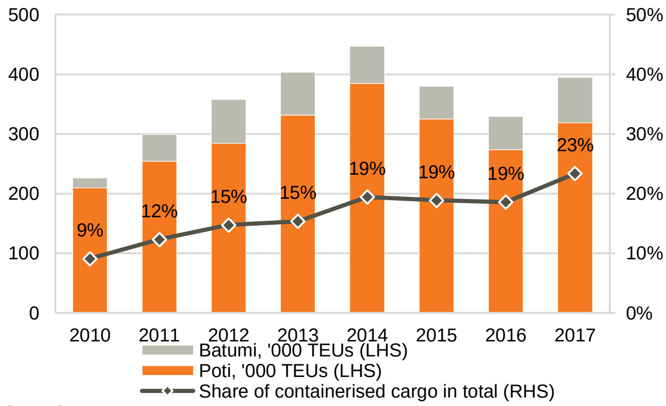
On the positive note, containerization rate has been on the rise over the past several years, with 394,787 container TEUs or 23.4% of total freight handled at Georgian ports in 2017.

Figure 13: Freight handled at Georgian sea ports, mn tons



Source: Georgian Railway

Figure 14: Containers handled at Georgian sea ports

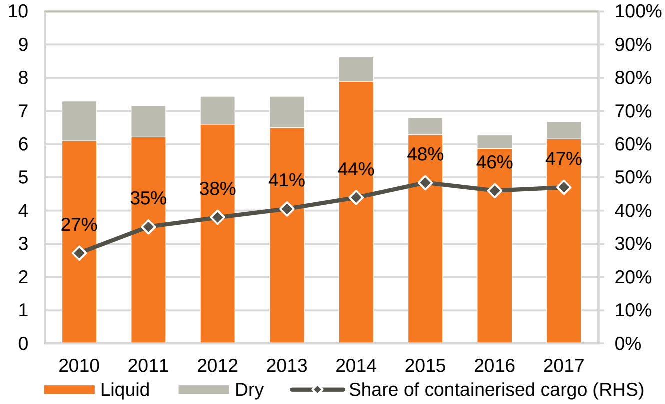


Source: Georgian Railway

Turnover in Poti port, the main port on the Georgian coast accounting for 41.1% of total cargo handled, decreased 10.9% in 2017 compared to 2012. The reduced amount of dry cargo handled (-38.7% over 2012-17) was the main reason behind the fall.

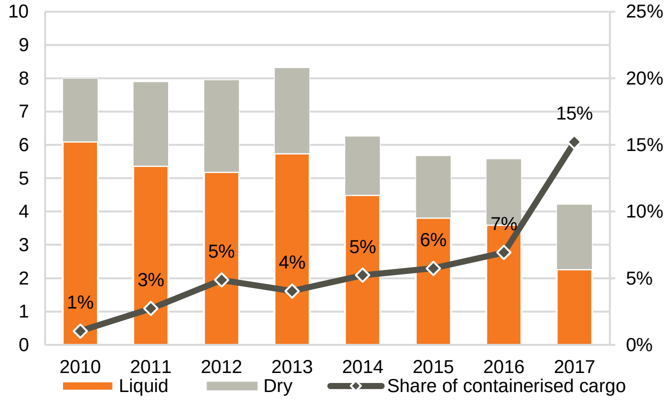
Substantial reduction in liquid cargo transportation going through Georgia, hit Batumi port the most, reducing its turnover 46.6% over 2012-17. This drop accounted for the lion's share (66.5%) in the overall decline in Georgia's sea ports' throughput.

Figure 15: Type of cargo handled at Poti port, mn tons



Source: Georgian Railway

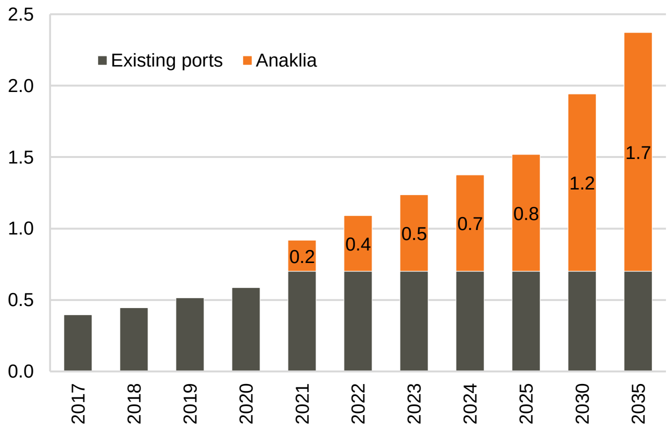
Figure 16: Type of cargo handled at Batumi Sea port, mn tons



Source: Georgian Railway

Construction of a deep sea port in Anaklia is expected to significantly increase Georgia's transit potential. Principal investors in the project are TBC Holding and Conti International (US). The port shall be constructed in 9 phases and gradually reach the capacity of handling 100mn tons of cargo and 1.6mn TEUs annually. The first phase construction is planned to be completed by December 2020 when the port's handling capacity will reach 9.3mn tons per annum.

Figure 17: Anaklia port TEU forecast, mn TEUs



Source: Anaklia Development Consortium, Ministry of Economy

Poti New Terminals Consortium plans to invest US$ 100mn in a new 1.5mn dry cargo terminal construction in Poti, according to the MOU signed with APM Terminals in January 2018.

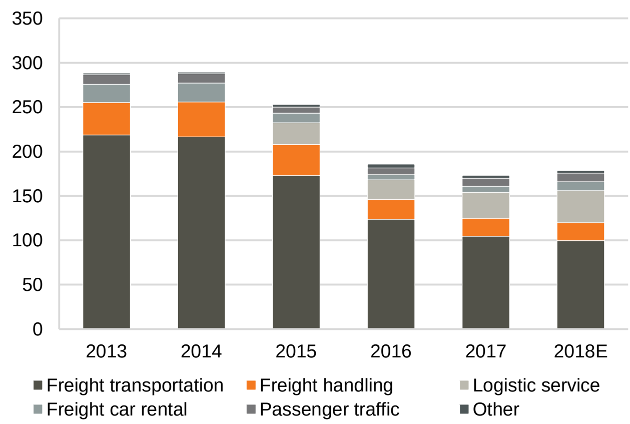
Baku-Tbilisi-Kars (BTK) railway line, completed in October 2017, could become an additional source of cargo flows going through Georgia, particularly for Chinese products going to Turkey and Europe. The BTK line is expected to be fully operational from 2019, with the initial capacity of 5.0mn tons annually.

