GALT & TAGGART RESEARCH

Georgian Railway - FY22 update

Fixed Income Research | Georgia
Georgian Railway
September 15, 2023

2022 turned out to be an impressive year for GR, with railway transportation volumes marking a substantial increase of 21.8% y/y to 14.8mn tons. As a result, the company generated US$ 231.4mn (+36.1% y/y) in revenue and the highest-ever net profit of US$ 136.1mn in 2022. The surge in revenue was driven by increased freight traffic and logistic service revenue, reflecting growth in dry cargo transportation (particularly sugar, chemicals & fertilizers, etc.). The growth in revenues contributed to a 38.6% y/y growth in company's EBITDA, totaling US$ 97.5mn in 2022, translating into the strong 42.1% EBITDA margin. This growth was instrumental in reducing the company's net debt to EBITDA ratio from 5.9x in 2021 to 3.9x in 2022.

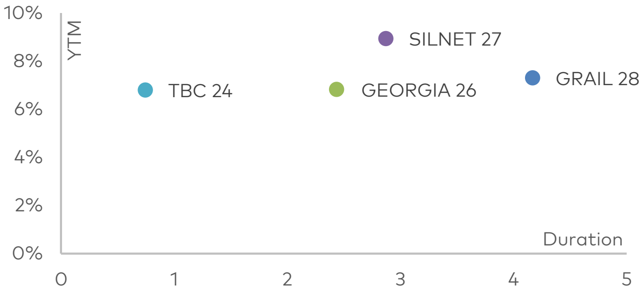
We expect revenue growth to moderate and increase by 4.7% y/y to US$ 242.3mn in 2023, considering last year's high base. At the same time, we expect growth in liquid cargo to continue and compensate anticipated decline in dry cargo transportation volumes. The former is based on projected increase in oil product transportation from Kazakhstan through Georgia, aligned with rising demand for oil products domestically and the revival of oil product transit flows from Azerbaijan. Additionally, we forecast EBITDA to stand at US$ 76.8mn, down by 21.2% y/y from last year's high base, due to increased operating expenses, particularly employee compensation, and appreciation of local currency.

FX gain– key driver for profit growth

Financial highlights, US$ mn	2021	2022	% change, y/y
Revenue	170.1	231.4	+36.1%
of which:			
Freight traffic	131.6	164.8	+25.3%
Logistic service	21.5	42.2	+96.0%
Passenger traffic	4.6	9.4	+104.6%
Freight car rental	4.5	4.7	+4.5%
Other	7.9	10.2	+30.3%
EBITDA	70.3	97.5	+38.6%
EBITDA margin	*41.4%*	*42.1%*	*+0.8ppts*
Adjusted EBITDA	69.2	94.1	+36.0%
Adjusted EBITDA margin	*40.7%*	*40.7%*	*-0.0ppts*
Net income	16.4	136.1	+8.3x
Net profit margin	*9.6%*	*58.8%*	*+49.2ppts*
Assets	729.5	888.1	+21.7%
Liabilities	596.1	599.0	+0.5%
Equity	133.4	289.1	+116.8%
Net Debt	429.9	413.7	-3.8%
Net Debt to EBITDA	5.9x	3.9x	

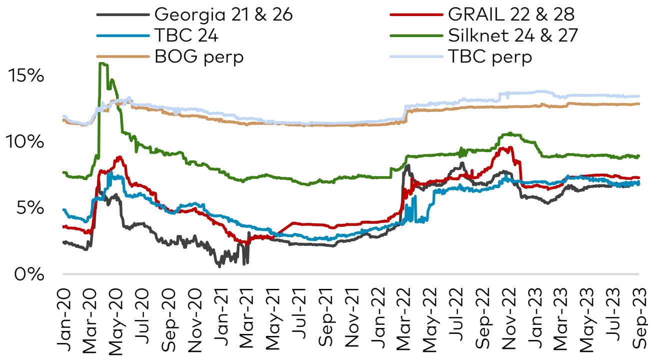
Source: Georgian Railway
Note: Net debt to EBITDA ratio calculated based on figures in GEL

Figure 1: Georgian Eurobond universe



Source: Bloomberg

Figure 2: Georgian Eurobond universe



Source: Bloomberg

Georgian Railway credit ratings

S&P Global Ratings	Fitch Ratings
BB-	**BB-**
Stable	Positive
Affirmed Dec-2022	Affirmed Feb-2023

