Georgian Railway
1H16 update

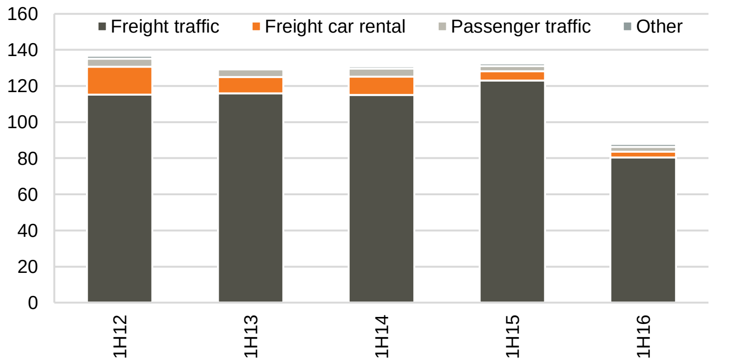
Georgia | Transportation
Georgian Railway
October 11, 2016

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

GR released 1H16 unaudited results and Management Discussion and Analysis. Revenue decreased 33.6% y/y to US$ 87.9mn due to a drop in freight traffic. A sharp decline in revenue from oil products transportation (-45.0% y/y) was the key contributor. The decrease in operating expenses, mostly GEL-denominated, was not as substantial (-6.1% y/y in US$ terms). As a result, adjusted EBITDA declined 53.2% y/y to US$ 35.2mn. Strengthening of GEL against US$ between end-15 and 1H16 led to a non-cash FX gain, which, combined with a tax loss carry forward from the previous year, propped up net income at US$ 21.3mn. The modernization project is proceeding as planned, expected to be completed by late 2019. The bypass project is under review, awaiting the final decision in early December 2016.

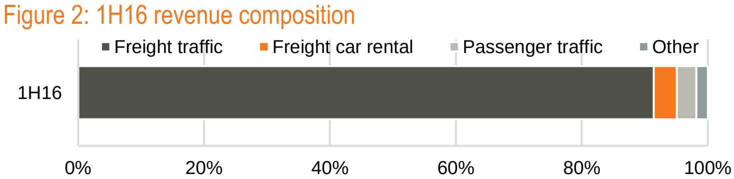
Revenue in 1H16 decreased 33.6% y/y to US$ 87.9mn on the back of weak performance in freight traffic. Freight transportation and freight handling revenues declined 35.2% y/y to US$ 67.7mn and 31.7% y/y to US$ 12.7mn, respectively. The main driver of the drop in freight transportation was the oil products category, down 45.0% y/y to US$ 27.1mn, on the back of lower shipments of heavy fuel from Kazakhstan and gas oil from Azerbaijan and Kazakhstan. Despite higher crude oil transportation volume in 1H16, crude oil transportation revenue declined 25.7% y/y to US$ 6.8mn, as GR lowered tariffs and freight origin shifted from Azerbaijan and Kazakhstan to Turkmenistan. In dry cargo, all categories except sugar posted declines. Grain saw the largest drop of 67.4% y/y to US$ 1.8mn due to diminished volumes from Russia to Armenia. Ferrous metals and other dry cargo transportation revenues declined 33.5% y/y and 23.7% y/y, respectively. Sugar transportation revenue grew 35.7% y/y to US$ 4.9mn, thanks to increased shipments of cane sugar from Brazil to Azerbaijan and Armenia. Freight car rental revenue dropped 37.7% y/y to US$ 3.2mn.

