TransContainer

FY16 results

Russian rail volumes continue to grow

Industrial support services

TransContainer's (TRC) FY16 results announcement on 29 March was in line with Edison and market expectations. Russian rail freight volumes are growing by double-digit amounts and TRC continues to show its ability to exploit this growth trend. Our three-year EBITDA (company definition) CAGR of 12.7% is driven by continued economic recovery in Russia, higher rates of 'containerisation' and enhanced profitability as an increasing volume of freight is handled by TRC's more profitable Integrated Freight Forwarding (IFF) business. TRC remains the only way to gain equity exposure to these underlying trends. The company's Q1 operating update further bolsters the equity story with an increase of 22.4% in Russian rail freight market volumes.

Year end	Revenue (RUBm)	PBT* (RUBm)	EPS* (RUB)	DPS (RUB)	P/E (x)	Yield (%)
12/15	20,311	3,530	138.7	251.8	24.2	7.5
12/16	21,988	4,302	202.4	58.7	16.6	1.7
12/17e	23,761	5,469	314.7	78.7	10.7	2.3
12/18e	25,256	5,650	325.1	81.3	10.3	2.4

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Story intact: Runaway market growth

10.2% year-on-year growth in Russian rail freight volumes (TRC 8.9%) in FY16, plus 22.4% year-on-year growth in Q117 (TRC 23.7%) shows our investment thesis remains intact. Namely, supernormal growth is set to continue in the coming years as Russian industry recovers from recession plus a larger share of freight is handled via rail flat cars. TRC is the only equity play on these trends.

EBITDA growth set to continue

The 8.9% volume growth enjoyed by TRC in FY16 converted into an 8.8% expansion in EBITDA (company-adjusted definition). Reported EBITDA margins nudged up to 32.3% in FY16 from 32.1% in FY15 and we expect margin expansion to continue. We note that EBITDA margins peaked at nearly 40% in the previous cycle and are therefore confident that TRC can grow EBITDA at a faster rate than our assumed average revenue growth figure of 9.3% in the key IFF business. On that basis, our forecast three-year EBITDA CAGR of 12.7% seems undemanding provided favourable macro conditions remain in place.

Valuation: RUB3,580 fair value offers 10% upside

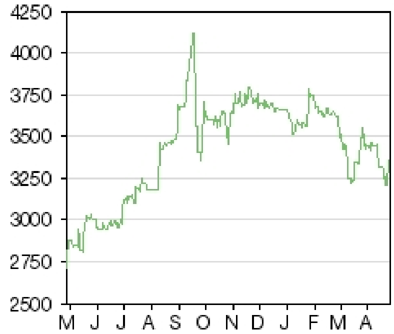
We take into account both a DCF analysis and a peer-based EV/EBITDA multiple-driven valuation in arriving at our fair value per share. Our DCF is based on four years of explicit cash flows, a terminal growth rate of 3% and a WACC of 10.2% and implies a fair value of RUB3,534 per share. We use a multiple of 6.7x FY17e EBITDA in arriving at our discount-to-peer-based fair value per share of RUB3,623. The average of these two methodologies is RUB3,580 and offers equity holders 10% upside from current levels.

26 April 2017

Price	**RUB3,360**
Market cap	**RUB46bn**

Net debt (RUBbn) as at December 2016	3.7
Shares in issue	13.8m
Free float	50%
Code	TRCN
Primary exchange	MCIX
Secondary exchange	LSE

Share price performance



%	1m	3m	12m
Abs	(5.4)	(11.4)	19.6
Rel (local)	(3.4)	(3.5)	17.0
52-week high/low		RUB4120	RUB2710

Business description

TransContainer owns and operates rail freight assets across Russia. Its assets comprise rail flatcars, handling terminals and trucks, through which it provides integrated end-to-end freight forwarding services to its customers

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FY16 results: Strong market growth remains the story

TRC continues to see rapid growth in its end-markets. 10.2% year-on-year volume growth across Russian rail freight in FY16 vs FY15 was driven by continued economic recovery and an increasing share of goods transported via rail container. We have been highlighting this trend since our initiation and see no reason for it to cease. This underlying market growth led to 8.9% year-on-year volume growth for TRC. As announced by TRC on 20 April, in its quarterly operating update, Russian rail freight volumes continue to grow at a high level, with Q117 volumes up 22.4% converting to a 23.7% increase in TRC's volumes handled versus Q116.

