

TransContainer

FY16 results

Russian rail volumes continue to grow

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.

Industrial support services

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

Next events

| | |
|----------|------------------------|
| May 2017 | Q117 financial results |
|----------|------------------------|

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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

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