Top line down

GR's FY17 revenue was down 6.8% y/y to US$ 173.2mn, from the low base of US$ 185.9mn in 2016. Decrease in freight transportation revenue, down 15.3% y/y, was the main reason behind the decline. Logistic service revenue was up 32.4% y/y to US$ 29.4mn due to the ship-or-pay agreement with Turkmenistan. Freight handling revenue declined 10.6% y/y to US$ 20.0mn, while passenger and freight revenue categories were up 19.7% y/y to US$ 9.1mn and 13.5% y/y to US$ 6.7mn, respectively. Other revenue was down 21.3% y/y to US$ 3.3mn, mainly driven by a 45.0% y/y decrease in revenue from sale of scrap.

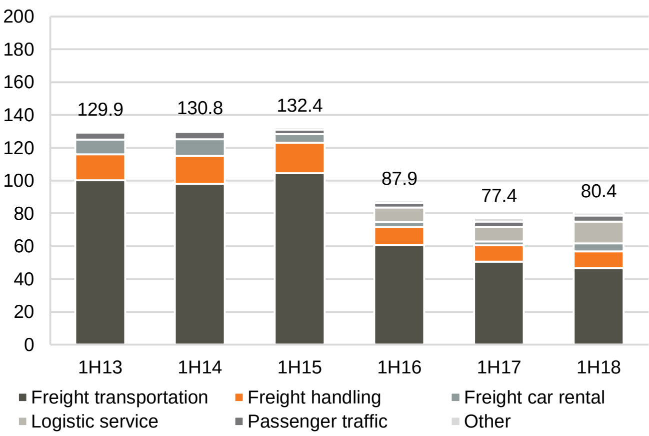
The downward trend reverted in 1H18, with revenue up 3.9% y/y to US$ 80.4mn. The decrease in freight transportation revenue (-7.6% y/y to US$ 46.8mn) was fully absorbed by the significant increase in logistic service and freight car rental revenue categories up 45.9% y/y to US$ 13.2mn and 108.2% y/y to US$ 4.9mn, respectively. Other revenue categories were also up, with freight handling and passenger revenue increasing 1.5% y/y to US$10.1mn and 21.2% y/y to US$ 3.8mn.

Figure 18: Revenue, US$ mn



Source: Georgian Railway, Galt & Taggart Research

Figure 19: Interim revenue, US$ mn



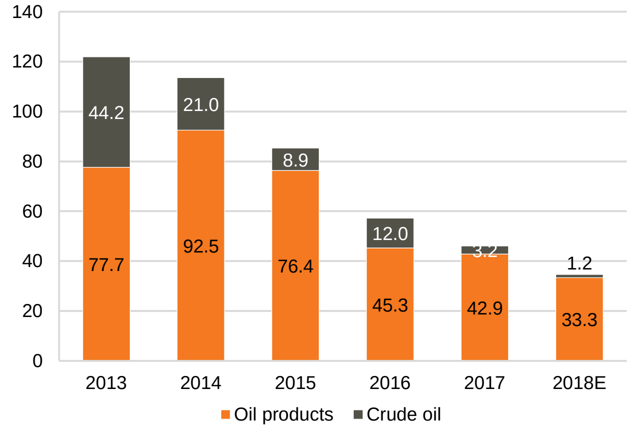
Source: Georgian Railway

Freight transportation revenue, accounting for the lion's share (60.5% in 2017) in GR's total revenue, was down 15.3% y/y to US$ 104.7mn in 2017. The downtrend persisted in 2018, with revenue down 7.6% y/y to US$ 46.8mn in 1H18.

A 73.1% y/y drop in crude oil transportation was the main reason behind the 19.5% y/y decrease in liquid cargo transportation revenue in 2017. The major negative impact came from suspension of crude oil transportation from Turkmenistan to Italy (down 94.0% y/y). The crude oil transportation revenue continued to decline in 1H18, down 57.7% y/y to US$ 0.9mn.

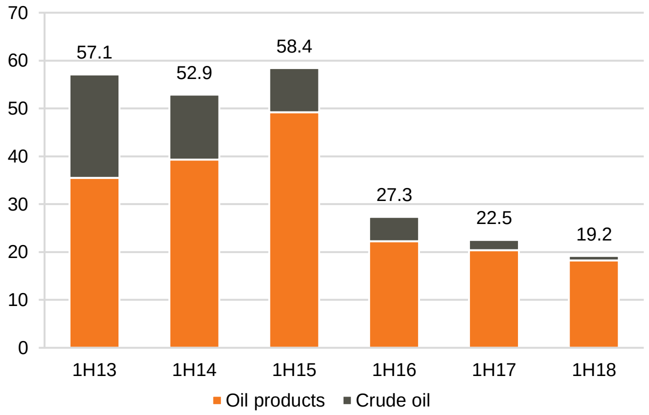
Oil products transportation posted a low single-digit decrease, down 5.3% y/y to US$ 42.9mn in 2017. Kazakhstan (34%), Azerbaijan (19%) and Turkmenistan (12%) were the major originating countries for oil products transportation, with Kazakhstan's share increasing significantly from 11% in 2016 to 34% in 2017. Fuel diesel, gasoil and special petrol were the major product categories transported by GR in 2017. Oil products transportation was down 10.5% y/y to US$ 18.2mn in 1H18.

Figure 20: Liquid cargo transportation, US$ mn



Source: Georgian Railway, Galt & Taggart Research

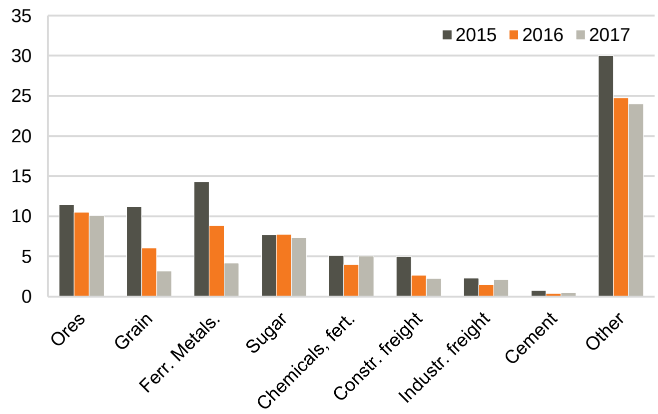
Figure 21: Interim liquid cargo transportation , US$ mn



