# Georgian Railway – 9M20 update

## Challenging Quarter for GR

Fixed Income Research | Georgia
Georgian Railway
December 24, 2020

Railway cargo transportation came under significant pressure in 3Q20, while overall transportation volumes going through Georgia remained on the positive trend. Freight transportation, which is the largest revenue stream for the company, dropped by c. 17% y/y in 3Q20, driven by lower transportation volumes (-7.0% y/y) as well as lower revenues generated per km. Other related segments also declined, while passenger traffic operations remained limited despite opening of the economy in the summer months. GR generated US$ 118.9mn in revenue (-9.3% y/y) and US$ 54.2mn in adjusted EBITDA in 9M20. Weaker GEL on the one hand and deteriorated profitability on the other were the main reasons behind high leverage, with net debt to EBITDA standing at 6.27x, significantly higher than Eurobond covenant. The company is actively working with IFIs and international investment banks to secure financing for the upcoming Eurobond maturity.

**A total of 31mn tonnes of cargo was transported throughout Georgia during 9M20, which is 1.3% higher y/y.** The growth was equally driven by increased transportation by rail and road, while air transportation was insignificant. Notably, road transportation volumes have shown resilience throughout 9M20, while rail transportation came under pressure in 3Q20, discussed below.

**Georgian Railway generated US$ 118.9mn in revenue in 9M20, down 9.3% y/y.** Notably, the pace of decline of the top line accelerated in 3Q20. After declining by 15.2% y/y in 2Q20, the top line dropped by 16.8% y/y in 3Q20. Unlike 2Q20 when freight transportation segment performed relatively well (slight decline), GR's largest revenue category came under significant pressure during 3Q, down 16.8% y/y to US$ 22.6mn.

**Other associated revenue categories – logistic service and freight car rental – also recorded losses in 3Q20.** Logistic service revenue dropped by 37.4% y/y to US$ 3.4mn (after increasing by 6.2% y/y in 2Q20) in 3Q20, while freight car rental revenue dropped by 25.7% y/y to US$ 1.4mn in the same period (-63.3% y/y in 2Q).

**Despite some revival in mobility throughout Georgia during summer months, passenger transportation by rail dropped in 3Q20.** Passenger transportation resumed operations from June 15 (after government lockdown restrictions ended), nevertheless passenger revenue dropped by 65.6% y/y to GEL 5.1mn in 3Q20. Overall, revenue from passenger transportation dropped by 63.1% y/y in 9M20.

**Lower revenue resulted in lower profitability for the company.** On an operational level, 3Q20 adjusted EBITDA came in at US$ 17.4mn, down 28.3% y/y. Adjusted EBITDA margin also squeezed, down to 45.4% vs. 52.8% in 3Q19. Overall, 9M20 adjusted EBITDA stood at US$ 54.2mn, translating into an EBITDA margin of 45.6%.

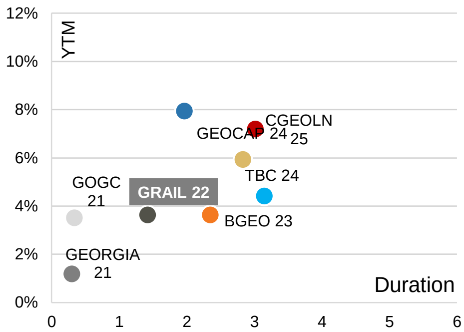
**Net-debt-to-EBITDA remains elevated, significantly higher than the Eurobond covenant.** Net-debt-to-EBITDA, calculated for last 12 months, stood at 6.27x as of September, 2020. Deteriorated operating performance on the one hand and weaker GEL on the other, were the main reasons behind high leverage.

**In November 2020, Fitch affirmed GR's Long-Term rating at 'BB-' with Negative Outlook.** Ties with the state and financial implications of default were assessed strong, resulting in one-notch differential between the ratings of Government and GR.

**Eva Bochorishvili** - Head of Research
| evabochorishvili@gt.ge | +995 32 2401 111 ext. 8036

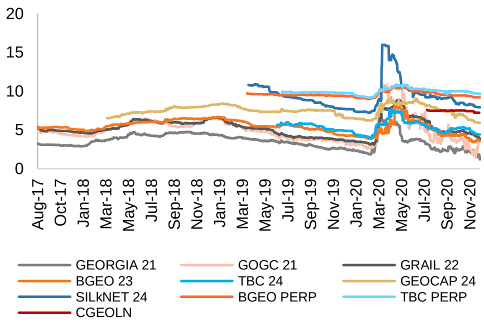
**Ana Nachkebia** - Senior Analyst
| ananachkebia@gt.ge | +995 32 2401 111 ext. 8137