Source: Georgian Railway

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

Tatia Mamrikishvili - Head of Sector
| tmamrikishvili@gt.ge | +995 32 2401 111 ext. 4693

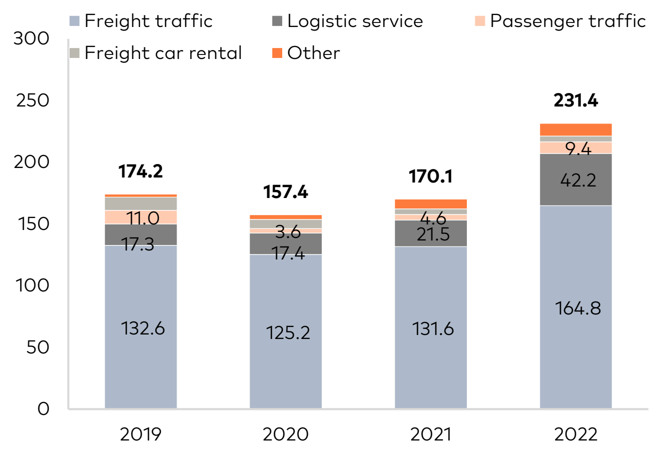
Mariam Okropiridze - Analyst
| maokropiridze@gt.ge | +995 32 2401 111 ext. 2495

How Georgian Railway performed in 2022

Georgian Railway's revenue surged by 36.1% y/y to US$ 231.4mn in 2022, predominantly driven by the growth in freight and logistic service revenues, while other segments also contributed to the overall growth:

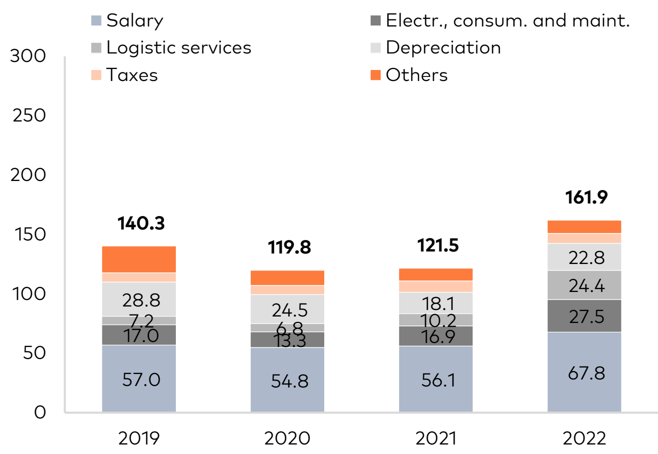
- **Freight traffic** segment, encompassing both freight transportation and handling accounted for 71.2% of the total revenue in 2022. This segment increased 25.3% y/y to US$ 164.8mn, propelled by the expansion of dry cargo transportation (particularly sugar, chemicals & fertilizers and other) and the corresponding freight handling.
- **Logistic services** revenue, the 2nd-largest contributor with a 18.2% revenue share, doubled to US$ 42.2mn in 2022. This growth reflected increased container transportation, as well as the transportation of crude oil and oil products, particularly from Kazakhstan, which explored alternatives to the Russian route in 2022.
- **Passenger traffic** revenue, the 3rd-largest revenue category at 4.1% of total, also doubled to US$ 9.4mn in 2022. This surge was the result of both, increase in the number of passengers driven by tourism recovery and tariff growth from July 2022.
- Lastly, the revenue from **freight car rental**, the smallest contributor, recorded a modest increase of 4.5% y/y, reaching US$ 4.7mn in 2022.