Source: Georgian Railway

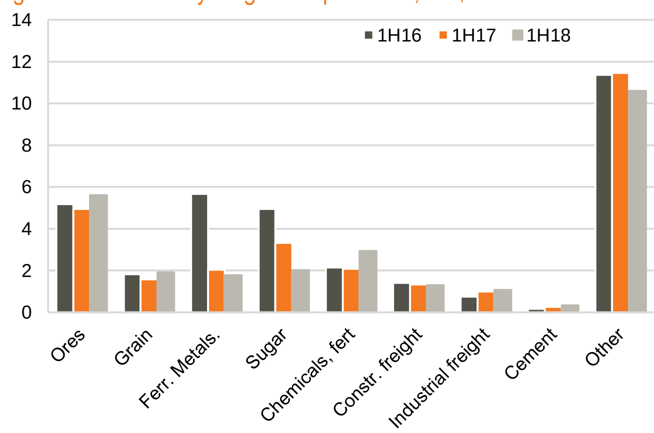
Dry cargo transportation was down 11.6% y/y to US$ 58.7mn in 2017, with ferrous metals & scrap (-52.6% y/y) and grain transportation (mostly wheat, -47.3% y/y) hit the most. The ferrous metals transportation drop can be explained by the completion of Southern Gas Corridor Expansion project[1] in Azerbaijan, reducing transportation of pipes used for the construction. Chemicals and fertilizers, industrial freight and cement transportation, which accounted for 7.3% of FY17 freight transportation revenue, were the only categories posting positive change in 2017 up 27.3% y/y, 43.9% y/y and 19.5% y/y, respectively.

Figure 22: Dry cargo transportation volume, US$ mn



Source: Georgian Railway

Figure 23: Interim dry cargo transportation , US$ mn

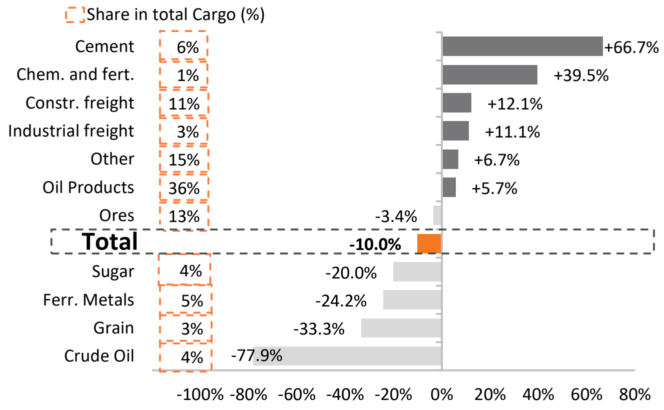


Source: Georgian Railway

Dry cargo transportation revenue decline slowed to 1.5% y/y to US$ 27.6mn in 1H18. Significant drop in sugar transportation (-39.0% y/y to US$ 2.0mn) was partially compensated by the increased transportation of chemicals, fertilizers, ores and grain, up 41.8% y/y to US$ 2.9mn, 13.3% y/y to US$ 5.6mn and 20.5% y/y to US$ 1.9mn, respectively. Introduction of the new regulation on wheat transportation, which prohibits transportation of wheat by road (rail and sea transportation will be the only option to transport) in order to reduce traffic on the borders from August 2018 will have a positive effect on the category (6.9% of dry cargo transportation in 1H18). This will increase grain transportation volumes for GR by circa. 6.0% going forward, however the share in total remains insignificant (3.6% in 2018).

[1]Southern Gas Expansion - The Southern Gas Pipeline is a transit pipeline system transporting natural gas from the Shah Deniz gas field in Azerbaijan to Turkey. In December 2014 the SCP Expansion project was launched, with an aim to triple the gas volumes exported through SCP to over 20 bcm per annum. The SCPX together with the Trans Anatolian Pipeline ("TANAP") at the Eastern Turkey and the Trans Adriatic Pipeline ("TAP") in Greece will bring Azeri oil to Europe.

Figure 24: Cargo transportation volume, y/y change in 2017



Source: Georgian Railway

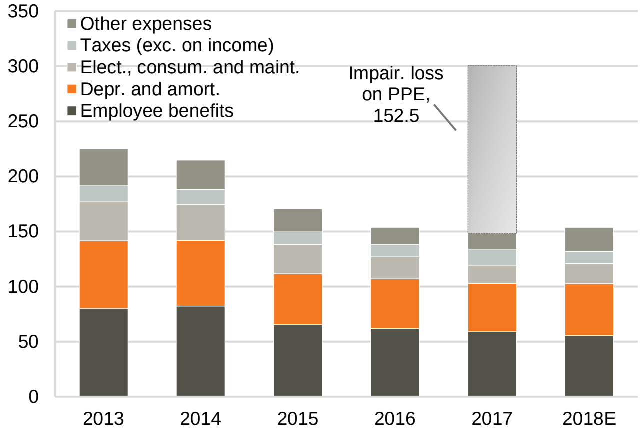
Increased logistic service, freight car rental and passenger traffic revenue (26.1% of total), partially compensated freight transportation revenue reduction in 2017. Ship-or-pay agreement with Turkmenistan for crude oil transportation brought in US$ 10.2mn to the company in 2017, which translated into a 32.4% y/y growth of logistic service revenue to US$ 29.4mn. Addition of two Stadler trains in 2017 along with the existing two double-decker trains, increased passengers numbers by 9.0% y/y. As a result, passenger traffic revenue increased by 19.7% y/y to US$ 9.1mn in 2017. In GEL terms the growth was more substantial, up 26.9% to GEL 22.8mn. Freight handling and other revenue categories were down 10.6% y/y to US$ 20.0mn and 21.3% to US$ 3.3mn, respectively.

Logistic service and freight car rental revenue growth fully compensated the decline in freight transportation revenue in 1H18. Logistic service revenue, accounting for 16.4% of total revenue in 1H18, was up 45.9% y/y to US$ 13.2mn, mainly caused by increased container transportation as well as additional income from oil products transportation to Armenia. Freight car rental revenue more than doubled in 1H18, reaching US$ 4.9mn, as a result of increased usage of the company's car rental services by Kazakhstan Railway. Passenger traffic category continued growth in 1H18, with revenue up 21.2% y/y to US$ 3.8mn. Reduction in sale of scrap resulted in other revenue category to fall 30.0% y/y to US$ 1.6mn in 1H18.

