EDISON

TransContainer

Q2/H119 results

Another beat, with structural and cyclical drivers

General industrials

Both cyclical and structural factors drove strong revenue growth in H119 (adjusted revenues up 32% y-o-y, above our expectations) which, combined with efficiency gains and economies of scale, led to EBITDA growth of 67% y-o-y and net income almost doubling. We forecast growth to continue, albeit at a more moderate pace, as we expect a stabilisation in rail container transportation prices. We have significantly increased our forecasts, which drives a 33% increase in our valuation to RUB9,460/share.

Year end	Revenue (RUBm)	PBT* (RUBm)	EPS* (RUB)	DPS (RUB)	P/E (x)	Yield (%)
12/17	27,782	8,147	448	293	20.1	3.2
12/18	31,288	10,263	561	480	16.1	5.3
12/19e	40,229	17,248	984	484	9.2	5.4
12/20e	47,858	22,021	1,252	626	7.2	6.9

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

H1 results boosted by volume and price growth

In H119, TransContainer experienced strong volume and price increases, which led to strong revenue and profit growth, ahead of our expectations. Adjusted revenues grew 32% y-o-y and net income almost doubled to RUB6.1bn. TransContainer benefited from strong cyclical growth in certain industries, such as the timber (+34% y-o-y transported volumes for TransContainer) and auto and components industries (+22% y-o-y), which represent a large portion of the volumes transported albeit a limited share of Russian GDP.

Forecasts raised again

TransContainer has consistently beat our expectations over the last 12 months and we increase our forecasts again following the H119 results (revenue up 10% in FY19 and 16% in FY20, and net income up 29% in FY19 and 44% in FY20). We believe the structural trend towards containerisation should continue to support growth. However, our forecasts reflect some moderation in revenue growth rates vs H1 (+32% y-o-y) to reflect the risks to the Russian economy and the likely stabilisation in prices. We now expect 26% adjusted revenue growth in H219 and a 16% increase in FY20.

Valuation: Share price doubled but multiples little changed

TransContainer's share price has continued to rise since the Q1 results and has now doubled year to date. We believe the recent strong results and the increase in future earnings expectations were the key drivers. However, the share price rise was not accompanied by a large re-rating, with the stock still trading at c 9x 2019e P/E. Hence, despite the share price rise, the stock remains at a discount to peers in both emerging markets and developed markets, which is at least partly explained by the limited liquidity, in our view. Following our forecasts revisions, we have significantly increased our DCF-based valuation to RUB9,460 /share (from RUB7,100/share). If the auction to sell a 50% stake in TransContainer to a Russian investor on 27 November 2019 results in an increased free float for the stock, we would see room for a re-rating.

11 September 2019

Price	**RUB9,025**
Market cap	**RUB125bn**

Net debt (RUBm) at H1	8,417
Shares in issue	13.9m
Free float	0.43%
Code	TRCN
Primary exchange	MICEX
Secondary exchange	LSE

Share price performance

%	1m	3m	12m
Abs	26.2	45.7	104.2
Rel (local)	21.3	43.3	71.1
52-week high/low		RUB9025	RUB4300

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

Auction for 50% stake sale	27 November 2019
Q3 results	November 2019

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Edison profile page

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Structural and cyclical drivers support FY19 results

We believe TransContainer is benefiting from both cyclical and structural growth trends in FY19. The two drivers combined led to a very strong revenue pick-up in H119 (adjusted revenue was up 32% y-o-y), which, compounded with economies of scale, led to EBITDA growth of 67% y-o-y and net income almost doubling. We forecast growth to continue, albeit at more moderate pace, reflecting our expectations of a stabilisation in prices but continued volume growth. We have significantly increased our forecasts, which has led us to increase our DCF-based valuation by 33% to RUB9,460/share.