The main drivers of TRC's growth were expansion in domestic, export and import routes. Note, differences in end-market industry exposure and geographic mix within Russia mean that TRC's performance year-on-year does not replicate exactly volume growth across Russia; however, TRC usually moves within 5% of market growth with the exception of 'Transit' routes where TRC suffered a significant contraction due to a reduced number of cars produced in Uzbekistan and Kazakhstan.

Exhibit 1: TransContainer and market volume growth, FY16 vs FY15

	Russian market-wide (TEU)			TRC volumes (TEU)		
	FY15	FY16	y-o-y (%)	FY15	FY16	y-o-y (%)
Domestic routes	1,498	1,678	12.0%	790	867	9.7%
Export	741	800	8.0%	318	360	13.2%
Import	503	525	4.4%	223	242	8.5%
Transit	217	258	18.9%	86	74	-14.0%
All routes	**2,959**	**3,261**	**10.2%**	**1,417**	**1,543**	**8.9%**

Source: TransContainer, Edison Investment Research. Note: TEU: 20 foot equivalent unit.

TRC's 8.9% volume growth in FY16 was consistent with its 8.3% increase in adjusted revenue and 8.8% expansion in EBITDA (TRC definition). The adjusted EBITDA margin increased from 32.1% in FY15 to 32.3% in FY16. Net debt over the year increased slightly to RUB3,685m vs RUB3,527m.

Exhibit 2: FY16 vs FY15 numbers

RUBm	2015	2016	% y-o-y
Integrated Freight Forwarding and Logistics Services	12,518	14,126	12.8%
Rail-based Container Shipping Services	4,390	4,061	-7.5%
Terminal Services and Agency Fees	2,130	2,393	12.3%
Truck Deliveries	848	875	3.2%
Other Freight Forwarding Services	134	226	68.7%
Bonded Warehousing Services	194	203	4.6%
Other	97	104	7.2%
Total adjusted revenue	**20,311**	**21,988**	**8.3%**
EBITDA (TRC Definition: PBT + int expense + D&A)	**6,526**	**7,099**	**8.8%**
EBIT	3,274	3,849	17.6%
Profit before tax	3,548	4,079	15.0%
Profit for the period	2,831	3,244	14.6%
Earnings per share, basic and diluted (RUB)	**207**	**235**	**13.5%**
DPS (RUB)	**251.8**	**59**	**13.5%**

Source: TransContainer, Edison Investment Research

Divisional adjusted revenue analysis

- Integrated Freight Forwarding (64.2% of FY16 revenues) – The 12.8% y-o-y increase in revenues was driven by an expansion in revenue-generating volumes as well as a continuation of the shift in customer demand towards TRC's integrated offering. The increase in revenue contribution for this division, from 61.6% in FY15 to 64.2% in FY16, shows how pronounced this trend is.

- Rail-based container shipping (18.5% of FY16 revenues) – The 7.5% y-o-y decline in revenues is a reflection of changing customer preferences in favour of TRC's integrated freight forwarding services.
- Terminal Services and agency (10.9% of FY16 revenues) – With a 12.3% y-o-y increase in revenues, Terminal Services' strong performance was due to tariff increases while volumes were broadly flat year-on-year.
- Truck deliveries (4.0% of FY16 revenues) – The largest driver behind the 3.2% increase in year-on-year revenues in this unit was a 1.5% volume increase.
- Other divisions (2.4% of FY16 revenues) – Bonded Warehouse and Other businesses grew by 4.6% y-o-y and 7.2% y-o-y, respectively. The standout performance came from Other Freight Forwarding, which grew by 68.7% y-o-y, albeit from a very low base of 0.7% of FY15 revenues (1% of FY16 revenues). The company credited this exceptional performance to "market recovery and resumed customer demand for added-value services".

Cost analysis

Year-on-year adjusted operating expenses increased by 5.3% in FY16. Increases in materials, payroll and repair and maintenance costs were partially offset by a decrease in rent expenses.