Figure 1: Revenue, US$ mn



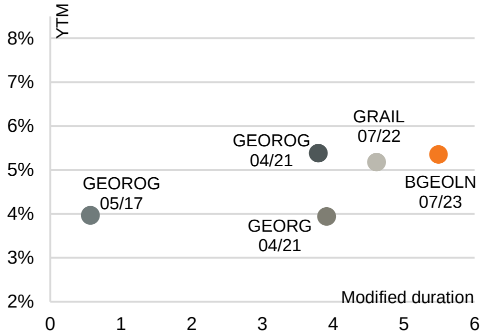
Source: Company data

Figure 2: 1H16 revenue composition



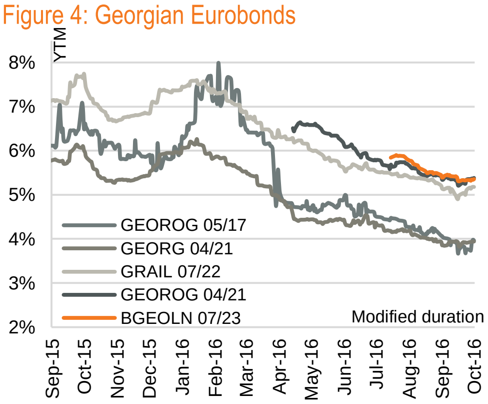
Source: Company data

Figure 3: Georgian Eurobond universe



Source: Bloomberg

Figure 4: Georgian Eurobonds



Source: Bloomberg

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

	1H15	1H16	Change, y/y
Revenue	132,396.9	87,932.8	*-33.6%*
EBITDA	74,834.1	35,034.0	*-53.2%*
EBITDA margin	*56.5%*	*39.8%*	*-1,668bps*
Adjusted EBITDA	73,595.2	35,249.1	*-52.1%*
Adjusted EBITDA margin	*55.6%*	*40.1%*	*-1,550bps*
EBIT	50,683.6	12,385.5	*-75.6%*
EBIT margin	*38.3%*	*14.1%*	*-2,420bps*
Net income	-29,404.3	21,331.2	*n/m*
Net profit margin	*n/m*	*24.3%*	*n/m*
Assets	1,386,273.6	1,323,957.6	*-4.5%*
Equity	655,213.7	649,344.7	*-0.9%*
Liabilities	731,059.9	674,613.0	*-7.7%*

Source: Company data

US$-GEL	1H12	1H13	1H14	1H15	1H16
Period-end	1.64	1.65	1.77	2.25	2.34
Average	1.65	1.65	1.76	2.18	2.32

Source: NBG

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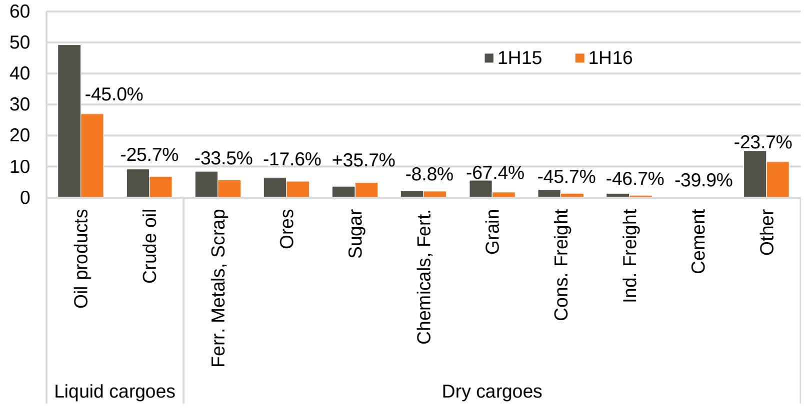
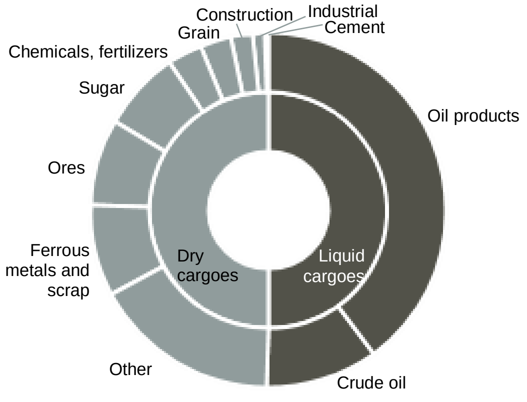
Figure 5: Freight transportation, US$ mn