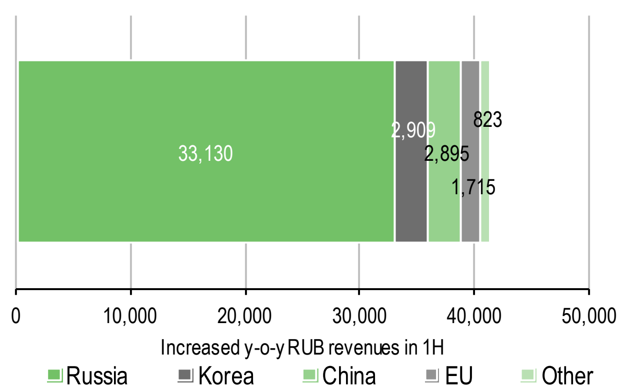
Q2/H119: Another strong set of results

TransContainer reported another strong set of results, with:

- Total revenues for H119 of RUB41.5bn, up 17% y-o-y (with Q2 revenues growing strongly, up 15% y-o-y, albeit slower than Q1's 20% y-o-y). Adjusted revenues (net of subcontractors' charges) were up 32% y-o-y to RUB18.5bn. As revenue-generating transportation volumes grew 11.2%, revenues also benefited from significant price growth.
- H119 EBITDA grew 67% to RUB9.4bn with margins expanding to 50.7% from 40.0% one year earlier. We believe this expansion was driven by economies of scale and other efficiency gains, including a higher proportion of containers transported in block trains, for which TransContainer receives a discount from Russian Railways as these trains take up less capacity on the railway.
- H119 profit before tax grew 91% to RUB7.7bn thanks to slower growth in adjusted operating expenses (+11% y-o-y) than revenues.
- H119 net income almost doubled to 6.1bn (vs RUB3.2bn one year earlier).

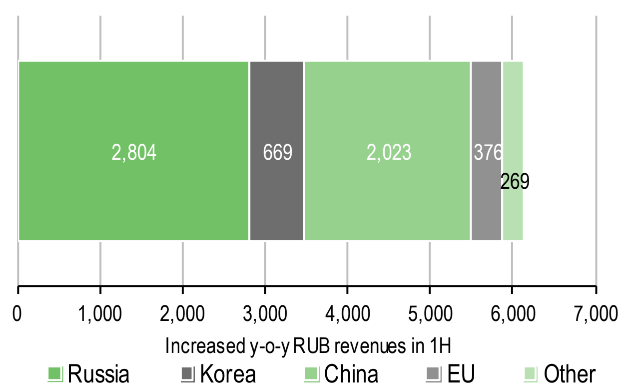
Based on TransContainer data, the H1 growth was strengthened by a strong pick-up in orders from South Korea and China. While Russia represents 80% of H119 total sales (Exhibit 1), it explains only 46% of the year-on-year sales increase (Exhibit 2), with the rest of the growth driven mostly by China and South Korea.

Exhibit 1: H1 total sales split by client location



Source: TransContainer data, Edison Investment Research

Exhibit 2: Increase in H1 total sales by client location



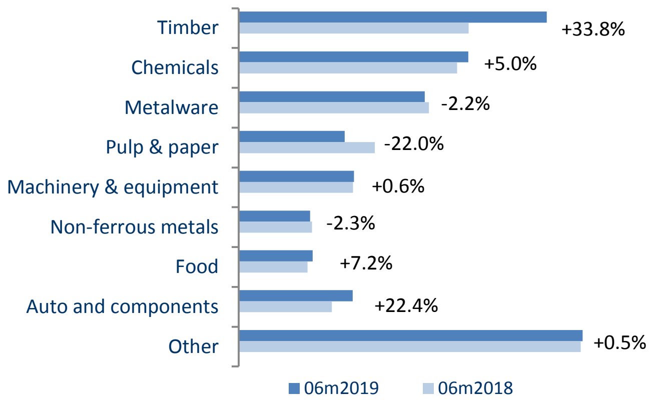
Source: TransContainer data, Edison Investment Research

Macroeconomic and industry context

TransContainer's ability to attract orders outside of Russia is sustaining its growth while the domestic economy is weak. Both the market and TransContainer benefited from strong cyclical growth in certain industries, such as the timber (+34% y-o-y transported volumes for

TransContainer) and auto and components industries (+22% y-o-y), which represent a large portion of the volumes transported albeit a limited share of Russian GDP (timber volumes represent c 20% of TransContainer's volumes, while auto and components c 7%).