Exhibit 3: TransContainer year-on-year cost evolution

RUBm	2015	2016	y-o-y (%)	Commentary
Freight and Transportation Services	5,858	5,972	1.9%	Increase in tariff from network owner offset by lower empty run ratio
Payroll and related charges	4,507	5,244	16.4%	Increase in salaries and incentives, offset by lower headcount
Depreciation and amortisation	2,470	2,528	2.3%	Reflective of higher PP&E during the year
Materials, Repair and Maintenance	2,275	2,605	14.5%	6.9% increase in flatcar repairs and cost. Higher terminal maintenance
Taxes other than income tax	521	543	4.2%	Higher VAT
Rent	638	311	-51.3%	Flatcar operating lease reduction
Other expenses	1,579	1,596	1.1%	Increase in charity amount offset by consulting costs
Adjusted operating expenses	17,848	18,799	5.3%	

Source: TransContainer, Edison Investment Research

Financials and forecasts

We have adjusted our forecasts to reflect TRC's FY16 results announcement. By far the largest moving part, Integrated Freight Forwarding (IFF), performed well in FY16, and we see little reason to materially alter our growth forecasts for this division. We decrease our forecasts for the Rail Based Container Shipping business while increasing them for the Terminal Services division, although both of these are far less material than the IFF business. The net result of all our earnings movements is that adjusted EBITDA (company definition) is slightly down versus our previous estimates (2.4% to 3.1% across our forecast period). Our EPS forecasts are around 3.8% to 10.0% lower than our previous forecasts in the coming years due to the slight declines in EBITDA in tandem with higher depreciation driven by higher FY17 capex together with a higher interest charge. TRC's high dividend payment in FY15 was a special dividend and will not be repeated. We forecast that TRC's dividend will continue to be based on a 25% payout ratio in line with company guidance.

We increase our FY17 capex forecasts to reflect an estimated RUB5.0bn investment in flat cars. Given the fact that capex has fluctuated and FY16 capex came in below budget, we will keep this forecast under review and seek to question management about their capex plans at the next announcement.

Exhibit 4: Transcontainer earnings forecast changes

RUBm	2017e	2018e	2019e
New Integrated Freight Forwarding and Logistics Revenues	**15,750**	**17,089**	**18,542**
Old Integrated Freight Forwarding and Logistics Revenues	15,492	16,887	
± New vs old	1.7%	1.2%	
New Rail Based Container Shipping Revenues	**4,163**	**4,267**	**4,373**
Old Rail Based Container Shipping Revenues	4,612	4,704	
± New vs old	-9.7%	-9.3%	
New Terminal Services and Agency Fees Revenues	**2,417**	**2,441**	**2,466**
Old Terminal Services and Agency Fees Revenues	2,238	2,271	
± New vs old	8.0%	7.5%	
New Truck Deliveries Revenues	**893**	**825**	**825**
Old Truck Deliveries Revenues	891	909	
± New vs old	0.2%	-9.2%	
New Other Revenues	**538**	**549**	**566**
Old Other Revenues	431	440	
± New vs old	24.8%	24.8%	
New Adjusted Revenues	**23,761**	**25,256**	**26,875**
Old Adjusted Revenues	23,664	25,211	
± New vs old	0.4%	0.2%	
New EBITDA (company definition)	**8,562**	**9,238**	**10,153**
Old EBITDA (company definition)	8,771	9,533	
± New vs old	-2.4%	-3.1%	
New EBIT (company definition)	**4,938**	**5,234**	**5,752**
Old EBIT (company definition)	5,231	5,739	
± New vs old	-5.6%	-8.8%	
New EPS (RUB)	**315**	**325**	**364**
Old EPS (RUB)	327	362	
± New vs old	-3.8%	-10.1%	
New DPS (RUB)	**79**	**81**	**91**
Old DPS (RUB)	82	90	
± New vs old	-3.8%	-10.1%	
New net debt	**6,215**	**5,401**	**4,366**
Old net debt	2,412	2,069	
± New vs old	157.6%	161.0%	

Source: Edison Investment Research

Valuation

Our fair value per share of RUB3,580 is driven by a mixture of a DCF (WACC 10.2%, terminal growth 3%), which implies a fair value of RUB3,534 per share. We also take into account an FY17e EBITDA multiple of 6.7x, which gives a fair value of RUB3,623 per share. We select an EBITDA multiple that is comfortably below the global average one-year forward EV/EBITDA of 8.7x (Exhibit 5). We apply a discount to the global average to reflect the low free float, a high degree of country risk and a high level of government involvement in the sector.