Figure 3: Georgian Railway's revenue, US$ mn



Source: Georgian Railway

Figure 4: Operating expenses, US$ mn

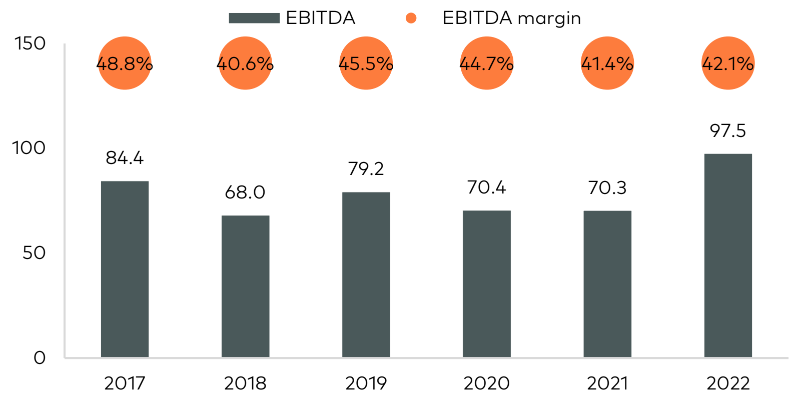


Source: Georgian Railway

Georgian Railway's operating expenses were up by 33.3% y/y to US$ 161.9mn, in line with revenue growth in 2022. This rise was primarily influenced by higher salaries, electricity & maintenance expenses and logistics service charges and GEL strengthening in 2022, as company's operational expenses are mostly GEL-denominated. The company's operating expenses are distributed across five major expense categories, with employee benefits accounting for 41.9% of total in 2022, followed by electricity & maintenance costs (17.0% of total), logistic service charges (15.1% of total), depreciation (14.1% of total) and taxes (5.1% of total).

Georgian Railway's EBITDA was up 38.6% y/y reaching US$ 97.5mn in 2022, entirely driven by the growth in revenue. EBITDA margin was flat, standing at 42.1% in 2022. This growth in EBITDA resulted into company's net debt to EBITDA ratio reducing from 5.9x in 2021 to 3.9x in 2022. The company's capital structure includes two distinct debt instruments, US$ 500mn green Eurobonds, which were refinanced in Jun-2021 from 7.75% coupon rate to 4.00% and GEL- denominated secured loan valued at US$ 15.5mn.

Figure 5: Georgian Railway's EBITDA and EBITDA margin, US$ mn



Source: Georgian Railway

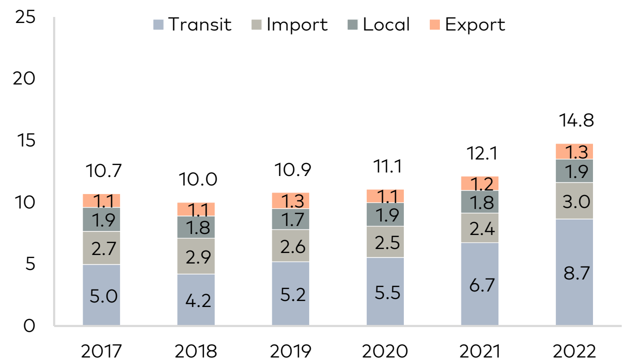
US$ 136.1mn marked the highest-ever net profit for Georgian Railway. This notable accomplishment reflects both improved operational profitability as well as a favorable net finance income at US$ 61.4mn in 2022, a significant shift from the negative US$ 34.8mn in 2021. Two main factors account for this favorable net finance income: (1) a substantial net FX gain of US$ 75.1mn resulting from GEL appreciation against US$, and (2) a reduction in finance costs to US$ 24.2mn in 2022 from US$ 68.3mn in 2021. This decline in finance costs is a result of various factors, including the issuance of new Green Eurobonds in 2021 at a lower coupon rate, as well as the resolution of a one-time early redemption expense tied to outstanding bonds in 2021. Notably, the company's USD-denominated tariff structure provides a natural hedge against the USD-denominated obligations, however the company's exposure to FX fluctuations remains significant, given its substantial portion of operating expenses denominated in GEL.

Credit ratings improved, indicating a more favorable outlook for the company's financial stability. S&P's upgraded GR's rating from 'B+' to 'BB-' with a stable outlook in Dec-22. The improvement was mostly due to the increase in freight turnover and better operational indicators. Notably, GR's credit rating is single notch behind Georgia BB "stable" rating. Fitch also revised GR's 'BB-'rating from stable to positive in Feb-23. This reflected the revision of Sovereign's outlook from stable to positive, as Fitch considers GR as a government-related entity.

Increased transportation through Middle Corridor supported GR's cargo volumes in 2022

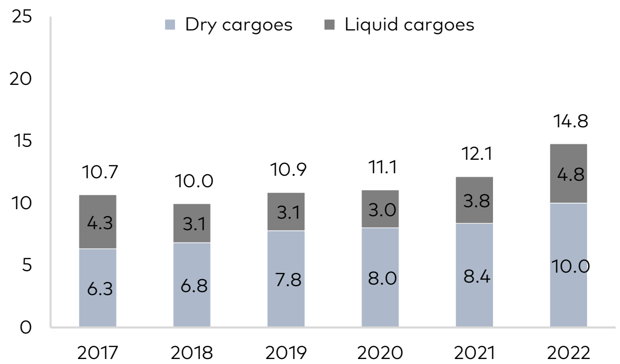
Railway transport volumes surged by 21.8% y/y to 14.8mn tons in 2022, predominantly propelled by transit activities. Transit, which constituted half of the overall rail freight over 2017-21, experienced a remarkable growth of 28.6% y/y reaching 8.7mn tons in 2022. This growth in transit can be attributed to Russia-Ukraine war, resulting in heightened interest towards Middle Corridor. Parallelly, imports also registered an uptick of 23.2% y/y to 3.0mn tons, mostly driven by the increased demand on oil products, construction and industrial freight. While growing at a slightly moderate pace, both exports (up 9.7% y/y to 1.3mn tons) and local transportation (up 2.6% y/y to 1.9mn tons) also contributed positively to the overall growth in 2022.