Source: Company data

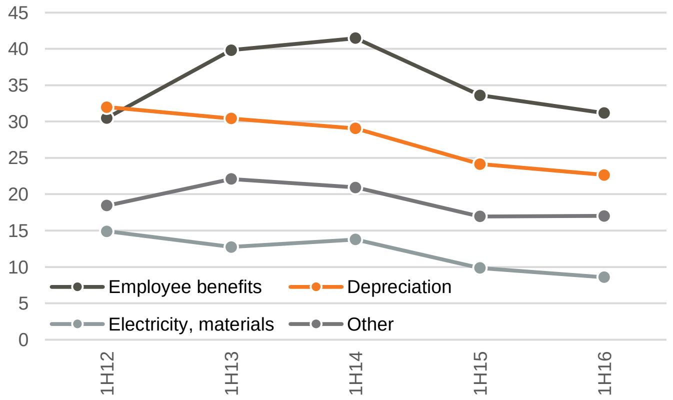
Figure 6: 1H16 freight transportation composition



Source: Company data

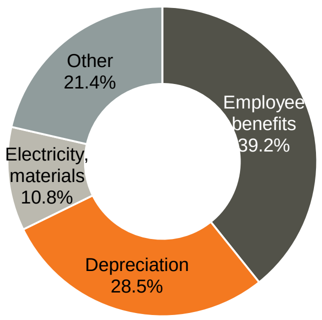
1H16 operating expenses, which are mostly GEL-denominated, declined by only 6.1% y/y, in line with the US$-GEL FX rate over the period. Employee benefits expense dropped the most in absolute terms, down 7.2% y/y to US$ 31.2mn, while electricity, materials expense dropped 12.8% y/y to US$ 8.6mn.

Figure 7: Operating expenses, US$ mn



Source: Company data

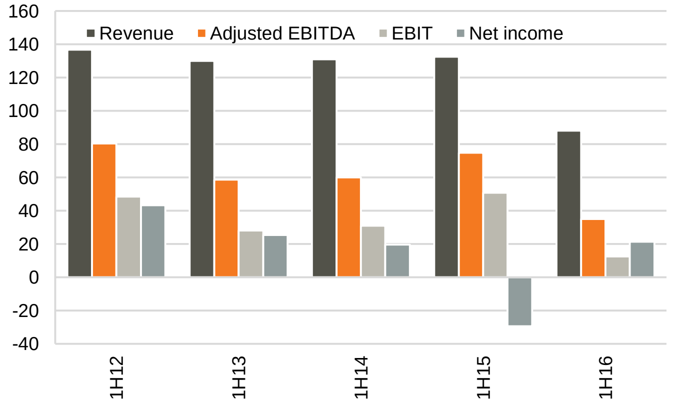
Figure 8: 1H16 operating expenses composition



Source: Company data

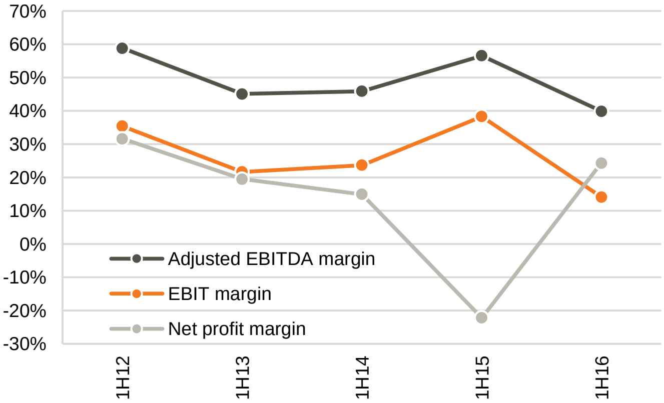
1H16 adjusted EBITDA decreased 52.1% y/y to US$ 35.2mn, while the adjusted EBITDA margin shrank from 55.6% in 1H15 to 40.1% in 1H16. Strengthening of GEL against US$ between end-15 and 1H16 led to a non-cash FX gain, which, combined with a tax loss carry forward of US$ 7.0mn from the previous year, propped up net income at US$ 21.3mn.