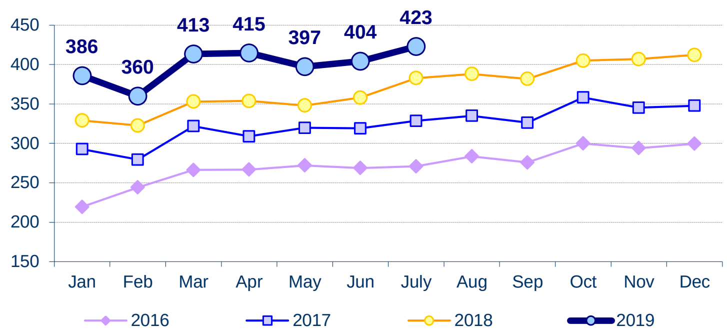
Exhibit 3: Percentage change in transported volumes by type of cargo



Source: TransContainer

Total volumes for Russian rail container transportation increased significantly in H1 (+15.1% y-o-y) and July rail container volumes were up 10.5% y-o-y (Exhibit 4). The growth rate is well above the historical CAGR of 9.3% (2001–18). TransContainer maintains the highest market share in rail-based container transportation in Russia, with a 42% share in H119, albeit this reduced three percentage points vs the previous year.

Exhibit 4: Russian monthly rail container transportation volumes



Source: TransContainer, RZD Information Centre

The strong growth in transported volumes and TransContainer's business is at odds with the evolution of the Russian economy. Russian GDP grew by only 0.9% y-o-y in Q2, only slightly stronger than Q1's +0.5% y-o-y. With slow economic growth and a slowdown in inflation, the Russian central bank cut interest rates again at the end of July and once more in September. Most forecasts expect a rebound in economic growth next year, thanks to increased government spending as Russia targets an extra RUB25.7tn (c US$390bn) by 2024 to boost infrastructure, healthcare and education. However, there are significant uncertainties around the timing of the increased government spending. In this respect, TransContainer's ability to grow internationally through increased sales to other Asian customers (mostly China) increases the resilience of its business model and reduces risks for the company.

In addition to the cyclical drivers set out above, we believe TransContainer continues to enjoy structural growth from containerisation, which we believe should support revenue and profit growth for the company in the coming years. Currently, only c 7% of Russia's potentially containerisable rail cargo is transported in containers, and although this figure rose from 2.2% in 2001, it is still much lower than in the US (18%), India (16%) and Europe (14%).

Even though timber transport volumes were a key driver for TransContainer in H1, we note that the Russian government has recently threatened to ban timber exports to China unless the country cooperates to mitigate the impact of illegal timber logging in Russia (Reuters 15 August 2019); reduced timber exports would have a negative impact on TransContainer's business (these volumes represent c 20% of volumes transported in H119). We currently assume no impact from the potential export ban.

Forecasts increased significantly

We previously expected a moderation in revenue growth in the remaining quarters of FY19, reflecting the risks from a slowing Russian economy, but growth continued to be very strong in Q2 and ahead of our expectations. TransContainer has consistently beat our forecasts over the last 12 months and we increase our forecasts again following the recent results.

Exhibit 5: Forecasts changes

RUBm		2018	2019e	2020e
Adjusted revenue	New	31,288	40,229	47,858
	Old		36,480	41,090
	% change		10%	16%
EBIT	New	10,415	17,779	23,122
	Old		14,304	16,901
	% change		24%	37%
Net income	New	9,509	13,456	17,396
	Old		10,445	12,072
	% change		29%	44%
Net debt	New	1,779	7,661	10,415
	Old		8,256	17,064
	% change		-7%	-39%

Source: TransContainer data, Edison Investment Research

We believe the structural trend towards containerisation should continue to support growth. However, our forecasts reflect some moderation in growth rates vs H1 (+32% y-o-y) to reflect the risks to the Russian economy and the likely stabilisation in rail container transportation prices. We project 26% adjusted revenue growth in H219 and a 16% increase in FY20.

Valuation: DCF increased to RUB9,460 a share

TransContainer's share price has continued to rise since the Q1 results and has now roughly doubled year-to-date. We believe the recent strong results and the increase in future earnings expectations were the key drivers. However, the share price rise was not accompanied by a visible re-rating, with the stock trading still at c 9x 2019e P/E, at roughly the same level as the end of 2018. Hence, despite the share price rise, the stock remains at a discount to peers in both emerging markets and developed markets. We believe at least part of the discount to international peers reflects the stock's limited liquidity, as well as higher perceived country risk. In this respect, we note that Russian Railways plans to sell a 50% stake in TransContainer to a Russian investor at an upcoming auction set for 27 November 2019. If the sale results in an increased free float for the stock, we would see room for a re-rating.