Figure 1: Georgian Eurobond universe




Source: Bloomberg

Figure 2: Georgian Eurobond universe




Source: Bloomberg, as of 18 December 2020

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

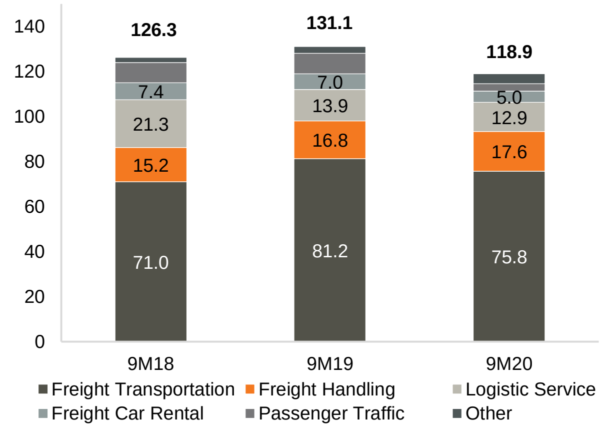
| | 9M19 | 9M20 | Change, y/y |
|---|---|---|---|
| Revenue | 131,161 | 118,949 | -9.3% |
| EBITDA | 63,591 | 56,430 | -11.3% |
| *EBITDA margin* | *48.5%* | *47.4%* | *-215bps* |
| Adjusted EBITDA | 60,435 | 54,200 | -10.3% |
| *Adjusted EBITDA margin* | *46.1%* | *45.6%* | *-111bps* |
| Net income | -23,002 | -38,521 | n/a |
| *Net profit margin* | *-17.5%* | *-32.4%* | *n/a* |
| Assets | 824,530 | 779,715 | -5.4% |
| Liabilities | 657,033 | 646,818 | -1.6% |
| Equity | 167,497 | 132,898 | -20.7% |
| **Net debt to EBITDA** | **6.93x** | **6.27x** | |

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

Georgian Railway credit ratings

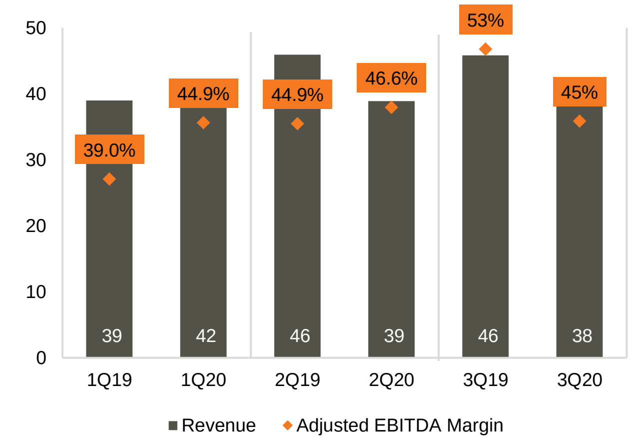
| S&P Global Ratings | Fitch Ratings |
|---|---|
| **B+** | **BB-** |
| **Negative** | **Negative** |
| Affirmed June-2020 | Affirmed Nov-2020 |

Figure 3: Revenue, US$ mn




Source: Georgian Railway, Galt & Taggart Research

Figure 4: Quarterly revenue and adjusted EBITDA margin, US$



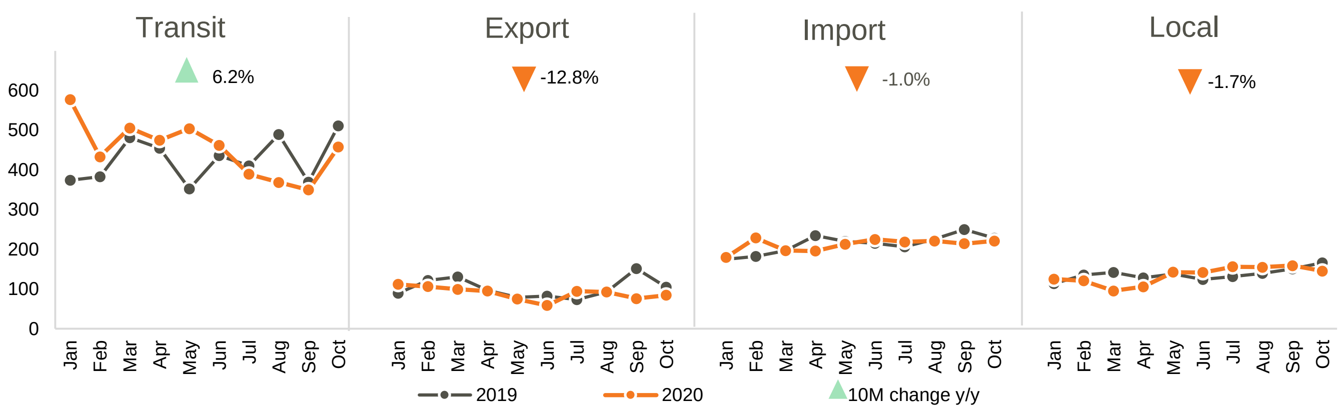

Source: Georgian Railway, Galt & Taggart Research

**Freight transportation, the largest revenue category for the company,** contributing to c. 64.0% of GR's 9M20 revenue, was down 7% y/y in 9M20. Sharp drop (-16.8% y/y) in 3Q20 revenue was the main reason behind the overall decline of the segment, as drop in 1H20 was marginal, just 2% y/y.