Figure 6: Cargo breakdown by destination, mn tons



Source: Georgian Railway

Figure 7: Cargo breakdown by category, mn tons



Source: Georgian Railway

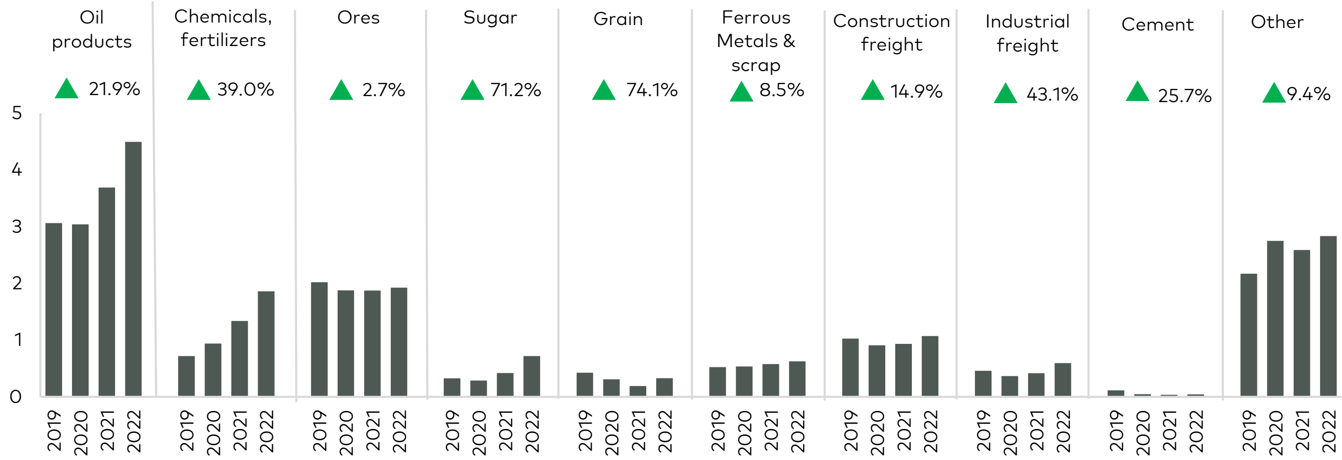
Dry cargo transportation volume was up 19.5% y/y to 10.0mn tons in 2022. This particular segment constitutes c. 70.0% of the company's average transportation volume and played a pivotal role in driving the overall growth in 2022. The surge in dry cargo transportation was driven by rise in transportation of chemicals & fertilizers, and sugar:

- **Chemicals & fertilizers transportation surged by 39.0% y/y to 1.9mn tons in 2022, supported by increased demand on Central Asian fertilizers.** In 2022, fertilizer production in Europe was cut due to increased natural gas prices, which is primary input for fertilizer production. As a result, countries started to seek alternative suppliers in Central Asia, where cheap natural gas allows large-scale production of nitrogenous fertilizers.

- **Sugar transportation increased 71.2% y/y to 0.7mn tons in 2022,** potentially attributed to a singular surge in demand triggered by the ongoing war in Ukraine. Mexico and Brazil were primary sources of sugar transportation to Azerbaijan, Uzbekistan, Armenia, Kazakhstan and Kyrgyzstan in 2022.

Liquid cargo, consisting entirely of oil and oil products, experienced a notable 26.8% y/y increase, reaching 4.8mn tons in 2022. This increase in liquid cargo transportation predominantly resulted from shipments originating from Russia and Kazakhstan (together constituting half of the total) destined for the region (including Georgia, Turkey, and Armenia) and the Netherlands throughout 2022. Notably, the proportion of liquid cargo shipments originating from Kazakhstan climbed to 28.2% of total liquid cargo transportation in 2022, from 3.7% in 2021, reflecting efforts to diversify transportation routes.