Operating Expenses elevated hitting the bottom line

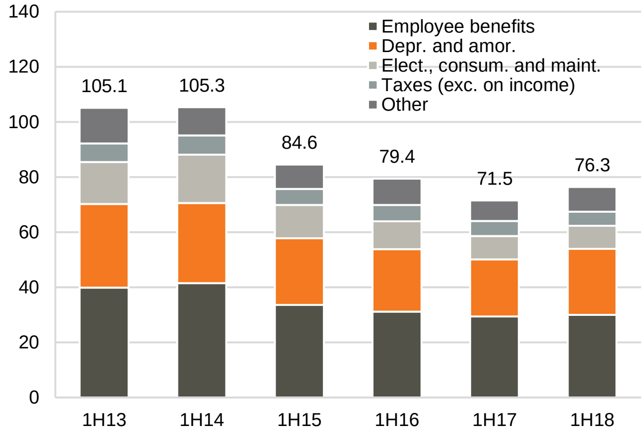
FY17 operating expenses (excluding the PPE impairment), which are mostly GEL-dominated, decreased 3.7% y/y to US$ 148.0mn. The decrease was mainly attributed to GEL's 6.0% depreciation against US$ in 2017 vs 2016. Employee benefits expenses, the largest operating expense category accounting for 39.9% of total expenses (excluding impairment), were down 4.6% y/y to US$ 59.1mn (in GEL terms up 1.1% to GEL 148.3mn). Electricity, consumables and maintenance expense was the only category that posted a decrease in GEL terms down 12.3% y/y to GEL 41.5mn (-17.2% y/y to US$ 16.5mn). This is mainly attributed to the lower utilization of the company's rolling stock. Taxes (other than income tax) were up 24.0% y/y to US$ 13.9mn, mainly driven by the one-off increase in other tax expenses (US$ 3.1mn difference between accounting and tax base).

Figure 25: Operating expenses, US$ mn



Source: Georgian Railway, Galt & Taggart Research

Figure 26: Interim operating expenses, US$ mn



Source: Georgian Railway

GEL 382.6 (US$ 152.5mn) impairment loss was recognized on Tbilisi Bypass Project in 2017. The project has been suspended since March 2014 and the decision was not made in 2017. Considering uncertainties related to the future of the project and the associated potential economic benefits, it was decided to write down the project's carrying value to its recoverable amount. The project value was estimated on the basis of the land cost (estimated at GEL 14.7mn) and costs incurred during construction of tunnels and bridges (estimated at zero due to its specific nature - cannot be used/sold). As a result, the project's carrying value of GEL 397.3mn was written down to GEL 14.7mn (recoverable amount) and GEL 382.6mn (US$ 152.5mn) was recognized as impairment loss in the income statement.

1H18 operating expenses increased 6.8% y/y to US$ 76.3mn. This was almost entirely driven by the increased depreciation and amortization expenses, up 16.0% y/y to US$ 24.0mn, while employee benefit expenses remained relatively flat up 1.8% y/y to US$ 30.0mn. Other expenses category was also up 21.2% y/y to US$ 8.9mn, caused by the increased logistic service costs (up 38.9% y/y to US$ 3.3mn).

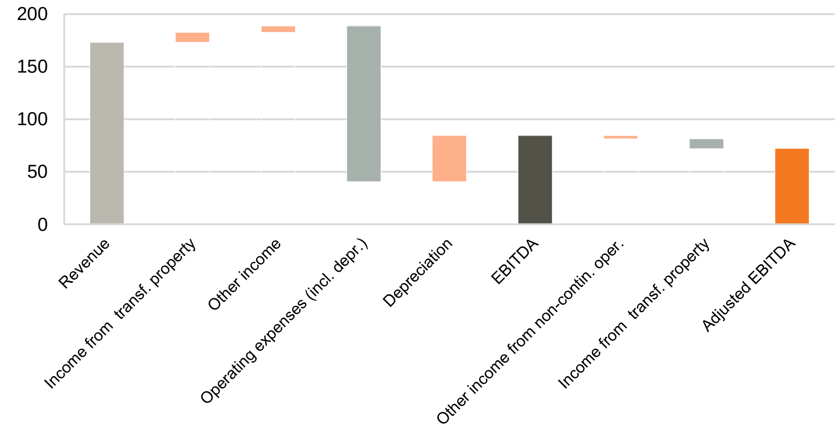
Net debt-to-EBITDA ratio above the Eurobond covenant

FY17 adjusted EBITDA declined 12.3% y/y to US$ 72.3mn. The reduction was mostly driven by the 6.8% y/y decrease in revenue, coupled with 39.9% y/y decrease in other income from continuing operations to US$ 3.1mn. As a result, adjusted EBITDA margin contracted to 41.8% from 44.4% a year before.

FY17 EBITDA was down 29.1% y/y to US$ 84.5mn. Due to significantly higher income from the transferred property in 2016 (US$ 33.9mn vs US$ 9.3mn in 2017), the drop in EBITDA was more pronounced.

With 1H18 revenue growth outpacing the growth of operating expenses, the EBITDA posted a positive growth in 1H18 up 3.4% y/y to US$ 31.6mn. Adjusted EBITDA remained flat at US$ 28.6mn (+0.6% y/y).

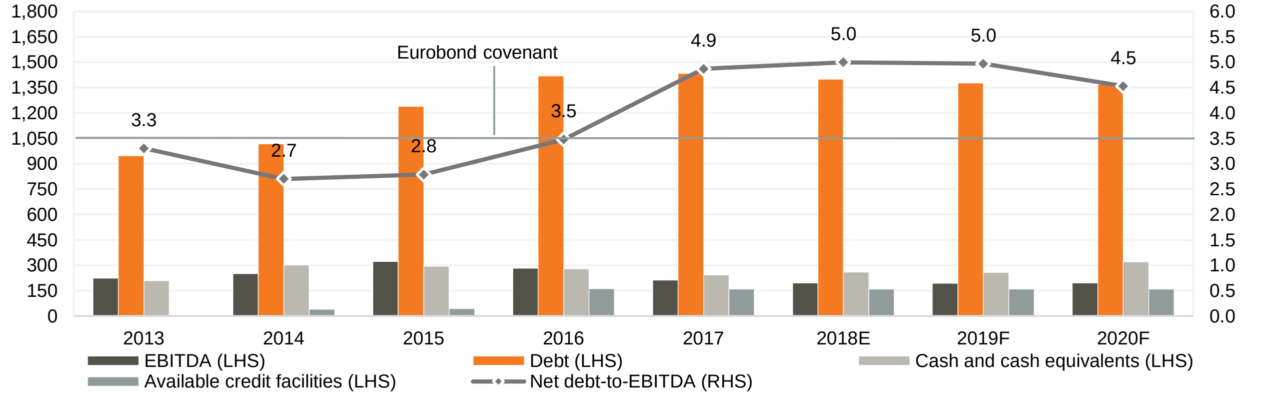
Figure 27: Calculation of EBITDA and adjusted EBITDA, 2017



Source: Georgian Railway

The fall in EBITDA in 2017 contributed to the substantial deterioration of net debt-to-EBITDA ratio, which came in at 4.9x, exceeding the Eurobond covenant of 3.5x. With the ratio exceeding 3.5x threshold, GR and any of its subsidiaries are not allowed to incur, directly or indirectly, any financial indebtedness in 2018. According to our calculations, minimum 32.0% increase in EBITDA is required for the ratio to return to the Eurobond covenant level. Considering the low probability of significant growth of EBITDA in the foreseeable future, we expect net debt-to-EBITDA ratio to remain above the covenant for the medium term.