Following our forecasts revisions, we have significantly increased our DCF-based valuation to RUB9,460/share (from RUB7,100/share). Our valuation methodology (DCF) and assumptions are unchanged, with WACC of 10.4% and a terminal growth rate of 1% (we obtain an EV of RUB139.1bn and an equity value of RUB131.4bn). Our valuation implies 6.5x FY19e EV/EBITDA and 9.6x P/E.

The key downside and upside risks for the stock are a slowdown or pick-up in economic activity in Russia and rail container transportation volumes and, globally, higher or lower profit margins.

Exhibit 6: Financial summary

RUBm	2017	2018	2019e	2020e
Year end 31 December	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	27,782	31,288	40,229	47,858
EBITDA	10,252	13,342	21,542	27,599
EBIT	7,495	10,415	17,779	23,122
Operating Profit (before amort. and except.)	7,495	10,415	17,779	23,122
Intangible Amortisation	0	0	0	0
Exceptionals	306	1,715	(216)	0
Other	704	268	300	318
Operating Profit (post exceptionals)	8,505	12,398	17,863	23,440
Net Interest	(333)	(420)	(831)	(1,419)
Profit Before Tax (norm)	8,147	10,263	17,248	22,021
Profit Before Tax (FRS 3)	8,213	11,978	17,032	22,021
Tax	(1,638)	(2,469)	(3,577)	(4,624)
Profit After Tax (norm)	6,228	7,794	13,672	17,396
Profit After Tax (FRS 3)	6,575	9,509	13,456	17,396
Average Number of Shares Outstanding (m)	13.9	13.9	13.9	13.9
EPS - normalised (RUB)	448.2	560.9	983.9	1,252.0
EPS - normalised fully diluted (RUB)	448.2	560.9	983.9	1,252.0
EPS - (IFRS) (RUB)	473.2	684.4	968.4	1,252.0
Dividend per share (RUB)	293.0	480.4	484.2	626.0
EBITDA Margin (%) (company definition)	36.9	42.6	53.5	57.7
Operating Margin (before GW and except.) (%)	27.0	33.3	44.2	48.3
BALANCE SHEET				
Fixed Assets	45,983	52,139	66,076	80,742
Intangible Assets	384	269	269	269
Tangible Assets	42,196	48,500	62,437	77,103
Investments	3,403	3,370	3,370	3,370
Current Assets	9,756	15,973	17,815	19,387
Stocks	287	222	285	340
Debtors	1,323	1,744	2,242	2,668
Cash	4,171	9,527	9,527	9,527
Other	3,975	4,480	5,760	6,853
Current Liabilities	(7,493)	(8,246)	(8,525)	(8,762)
Creditors	(6,068)	(7,920)	(8,199)	(8,436)
Short term borrowings	(457)	(931)	(931)	(931)
Long Term Liabilities	(7,879)	(13,805)	(19,687)	(22,441)
Long term borrowings	(4,987)	(10,980)	(16,862)	(19,616)
Other long term liabilities	(2,892)	(2,825)	(2,825)	(2,825)
Net Assets	40,367	46,061	55,679	68,925
CASH FLOW				
Operating Cash Flow	10,670	14,267	22,484	28,718
Net Interest	(440)	(268)	(831)	(1,419)
Tax	(1,483)	(2,144)	(3,577)	(4,624)
Capex	(6,974)	(6,166)	(17,700)	(19,143)
Acquisitions/disposals	33	(1,868)	0	0
Financing	92	372	416	441
Dividends	(650)	(4,072)	(6,675)	(6,728)
Net Cash Flow	1,248	121	(5,882)	(2,754)
Opening net debt/(cash)	3,534	2,241	1,779	7,661
HP finance leases initiated	0	0	0	0
Other	45	341	0	0
Closing net debt/(cash)	2,241	1,779	7,661	10,415

Source: Company data, Edison Investment Research

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