Our fair value per share of RUB3,580 offers equity holders 10% upside to RUB3,250 – the share price at the time of publication. Both valuation methodologies are increased by a 'roll forward effect': using higher cash flows in the DCF and a higher EBITDA for the multiple-based model. It is worth noting that the MICEX index in Russia was strong at the end of 2016 and has since given back its gains. As an index it is very sensitive to commodity moves and perceived political risk. This is one of the main reasons why we have a higher WACC (and indeed lower EBITDA multiple) than would be the case in a similarly well-managed, cash-generative, conservatively financed company.

Exhibit 5: TransContainer peer multiples

		Market cap (local m)	Current EV/ EBITDA (x)	Next EV/ EBITDA (x)	Current P/E (x)	Next P/E (x)	Div yield this year (%)
European Transport							
Globaltrans Investment	Cyprus	1,421	5.2	4.8	13.1	10.9	3.8
PKP Cargo SA	Poland	2,990	5.5	4.6	43.3	17.2	0.0
VTG AG	Germany	867	7.1	6.8	15.3	12.4	2.2
Average			**5.9**	**5.4**	**23.9**	**13.5**	**2.02**
Emerging Markets Transport							
China Railway Tielong Container Logistics Co	China	12,011	21.8	20.9	40.7	36.7	0.9
Daqin Railway Co	China	116,704	9.3	7.8	16.7	12.6	4.2
Guangshen Railway Co	China	28,374	7.6	7.0	24.4	22.0	1.9
Average			**12.9**	**11.9**	**27.2**	**23.8**	**2.36**
Developed Market Transport							
Canadian Pacific Railway	Canada	30,543	11.5	10.8	18.1	16.1	0.9
Union Pacific Corp	US	88,677	10.3	9.6	19.4	17.2	2.4
Norfolk Southern Corp	US	33,991	9.9	9.3	18.9	16.9	2.5
Canadian National Railway Co	Canada	77,745	12.7	12.0	20.1	18.5	1.8
Genesee & Wyoming Inc	US	4,225	9.3	8.7	21.3	18.2	0.0
CSX Corp	US	46,251	11.0	9.9	22.1	18.5	2.6
Aurizon Holdings	Australia	10,464	10.1	9.0	21.4	19.2	5.8
Average			**10.7**	**9.9**	**20.2**	**17.8**	**2.3**
Overall Transport Average			**9.4**	**8.7**	**21.1**	**16.9**	**2.1**
TransContainer PJSC	**Russia**	**47,034**	**6.1**	**5.6**	**10.3**	**10.0**	**2.4**

Source: Bloomberg data, plus Edison estimates for Transcontainer. Note: Priced on 20 April 2017.