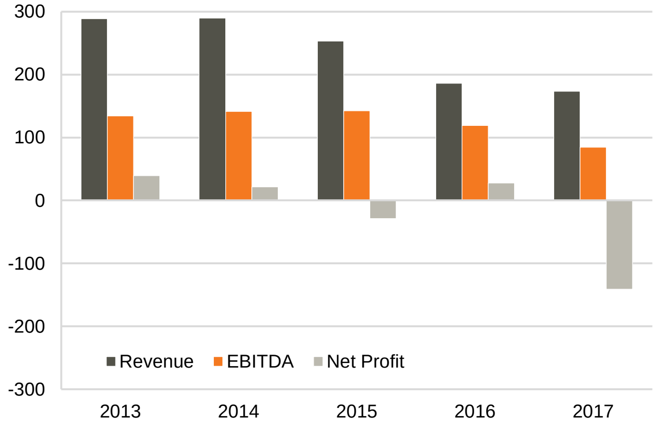
Figure 28: Net debt-to-EBITDA breakdown, GEL mn



Source: Georgian Railway, Galt & Taggart Research

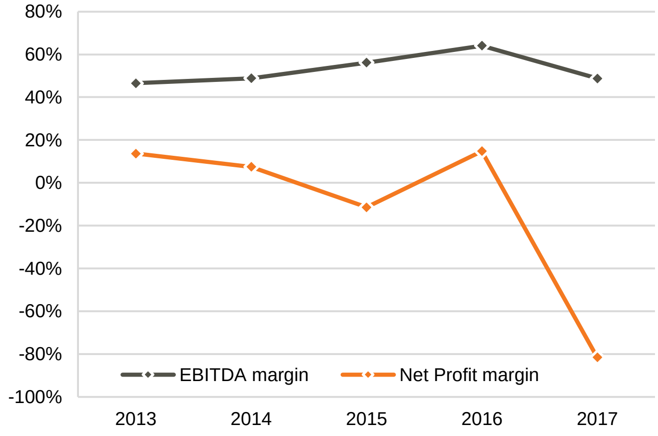
With the significant impairment loss recognized on Tbilisi Bypass project (US$ 152.5mn), FY17 net loss came in at US$ 141.2mn vs US$ 27.5mn profit in 2016. GEL's end-year appreciation against US$ in 2017 resulted in US$ 10.2mn FX gain compared to US$ 47.5mn loss in 2016, which propped up finance income 71.0% y/y to US$ 17.3mn. Impairment loss recognized on trade receivable from the Government of Georgia (US$ 15.7mn, related to the transferred property transaction) and provision on the loan given to the group entity (US$ 9.4mn) were both classified as finance cost in 2017. As a result, net finance income reached US$ -29.1mn in 2017 from US$ -63.1mn in 2016.

Figure 29: Income statement highlights, US$ mn



Source: Georgian Railway

Figure 30: Profitability margins

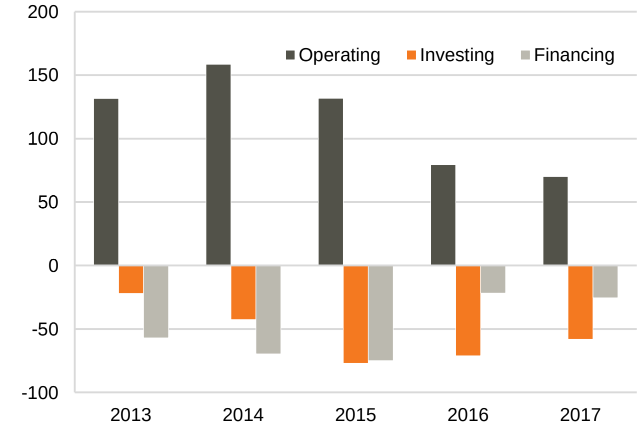


Source: Georgian Railway

FY17 operating cash decreased 11.3% y/y to US$ 70.3mn. Cash flows from investing activities (mainly related to the modernization project) were down 18.5% y/y to US$ 57.9mn. To finance the purchase of four new passenger trains, the company borrowed US$ 30.9mn in two tranches in 2016 and 2017.

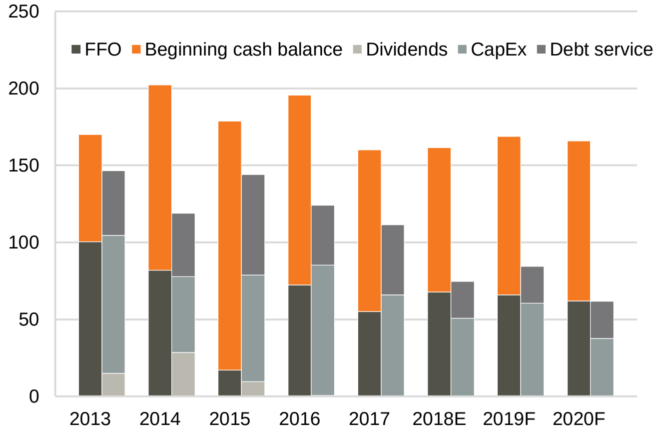
Investments in the Main Line Modernization project reached US$ 257mn (over 70% of total cost) in 2017. GR has renegotiated the payment schedule with contractor for the remaining portion (US$ 95mn) of the cost over 2018-21, being faced the restrictions on additional borrowings. The project finalization is anticipated for the end-19 and GR plans to finance the capital expenditures with its internal sources. Considering the comfortable levels of liquidity on hand as well as its cash generation capacity, GR is not likely to need additional sources of finance in the medium-term.