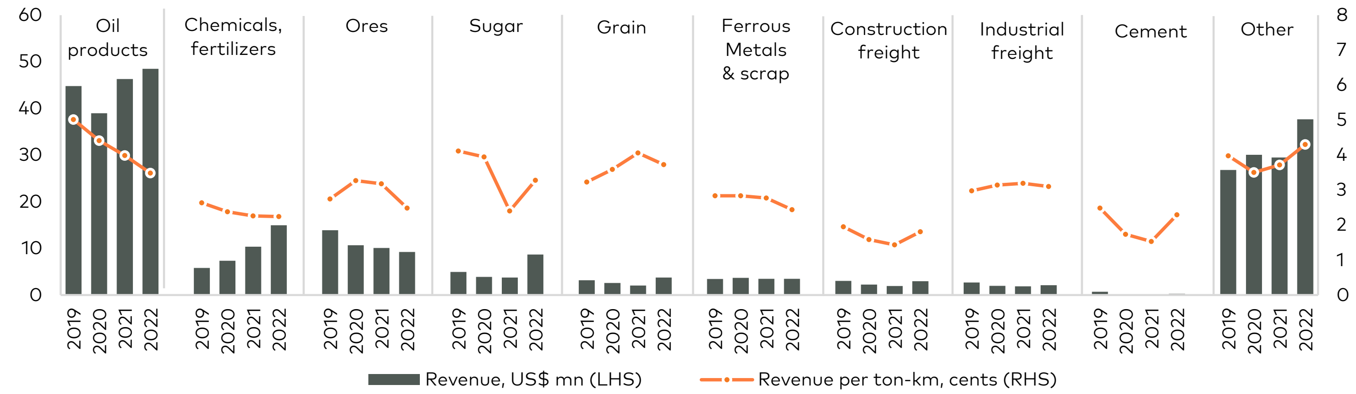
Figure 8: Cargo transportation by volume, mn tons and % y/y change in 2022



Source: Georgian Railway

While there was a general rise in the transportation volume of oil products, chemicals & fertilizers, and sugar in 2022, alterations in product categories and transport directions have led to notable shifts in the average revenue per ton-km. Notably, the revenue per ton-km has declined for oil products and chemicals & fertilizers, while it rose for sugar in 2022.

Figure 9: Oil products & dry cargo transportation revenue and revenue per ton-km

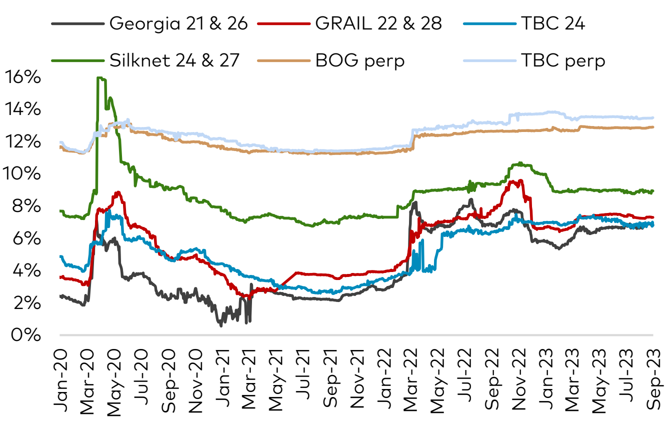


Source: Georgian Railway

Eurobond performance

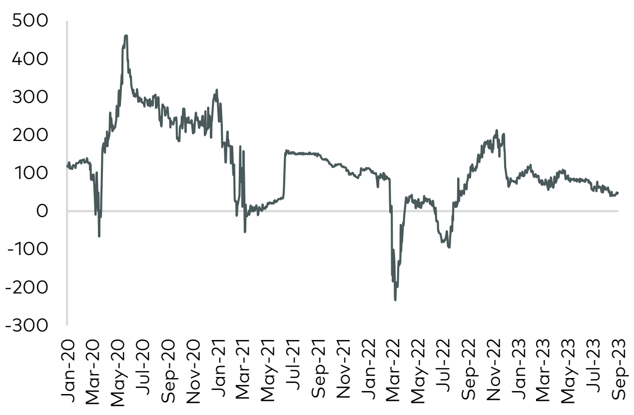
Yields on Georgian corporate Eurobonds, including GRAIL 28, followed an upward trend throughout 2022, reflecting heightened investor concerns due to ongoing regional geopolitical conflicts. However, the trend has reversed in 2023. As of Sep-1, 2023, the yield on GRAIL 28 stood at 7.3%, down from the peak of 9.6% on Nov-7, 2022. This positive sentiment is also evident in the narrowing spread between GRAIL 28 and the sovereign GEORGIA 26 bonds, reducing to 48.5 bps by the end of August 2023, from the 212.6 bps seen on Nov-11, 2022.