**In 1H20, transportation volumes by rail have remained steady, while slight declines in revenue were associated to the lower tariffs applied.** After growing by 10.1% y/y in 1Q20 and 5.1% y/y in 2Q20, freight cargo transported by GR dropped 7.3% y/y in 3Q20.

**Transit freight, accounting for more than half of GR freight, was the hardest hit category during 3Q20.** After growing by a significant 20% y/y in 1H20, transit cargo transported by GR dropped in 3Q20 by 12.7% y/y to 1.1mn tonnes. Exported and imported cargo volumes also declined in 3Q20, related to COVID-19 recession.

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




Source: Georgian Railway

Due to GEL's 6.6% depreciation against dollar during 9M20, GR recognized large FX loss (US$ 61.9mn), which **dragged the company's bottom line to a negative US$ 38.5mn in 9M20**.

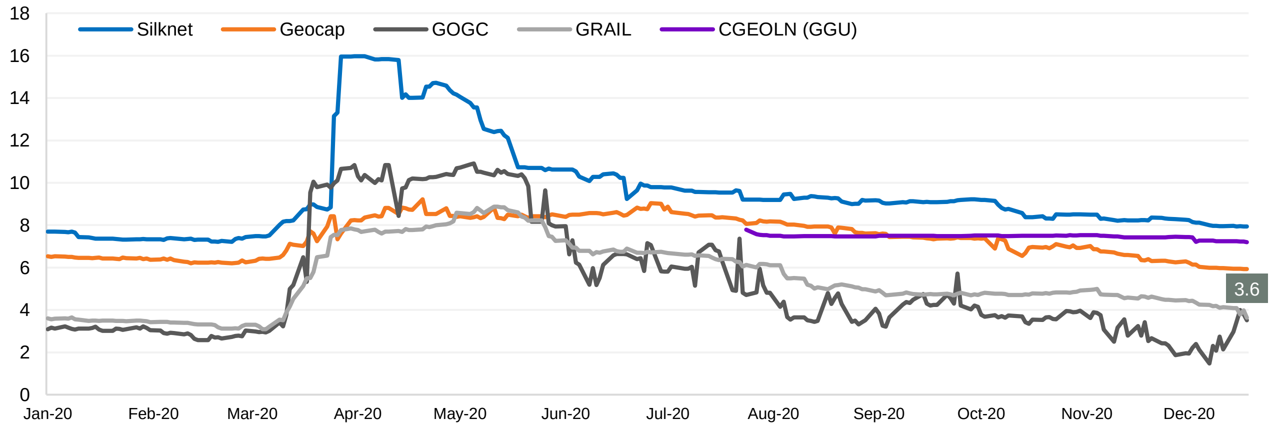
After a 2-month war between Azerbaijan and Armenia over Nagorno-Karabakh region, a ceasefire agreement was signed on 10 November, 2020. The agreement confirmed territorial gains of Azerbaijan, opening direct land link with Turkey. Soon after the agreement, Turkish Government announced plans to build a railway connecting to Azerbaijan directly. This decision may shift transportation routes in the region in long term, which could negatively affect GR. However, at this stage we do not assume cargo flows to shift from Georgian corridor in the future, considering the difficult landscape of this potential new route and uncertainties related to security.

## Eurobond performance

With improved investor sentiments, boosted by vaccine news, the interest towards Emerging Markets, including regional fixed income universe has increased in 2H20. For the past couple of months, yields on Georgian Eurobonds have been on the downward trajectory, dropping to pre-pandemic levels. Yield on GRAIL 22 dropped to 3.6% by 18 December, the level last seen in early March. Notably, the spread between the sovereign GEORGIA 21 and GRAIL 22 has narrowed to 193bps. As GOGC 21 – another quasi-government entity – is facing maturity in 1Q21, the only remaining government related entity with outstanding Eurobonds will be GR.

**GR continues active work with IFIs and international investment banks to secure financing for its upcoming Eurobond maturity. No major agreements have been reached yet.**

Figure 6: Yields on Georgian Eurobonds dropped to pre-pandemic levels in 3Q20




*Source: Bloomberg, as of 18 December 2020*

# Disclaimer



**Head of Research**
Eva Bochorishvili | evabochorishvili@gt.ge

**Head of Macroeconomic Analysis and Forecasting**
Lasha Kavtaradze | lashakavtaradze@gt.ge

**Head of Analytics**
Giorgi Iremashvili | giremashvili@gt.ge

**Head of Sector Research**
Bachana Shengelia | bshengelia@gt.ge

**Senior Analyst**
Mariam Chakhvashvili | mchakhvashvili@gt.ge

**Senior Analyst**
Ana Nachkebia | ananachkebia@gt.ge

**Senior Analyst**
Kakhaber Samkurashvili | ksamkurashvili@gt.ge

**Analyst**
Tatia Mamrikishvili | tmamrikishvili@gt.ge

**Analyst**
Nino Peranidze | ninoperanidze@gt.ge

**Analyst**
Nika Megutnishvili | nmegutnishvili@gt.ge

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