Figure 31: Cash flows, US$ mn



Source: Georgian Railway

Figure 32: Available cash vs. cash outflows, US$ mn

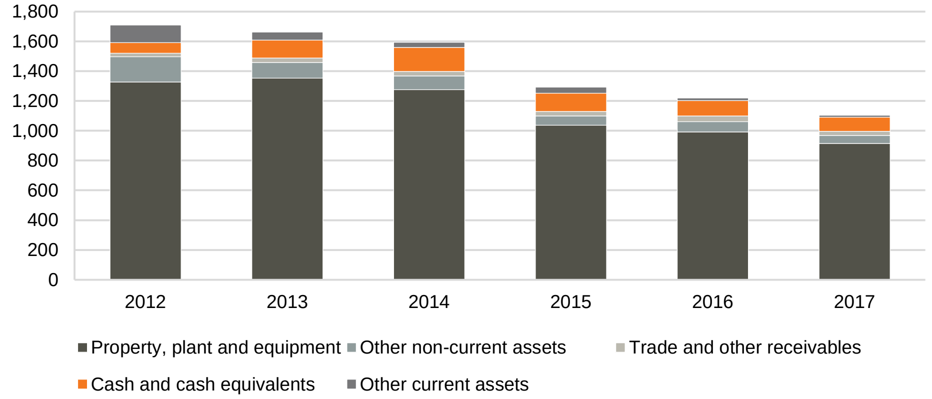


Source: Georgian Railway, Galt & Taggart Research

Balance sheet hit by the impairment loss

GR's balance sheet was hit by the US$ 152.5mn impairment loss on property, plant and equipment, which was down 7.8% y/y to US$ 913.7mn. 24.6% y/y decrease in trade and other receivables was associated with the US$ 15.7mn impairment loss on trade receivable from the Government of Georgia along with the US$ 9.4mn provision on the loan given to the group entity. FY17 cash balance decreased 10.7% y/y to US$ 93.8.

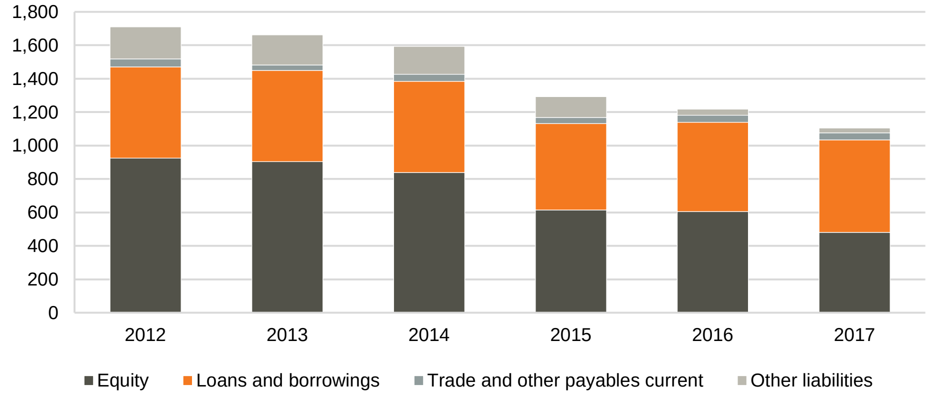
Figure 33: Asset composition, US$ mn



Source: Georgian Railway

With considerable decline in the equity balance (-20.5% y/y to US$ 480.2mn, due to the impairment loss) the company's capital structure has slightly changed and debt to invested capital ratio reached 53.5% in 2017 vs 47.0% a year before. Debt-to-equity ratio exceeded 100% threshold in 2017, coming in at 115.1%.

Figure 34: Liabilities and equity composition, US$ mn



Source: Georgian Railway

Financial statements

Income statement

US$, '000	2014	2015	2016	2017	2018E	2019F	2020F
Revenue	**289,700.7**	**253,184.0**	**185,938.9**	**173,214.9**	**178,593.8**	**175,888.0**	**179,772.5**
Freight transportation	216,740.1	173,014.6	123,635.9	104,747.0	99,440.5	101,416.8	103,432.5
Freight handling	39,102.3	34,877.0	22,382.9	20,006.5	20,326.4	20,050.4	20,448.9
Logistic service	-	24,705.5	22,217.3	29,407.6	36,151.5	32,671.3	33,320.7
Freight car rental	21,412.3	10,687.0	5,893.4	6,689.3	9,978.0	8,326.5	8,492.0
Passenger traffic	10,372.9	6,822.0	7,608.4	9,105.7	9,978.0	10,649.6	11,249.9
Other	2,073.2	3,078.1	4,140.3	3,258.7	2,719.3	2,773.4	2,828.5
Other income	6,995.5	13,554.4	42,005.9	15,537.1	5,378.2	5,296.7	5,413.7
Operating expenses	**(214,712.2)**	**(170,547.0)**	**(153,660.5)**	**(300,552.5)**	**(153,387.8)**	**(153,348.7)**	**(150,107.2)**
Employee benefits expense	(82,211.6)	(65,468.0)	(61,953.4)	(59,115.8)	(55,552.5)	(54,710.9)	(55,919.2)
Electricity, inventory and repair work	(32,414.9)	(26,838.0)	(19,980.9)	(16,538.5)	(18,393.7)	(18,115.0)	(18,515.1)
Other expenses	(40,478.4)	(32,246.4)	(26,901.3)	(28,648.6)	(32,401.4)	(30,662.1)	(31,314.9)
Operating expenses excl. depr. and amort.	(155,104.9)	(124,552.4)	(108,835.5)	(256,822.5)	(106,347.6)	(103,488.0)	(105,749.2)
EBITDA	141,591.3	142,186.3	119,048.6	84,449.1	77,624.4	77,696.7	79,437.0
Adjusted EBITDA	**142,664.4**	**135,597.0**	**82,455.1**	**72,321.0**	**77,624.4**	**77,696.7**	**79,437.0**
Depreciation and amortization expense	(59,607.3)	(45,994.6)	(44,825.0)	(43,730.0)	(47,040.1)	(49,860.7)	(44,358.0)
Results from operating activities	81,984.0	96,191.7	74,223.7	(111,800.5)	30,584.2	27,836.0	35,079.0
Finance income	6,606.4	9,220.4	10,090.8	17,252.8	17,843.3	14,932.4	9,719.4
Finance costs	(63,011.3)	(138,912.0)	(73,140.6)	(46,345.9)	(23,974.5)	(23,970.7)	(24,020.3)
Net finance costs	(56,404.9)	(129,691.5)	(63,049.8)	(29,093.1)	(6,131.3)	(9,038.3)	(14,300.9)
Profit before income tax	25,579.1	(33,499.8)	11,173.8	(140,893.6)	24,453.0	18,797.7	20,778.1
Income tax expense	(3,331.5)	4,649.4	16,419.0	(258.3)	(3,667.9)	(2,819.6)	(3,116.7)
Profit and total comprehensive income	**22,247.6**	**(28,850.4)**	**27,592.8**	**(141,151.9)**	**20,785.0**	**15,978.0**	**17,661.4**