Figure 10: YTM on selected Georgian Eurobonds



Source: Bloomberg

Figure 11: GRAIL 22 & 28 spread over GEORGIA 21 & 26, bps

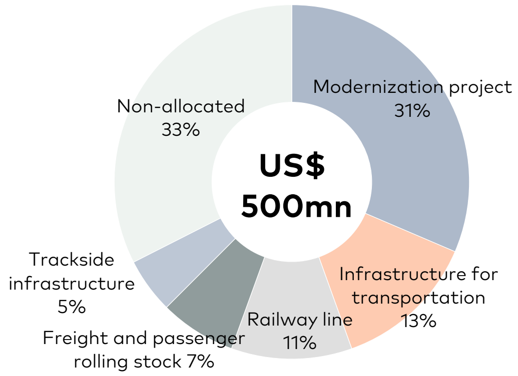


Source: Bloomberg

US$ 500mn green Eurobond outstanding as of end-2022. In Jun-2021, Georgian Railway repurchased its outstanding US$ 500mn bonds due in 2022. Subsequently, the company issued green bonds of the same amount, aimed at funding projects that reduce its environmental impact and promote the sustainable transport in

Georgia. Funds are allocated to five projects, with the ongoing modernization project (discussed below) being the key priority.

Figure 12: Eurobond funds allocated to projects



Source: Georgian Railway

Competitive landscape and future outlook

Georgian Railway, operating within the Middle Corridor, faces competition from Northern and Southern railway routes:

- The Northern route, running through Russia from Central Asia to the Baltic or Black Sea basins, offers ample capacity, rapid transit and a single transport mode, but has lost appeal due to political instability in Russia.

- The Southern route, running through Iran to Turkey, competes for certain cargo from China and Central Asia but faces challenges such as international sanctions, longer distance, increased costs and risks.

Middle Corridor, running through Georgia, is multimodal, raising costs and time of transportation. The completion of the railway Modernization Project anticipated to increase capacity, speed and competitiveness of GR. The Modernization Project aims to alleviate some of these challenges by upgrading the railroad, electrical infrastructure and the mainline connecting Tbilisi to the Black Sea terminals in Poti and Batumi. This upgrade is expected to almost double the annual freight throughput capacity to 48mn tons from 27mn currently, with potential for further expansion.
Additionally, the company has recently issued a procurement tender for the acquisition of 300 platform cars valued at GEL 54.9mn. These platform cars are set to resolve the deficit the company faced in its wagon fleet of this particular type.

Apart from Modernization Project, the Baku-Tbilisi-Kars (BTK) route expected to enhance company's effectiveness by redirecting a portion of cargo transportation from sea ports to railways. The Baku-Tbilisi-Kars route has the annual freight capacity of 5mn tons, with the potential for expansion to accommodate 15mn tons of cargo. BTK line was in a test regime during 2017-22, but it ceased operations in 2023 due to finalizing construction works and the company plans to resume its operation in 2024.

Following a 15.6% y/y increase in revenue in 1H23, we anticipate the moderate 2023 full-year growth at 4.7% y/y, reaching US$ 242.3mn. The surge in revenue witnessed in 2022 was predominantly driven by the revenue generated during 2H22. Consequently, the 15.6% y/y growth recorded in 1H23 can largely be attributed to a lower initial revenue baseline, which is unlikely to be sustained in 2H23. This leads us to anticipate a more moderate 4.7% y/y growth in revenue for the entire year.

We expect revenues from liquid cargo to increase 25.8% y/y to US$ 62.9mn in 2023, after growing 7.1% y/y to US$ 50.0mn in 2022. Our expectations stem from the rising volumes of oil product transportation from Kazakhstan through Georgia, coinciding with a recent increase in demand for oil products from Georgia and restored oil product transit flows from Azerbaijan. Notably, projected rise in imports from Russia is tied to the reduced prices of Russian oil products.

Following an impressive 31.7% y/y growth observed in dry cargo revenues in 2022, we anticipate a 9.6% y/y decline to US$ 75.2mn in 2023. This prediction considers last year's high base and excludes the one-off impacts of increased transit volumes for sugar, chemicals & fertilizers seen in 2022.