Figure 9: Income statement highlights, US$ mn



Source: Company data

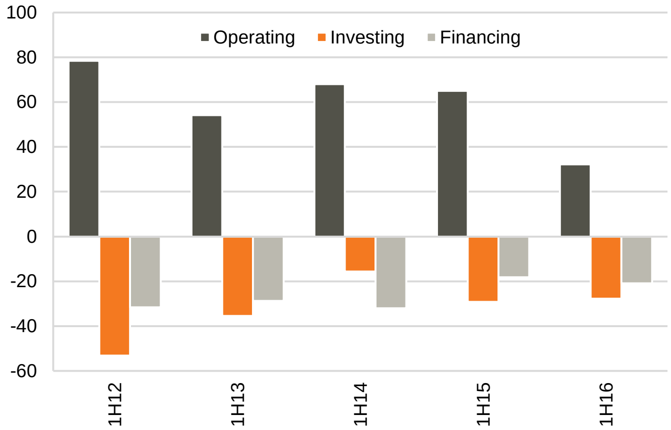
Figure 10: Profitability margins



Source: Company data

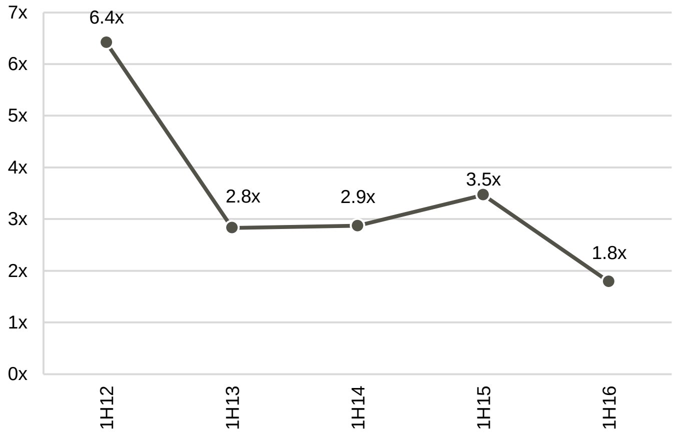
Operating cash declined 50.4% y/y to US$ 32.2mn in 1H16 on the back of lower cash receipts (-32.7% y/y). Investing outflows on long-term assets, mostly related to the modernization project, were at US$ 36.0mn, about the same level as last year. In May-16, GR granted a new, 7-year, US$ 6.0mn loan to Partnership Fund (a Georgian state-owned investment fund and the 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.

Figure 11: Cash flows, US$ mn



Source: Company data

Figure 12: Adjusted EBITDA coverage ratio



Source: Company data

On September 22, S&P lowered GR's credit rating from BB- to B+, leaving the outlook at stable. The rating action primarily reflects S&P's assessment that the financial leverage at GR has increased on the back of the decline in freight volumes in 1H16. The stable outlook reflects S&P's expectation that GR should be able to stabilize its operating performance in the remaining months of 2016 and begin to gradually recover to previous levels in 2017 and 2018, following the improvement of transportation volumes on major freight types. Certain types of freight, such as oil products, sugar, and grain, have already demonstrated positive dynamics in Aug-16 and S&P expects the trend to continue.

On September 29, Fitch placed GR on Rating Watch Negative (RWN), reflecting the under-performance in transportation volumes in 1H16, already under pressure from slowing economies in the region. The RWN will be resolved once Fitch assesses GR's updated business plan, including capital spending and expected dividends, as well as the strength of the government links. A one-notch downgrade is likely, unless profitability and leverage metrics show signs of improvement.

A full report with in-depth analysis and forecasts will follow once the company releases its FY15 Management Discussion and Analysis.

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