Exhibit 6: Financial summary

RUBm	2014	2015	2016	2017e	2018e	2019e	2020e
31-December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue	20,538	20,311	21,988	23,761	25,256	26,875	28,620
EBITDA (company definition)	7,816	6,526	7,099	8,562	9,238	10,153	11,141
EBITDA	6,544	5,744	6,377	7,426	8,083	8,713	9,392
Operating Profit (before amort. and except.)	4,083	3,274	3,849	4,938	5,234	5,752	6,306
Intangible Amortisation	0	0	0	0	0	0	0
Exceptionals	0	0	0	0	0	0	0
Other	0	0	0	0	0	0	0
Operating Profit	4,083	3,274	3,849	4,938	5,234	5,752	6,306
Net Interest	(497)	(356)	(216)	(206)	(394)	(325)	(240)
Share of assocs/jvs gains/(losses)	165	612	669	736	809	890	979
Forex gains/(losses	938	0	(223)	0	0	0	0
Other	18	18	0	0	0	0	0
Profit Before Tax (norm)	3,751	3,530	4,302	5,469	5,650	6,318	7,045
Profit Before Tax (FRS 3)	4,707	3,548	4,079	5,469	5,650	6,318	7,045
Tax	(1,049)	(717)	(835)	(1,119)	(1,157)	(1,293)	(1,442)
Profit After Tax (norm)	2,702	2,813	3,467	4,349	4,494	5,024	5,603
Profit After Tax (FRS 3)	3,658	2,831	3,244	4,349	4,494	5,024	5,603
Average Number of Shares Outstanding (m)	13.7	13.7	13.8	13.8	13.8	13.8	13.8
EPS - normalised (RUB)	286.0	138.7	202.4	314.7	325.1	363.5	405.4
EPS - normalised fully diluted (RUB)	286.0	138.7	202.4	314.7	325.1	363.5	405.4
EPS - (IFRS) (RUB)	267.1	206.7	234.7	314.7	325.1	363.5	405.4
Dividend per share (RUB)	71.0	251.8	58.7	78.7	81.3	90.9	101.3
EBITDA Margin (%)	31.9	28.3	29.0	31.3	32.0	32.4	32.8
Operating Margin (before GW and except.) (%)	19.9	16.1	17.5	20.8	20.7	21.4	22.0
BALANCE SHEET							
Fixed Assets	42,012	41,739	40,822	46,234	47,932	49,807	51,872
Intangible Assets	210	246	290	290	290	290	290
Tangible Assets	37,900	37,827	37,485	42,897	44,595	46,470	48,535
Investments	3,343	3,023	2,685	2,685	2,685	2,685	2,685
Other	559	643	362	362	362	362	362
Current Assets	6,965	7,435	11,006	10,485	13,620	16,957	20,477
Stocks	340	315	209	226	240	255	272
Debtors	1,542	1,392	1,605	1,734	1,844	1,962	2,089
Cash	1,904	2,110	5,525	4,783	7,597	10,632	13,826
Other	3,179	3,618	3,667	3,742	3,939	4,108	4,291
Current Liabilities	(5,581)	(6,747)	(8,372)	(8,461)	(8,697)	(8,899)	(9,117)
Creditors	(3,084)	(3,405)	(4,279)	(4,368)	(4,604)	(4,806)	(5,024)
Short term borrowings	(919)	(1,893)	(2,762)	(2,762)	(2,762)	(2,762)	(2,762)
Other	(1,578)	(1,449)	(1,331)	(1,331)	(1,331)	(1,331)	(1,331)
Long Term Liabilities	(8,151)	(6,240)	(8,947)	(10,947)	(12,947)	(14,947)	(16,947)
Long term borrowings	(5,458)	(3,744)	(6,236)	(8,236)	(10,236)	(12,236)	(14,236)
Other long term liabilities	(2,693)	(2,496)	(2,711)	(2,711)	(2,711)	(2,711)	(2,711)
Net Assets	62,709	62,161	69,147	76,128	83,195	90,610	98,413
CASH FLOW							
Operating Cash Flow	7,617	5,437	7,421	7,294	7,998	8,613	9,284
Net Interest	(557)	(394)	(165)	(206)	(394)	(325)	(240)
Tax	(964)	(727)	(781)	(1,119)	(1,157)	(1,293)	(1,442)
Capex	(4,136)	(2,400)	(2,192)	(7,900)	(4,546)	(4,837)	(5,152)
Acquisitions/disposals	(75)	(12)	(128)	0	0	0	0
Financing	199	0	517	0	0	0	0
Dividends	(1,117)	(974)	(4,830)	(811)	(1,087)	(1,123)	(1,256)
Other	199	0	517	0	0	0	0
Net Cash Flow	967	930	(158)	(2,742)	814	1,034	1,194
Opening net debt/(cash)	6,004	4,473	3,527	3,685	6,427	5,613	4,578
HP finance leases initiated	0	0	0	0	0	0	0
Other	564	16	0	0	0	0	0
Closing net debt/(cash)	4,473	3,527	3,685	6,427	5,613	4,578	3,384

Source: TransContainer accounts, Edison Investment Research