Note: GR reclassified the revenue generated by its freight forwarding subsidiaries under logistic service, a new revenue line
Source: Company data, Galt & Taggart Research

Statement of changes in equity

US$, '000	2014	2015	2016	2017	2018E	2019F	2020F
Share capital, 1 January	604,777.4	564,607.2	439,519.4	397,840.4	406,323.2	416,477.3	423,340.4
Common capital issued for PPE	-	-	-	-	-	-	-
Net non-cash contr. by and distr. to owners	1,204.5	177.5	168.6	106.4	-	-	-
FX rate translation adjustment	(41,374.7)		(41,831.2)	8,376.4	10,154.1	6,863.2	2,567.8
Share capital, 31 December	**564,607.2**	**439,519.4**	**397,840.4**	**406,323.2**	**416,477.3**	**423,340.4**	**425,908.2**
Non-cash owner contribution reserve, 1 Jan.	18,241.7	18,359.1	14,286.2	37,143.7	37,879.8	38,826.4	39,466.2
Net non-cash contr. by and distr. to owners	1,439.0	-	27,083.1	(47.9)	-	-	-
FX rate translation adjustment	(1,321.5)	(4,072.9)	(4,225.6)	783.9	946.6	639.8	239.4
Non-cash owner contr. reserve, 31 Dec.	**18,359.1**	**14,286.2**	**37,143.7**	**37,879.8**	**38,826.4**	**39,466.2**	**39,705.6**
Retained earnings, 1 January	280,699.8	255,599.4	160,504.0	169,313.9	36,026.3	57,711.6	74,640.7
Profit and total comprehensive income for the	22,247.6	(28,851.0)	27,526.4	(141,151.9)	20,785.0	15,978.0	17,661.4
Dividends to equity holders	**(28,501.7)**	**(11,248.9)**	**-**	**-**	**-**	**-**	**-**
Net non-cash contr. by and distr. to owners	-	(400.8)	(657.9)	(189.3)	-	-	-
Cash contr. by and distr. to owners	-	-	-	-	-	-	-
Total transactions with owners…	(28,501.7)	(11,649.7)	(657.9)	(189.3)	-	-	-
FX rate translation adjustment	(18,846.2)	(54,595)	(18,126)	8,122.7	900.3	951.0	452.7
Retained earnings, 31 December	**255,599.4**	**160,504.0**	**169,313.9**	**36,095.3**	**57,711.6**	**74,640.7**	**92,754.8**
Total equity	**838,565.7**	**614,309.6**	**604,298.1**	**480,298.3**	**513,015.3**	**537,447.3**	**558,368.6**

Source: Company data, Galt & Taggart Research

Statement of financial position

US$, '000	2014	2015	2016	2017	2018E	2019F	2020F
Assets							
Property, plant and equipment	1,276,147.2	1,036,950.6	991,232.4	913,656.4	949,142.2	976,897.1	975,427.2
Deferred tax assets	835.5	456.8	-	-	-	-	-
Loan receivable	-	-	13,494.4	6,987.7	4,774.9	2,426.8	-
Other non-current assets	91,323.2	61,797.2	55,752.2	47,666.9	50,783.5	50,014.6	51,119.3
Non-current assets	1,368,306.0	1,099,204.6	1,060,479.1	968,310.9	1,004,700.5	1,029,338.5	1,026,546.5
Inventories	18,248.6	14,517.5	11,240.7	12,656.0	16,161.8	15,917.0	16,268.5
Loan receivable	-	16,009.4	1,501.4	-	-	-	-
Current tax assets	5,861.8	4,590.2	2,693.4	910.4	970.0	955.3	976.4
Trade and other receivables	28,946.1	29,498.1	37,648.9	28,398.3	27,263.7	25,826.5	24,225.1
Prepayments and other current assets	9,952.2	4,969.3	132.2	147.8	138.4	140.7	141.5
Term deposits	-	-	-	-	-	-	-
Cash and cash equivalents	161,506.2	123,088.2	105,014.7	93,749.7	102,856.5	103,825.9	129,877.3
Current assets	224,514.9	192,672.8	158,231.4	135,862.2	147,390.4	146,665.3	171,488.8
Total assets	**1,592,820.9**	**1,291,877.3**	**1,218,710.5**	**1,104,173.1**	**1,152,090.9**	**1,176,003.8**	**1,198,035.3**
Equity and liabilities							
Share capital	564,607.2	439,519.4	397,840.4	406,323.2	416,477.3	423,340.4	425,908.2
Non-cash owner contribution reserve	18,359.1	14,286.2	37,143.7	37,879.8	38,826.4	39,466.2	39,705.6
Retained earnings	255,599.4	160,504.0	169,245.9	36,026.3	57,711.6	74,640.7	92,754.8
Total equity	**838,565.7**	**614,309.6**	**604,230.0**	**480,229.3**	**513,015.3**	**537,447.3**	**558,368.6**
Loans and borrowings	498,697.7	498,267.6	514,433.3	530,191.7	530,975.2	530,975.2	530,975.2
Advance received from the government	123,082.7	92,608.5	27,886.1	17,974.3	29,185.1	29,666.0	29,845.9
Trade and other payables	27.9	21.7	-	-	-	-	-
Deferred tax liabilities	32,194.7	18,342.3	-	-	-	-	-
Non-current liabilities	654,003.0	609,240.1	542,319.4	548,166.1	560,160.3	560,641.2	560,821.2
Loans and borrowings	46,860.9	18,729.4	21,600.4	22,686.9	22,720.4	22,720.4	22,720.4
Trade and other payables	42,112.0	37,270.0	41,422.9	43,291.8	46,123.0	45,424.2	46,427.8
Liabilities to the government	4,543.4	3,344.2	3,173.3	2,928.7	3,120.2	3,072.9	3,140.8
Provisions	3,459.4	3,476.1	3,229.2	3,068.1	2,900.6	2,707.9	2,478.6
Dividend payable	-	1,153.3	-	-	-	-	-
Other current liabilities	3,276.5	4,354.7	2,735.4	3,802.4	4,051.1	3,989.7	4,077.8
Current liabilities	100,252.2	68,327.7	72,161.1	75,777.8	78,915.3	77,915.2	78,845.5
Total liabilities	**754,255.2**	**677,567.7**	**614,480.5**	**623,943.9**	**639,075.6**	**638,556.5**	**639,666.7**
Total equity and liabilities	**1,592,820.9**	**1,291,877.3**	**1,218,710.5**	**1,104,173.2**	**1,152,090.9**	**1,176,003.8**	**1,198,035.3**