Considering other revenue categories, we expect:

- Logistic service revenue to grow 24.0% y/y to US$ 52.3mn, considering the trend witnessed in 1H23.
- Passenger traffic revenue to continue remarkable growth of 47.5% to US$ 13.9mn mostly attributed to a Batumi-Tbilisi ticket price growth by GEL 10.
- Freight car rental revenues to decline slightly by 2.9% y/y to US$ 4.6mn in 2023, after growing 4.5% y/y to US$ 4.7mn in 2022.

We forecast EBITDA to stand at US$ 76.8mn, down by 21.2% y/y in 2023, mainly attributed to the rise in operating expenses, particularly in employee compensation, and the projected strengthening of the GEL to USD, to 2.6 in 2023F from 2.9 in 2022.

This projection results in an EBITDA margin of 31.7% in 2023, down from 42.1% in 2022.

As mentioned above, there are certain strategic projects set to conclude in 2024, which will impact the capacity, speed, and competitiveness of the Georgian Railway. However, these effects have not been integrated into our current projections due to potential delays.

Annex 1: Financials

Income Statement, '000 GEL

	2020	2021	2022	2023F	2024F	2025F
Total revenue	**489,370**	**547,868**	**674,773**	**631,407**	**709,781**	**748,091**
Freight traffic	389,308	423,795	480,626	440,987	478,897	476,714
Logistic service	54,106	69,371	123,071	136,359	155,178	183,809
Passenger traffic	11,201	14,808	27,423	36,139	42,862	51,713
Freight car rental	22,985	14,558	13,775	11,958	12,832	13,691
Other	11,770	25,337	29,878	5,964	20,012	22,164
EBITDA	**218,962**	**226,576**	**284,162**	**200,003**	**225,467**	**208,022**
EBITDA margin	44.7%	41.4%	42.1%	31.7%	31.8%	27.8%
Adjusted EBITDA	211,738	222,889	274,327	190,168	215,632	198,187
Adjusted EBITDA margin	43.3%	40.7%	40.7%	30.1%	30.4%	26.5%
D&A	(76,156)	(58,397)	(66,585)	(78,635)	(71,707)	(69,733)
Financial income (costs), net	(293,376)	(112,177)	178,908	(2,322)	(81,880)	(91,083)
Profit before tax	(164,130)	53,211	397,325	113,524	69,035	44,432
Tax expense	(514)	(500)	(644)	(298)	(314)	(130)
Net income	**(164,644)**	**52,711**	**396,681**	**113,226**	**68,721**	**44,302**
Net margin	-33.6%	9.6%	58.8%	17.9%	9.7%	5.9%

Source: Georgian Railway, Galt & Taggart Research

Income Statement, '000 US$

	2020	2021	2022	2023F	2024F	2025F
Total revenue	**157,369**	**170,096**	**231,433**	**242,337**	**263,318**	**269,447**
Freight traffic	125,192	131,575	164,845	169,253	177,663	171,702
Logistic service	17,399	21,537	42,211	52,335	57,569	66,204
Passenger traffic	3,602	4,597	9,406	13,870	15,901	18,626
Freight car rental	7,392	4,520	4,724	4,590	4,760	4,931
Other	3,785	7,866	10,248	2,289	7,424	7,983
EBITDA	**70,413**	**70,345**	**97,462**	**76,762**	**83,645**	**74,925**
EBITDA margin	44.7%	41.4%	42.1%	31.7%	31.8%	27.8%
Adjusted EBITDA	68,091	69,200	94,088	72,988	79,996	71,383
Adjusted EBITDA margin	43.3%	40.7%	40.7%	30.1%	30.4%	26.5%
D&A	(24,490)	(18,130)	(22,837)	(30,181)	(26,602)	(25,116)
Financial income (costs), net	(94,342)	(34,828)	61,362	(891)	(30,376)	(32,806)
Profit before tax	(52,780)	16,520	136,274	43,571	25,611	16,003
Tax expense	(165)	(155)	(221)	(115)	(116)	(47)
Net income	**(52,945)**	**16,365**	**136,053**	**43,457**	**25,494**	**15,957**
Net margin	-33.6%	9.6%	58.8%	17.9%	9.7%	5.9%

Source: Georgian Railway, Galt & Taggart Research
Note 1: FX rates used in forecast: 2.61 GEL/US$ in 2023, 2.70 GEL/US$ in 2024 and 2.78 GEL/US$ in 2025
Note 2: We adjust EBITDA with write off of PPE and income from non-continuing operations

Balance Sheet, '000 GEL

	2020	2021	2022	2023F	2024F	2025F
Non-current assets	1,959,028	1,987,717	2,060,644	2,073,500	2,100,070	2,125,060
Net PP&E	1,829,561	1,825,474	1,831,197	1,836,340	1,839,397	1,852,895
Other	129,467	162,243	229,447	237,160	260,672	272,165
Current assets	388,736	272,015	338,873	422,413	506,685	566,286
Cash & equivalents	322,986	212,224	274,629	345,851	424,889	478,994
Receivables & prepayments	25,521	19,600	22,865	24,240	24,814	29,442
Other	40,229	40,191	41,378	52,322	56,981	57,851
Total assets	**2,347,764**	**2,259,732**	**2,399,517**	**2,495,913**	**2,606,755**	**2,691,347**
Shareholders' equity	359,288	413,129	781,268	894,495	963,216	1,007,517
Non-current liabilities	1,803,109	1,693,609	1,454,983	1,430,705	1,470,280	1,512,911
LT interest bearing debt	1,702,980	1,590,817	1,378,147	1,329,740	1,368,779	1,403,439
Other	100,129	102,792	76,836	100,965	101,501	109,472
Current liabilities	185,369	152,994	163,266	170,713	173,259	170,919
ST loans	74,356	16,015	14,273	11,247	9,998	7,888
Trade payables & prepayments	82,331	105,873	122,242	127,767	129,549	128,413
Other	28,682	31,106	26,751	31,699	33,712	34,618
Total liabilities & equity	**2,347,764**	**2,259,732**	**2,399,517**	**2,495,913**	**2,606,755**	**2,691,347**

Source: Georgian Railway, Galt & Taggart Research

Balance Sheet, '000 US$

	2020	2021	2022	2023F	2024F	2025F
Non-current assets	597,884	641,696	762,637	794,193	786,566	774,518
Net PP&E	558,372	589,319	677,719	703,356	688,933	675,323
Other	39,513	52,377	84,917	90,837	97,633	99,196
Current assets	118,640	87,815	125,416	161,793	189,775	206,394
Cash & equivalents	98,574	68,512	101,639	132,468	159,139	174,578
Receivables & prepayments	7,789	6,327	8,462	9,284	9,294	10,731
Other	12,278	12,975	15,314	20,040	21,342	21,085
Total assets	**716,524**	**729,511**	**888,052**	**955,986**	**976,342**	**980,912**
Shareholders' equity	109,652	133,371	289,144	342,610	360,766	367,209
Non-current liabilities	550,299	546,749	538,484	547,990	550,683	551,409
LT interest bearing debt	519,740	513,564	510,047	509,318	512,667	511,510
Other	30,559	33,184	28,437	38,672	38,017	39,899
Current liabilities	56,574	49,391	60,424	65,387	64,893	62,295
ST loans	22,693	5,170	5,282	4,308	3,745	2,875
Trade payables & prepayments	25,127	34,179	45,241	48,937	48,522	46,803
Other	8,754	10,042	9,900	12,142	12,627	12,617
Total liabilities & equity	**716,524**	**729,510**	**888,052**	**955,986**	**976,342**	**980,912**

Source: Georgian Railway, Galt & Taggart Research
Note: FX rates used in forecast: 2.61 GEL/US$ in 2023, 2.67 GEL/US$ in 2024 and 2.74 GEL/US$ in 2025

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
Kakha Samkurashvili | ksamkurashvili@gt.ge

Head of Sector
Mariam Chakhvashvili | mchakhvashvili@gt.ge

Head of Sector
Tatia Mamrikishvili | tmamrikishvili@gt.ge

Senior Analyst
Giga Nozadze | gnozadze@gt.ge

Senior Analyst
Giorgi Tskitishvili | g.tskitishvili@gt.ge

Senior Analyst
Zurab Tavkelishvili | ztavkelishvili@gt.ge

Senior Analyst
Sergi Kurashvili | s.kurashvili@gt.ge

Analyst
Dachi Mujirishvili| dmujirishvili@gt.ge

Analyst
Mariam Okropiridze| maokropiridze@gt.ge

Analyst
Otar Tsukhishvili| otsukhishvili@gt.ge

Address: 3 Pushkin Street, Tbilisi 0105, Georgia
Tel: + (995) 32 2401 111
Email: research@gt.ge