Source: Company data, Galt & Taggart Research

Statement of cash flows

US$, '000	2014	2015	2016	2017	2018E	2019F	2020F
Cash flows from operating activities							
Cash receipts from customers	298,360.5	248,812.5	192,986	178,388	185,816	183,071	186,944
Cash paid to suppliers and employees	(138,081.4)	(114,630.6)	(111,590)	(107,067)	(106,348)	(103,488)	(105,749)
VAT refund from the State	-	-	-	-	-	-	-
Cash flows from operations before income taxes and interest paid	160,279	134,182	81,422	71,321	77,951	78,267	81,486
Income tax paid	(1,656)	(2,256)	(2,210)	(1,070)	(3,705)	(2,789)	(3,132)
Net cash from (used in) operating activities	**158,623**	**131,926**	**79,212**	70,251	74,246	75,478	78,354
Cash flows from investing activities							
Acquisition of property, plant and equipment	(49,141)	(69,155)	(84,649)	(65,878)	(50,739)	(60,468)	(37,715)
Proceeds from sale of property, plant and equipment	-	-	1,416	2,046	-	-	-
Interest received	6,525	9,247	9,483	5,902	6,151	6,693	6,687
Issuance of the loan	-	(16,962)	(13,763)	-	(2,387)	(2,427)	(2,441)
Repayment of loans given	-	-	15,993	-	-	-	-
Dividends received	-	-	454	-	-	-	-
Net cash from (used in) investing activities	**(42,616)**	**(76,870)**	**(71,066)**	**(57,931)**	**(42,200)**	**(51,348)**	**(28,587)**
Cash flows from financing activities							
Proceeds from borrowings	-	-	17,899	20,030	(1,307)	(885)	(326)
Repayment of borrowings	-	(27,537)	-	(4,383)	-	-	-
Interest paid	(41,241)	(37,764)	(38,863)	(41,109)	(23,975)	(23,971)	(24,020)
Dividends to equity holders	(28,502)	(9,626)	(679)	-	-	-	-
Distribution of cash to owners	-	-	-	-	-	-	-
Net cash from (used in) financing activities	**(69,743)**	**(74,927)**	**(21,642.9)**	**(25,462)**	**(25,282)**	**(24,856)**	**(24,346)**
Net increase in cash and cash equivalents	46,264	(19,870)	(13,497)	(13,142)	6,764	(726)	25,422
Cash and cash equivalents, 1 January	112,146	125,677	111,374	105,014	93,749	102,856	103,826
Effect of exchange rate fluctuations on cash and cash equivalents	3,096	17,2812	7,138	1,877	2,343	1,695	630
Cash and cash equivalents, 31 December	**161,506**	**123,088**	**105,015**	**93,749**	**102,856**	**103,826**	**129,877**

Source: Company data, Galt & Taggart Research

Note: Financial statements have been prepared by translating company-reported audited GEL numbers into US$ (using year-end and average annual FX rates, whichever more appropriate)

Financial ratios

	2014	2015	2016	2017	2018E	2019F	2020F
Profitability							
EBITDA margin	48.9%	56.2%	64.0%	48.8%	43.5%	44.2%	44.2%
Adjusted EBITDA margin	49.2%	53.6%	44.4%	41.8%	43.5%	44.2%	44.2%
EBIT margin	28.3%	38.0%	39.9%	-64.5%	17.1%	15.8%	19.5%
EBT margin	8.8%	-13.2%	6.0%	-81.3%	13.7%	10.7%	11.6%
Net profit margin	7.7%	-11.4%	14.8%	-81.5%	11.6%	9.1%	9.8%
Return on Investment							
Operating ROA / Basic earning power	4.9%	7.1%	5.4%	-9.8%	2.7%	2.4%	2.9%
Return on average assets (ROAA)	1.3%	-2.2%	2.1%	-11.6%	1.8%	1.4%	1.5%
Return on average equity (ROAE)	2.5%	-4.3%	4.2%	-24.9%	4.1%	3.0%	3.2%
Return on capital employed (ROCE)	5.2%	7.6%	5.9%	-9.8%	2.9%	2.5%	3.2%
Solvency							
Component percentage / debt ratios							
Liabilities to assets	47.4%	52.4%	50.4%	56.5%	55.5%	54.3%	53.4%
Liabilities to equity	89.9%	110.3%	101.7%	129.9%	124.6%	118.8%	114.6%
Liabilities to EBITDA	5.4x	4.7x	5.8x	7.7x	8.2x	8.3x	8.1x
Debt-to-assets	34.3%	40.0%	44.0%	50.1%	48.1%	47.1%	46.2%
Debt-to-invested capital	39.4%	45.7%	47.0%	53.5%	51.9%	50.7%	49.8%
Debt-to-equity	65.1%	84.2%	88.7%	115.1%	107.9%	103.0%	99.2%
Debt-to-EBITDA	3.9x	3.5x	4.7x	6.7x	7.2x	7.2x	7.0x
Net debt-to-EBITDA	2.7x	2.8x	3.5x	4.9x	5.0x	5.0x	4.5x
Net debt-to-adjusted EBITDA	**2.7x**	**2.9x**	**5.0x**	**5.7x**	**5.0x**	**5.0x**	**4.5x**
Long-term debt-to-assets	31.3%	38.6%	42.2%	48.0%	46.1%	45.2%	44.3%
Long-term debt-to-equity	59.5%	81.1%	85.1%	110.4%	103.5%	98.8%	95.1%
Financial leverage (equity multiplier)	1.9x	2.1x	2.0x	2.3x	2.2x	2.2x	2.1x
EBITDA coverage	3.4x	3.8x	3.1x	2.1x	3.2x	3.2x	3.3x
Liquidity							
Current ratio	2.2x	2.8x	2.2x	1.8x	1.9x	1.9x	2.2x
Quick ratio (acid test)	2.1x	2.6x	2.0x	1.6x	1.7x	1.7x	2.0x
Cash ratio	1.6x	1.8x	1.5x	1.2x	1.3x	1.3x	1.6x

Source: Company data, Galt & Taggart Research

Disclaimer

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