EDISON

TransContainer

Q3 results update

Growth accelerating in Q3, forecasts raised

General industrials

TransContainer delivered a significant step-up in revenue and EBITDA growth in Q3, supported by industry growth, higher efficiencies and a more favourable business mix. We have increased our FY18 forecasts to reflect the strong Q3 results (revenue, EBITDA and net income forecasts rise by 4%, 15% and 26% respectively) and made more modest increases to our FY19 and FY20 forecasts. Our DCF valuation increases by 4% to RUB5,400/share, implying 20% potential upside to the current share price.

Year end	Revenue (RUBm)	PBT* (RUBm)	EPS* (RUB)	DPS (RUB)	P/E (x)	Yield (%)
12/16	21,988	4,302	247.5	46.8	18.3	1.0
12/17	27,782	8,195	471.6	293.0	9.6	6.5
12/18e	30,249	10,033	577.6	296.6	7.8	6.5
12/19e	33,313	10,318	564.3	282.2	8.0	6.2

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

Q3 results show strong acceleration in growth

Revenue and profit growth rates accelerated over the course of Q318 with TransContainer reporting adjusted revenue growth of 13% y-o-y vs H1 growth of 8% y-o-y. Economies of scale, a more favourable revenue mix and efficiencies have also contributed to a large pick-up in margins, with Q3 EBITDA margin of 64% vs 41% in H1. The proportion of group revenues from the higher value-added Integrated Freight Forwarding and Logistics Services increased materially, to 82.0% from 74.5% in the same period of FY17, although the transition is stabilising in Q3 (proportion of integrated logistics revenues was similar to the level seen in Q317).

Forecasts raised, industry outlook supportive

We have raised our forecasts following the better-than-expected Q3 results. We have increased our FY18 revenue, EBITDA and net income forecasts by 4%, 15% and 26% respectively, while we have made more modest increases to our FY19 and FY20 forecasts. Containerisation is a structural trend for the Russian market and should support revenue and profit growth for TransContainer, in our view. Currently, only 6.2% of Russia's potentially containerisable rail cargo is actually 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%). In terms of economic outlook, while GDP growth forecasts for Russia remain supportive (World Bank estimates +1.8% for both 2019e/20e), we believe the recent tension with Ukraine represents the largest risk to economic growth in the country.

Valuation increased to RUB5,400/share

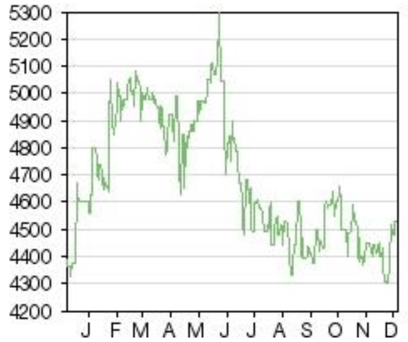
On respective FY18/19e P/E multiples of 7.8x/8.0x and EV/EBITDA multiples of 4.8x/4.5x, TransContainer is trading at a substantial discount to international peers, both in emerging markets and developed markets. We believe at least part of the discount reflects the limited liquidity as well as a higher perceived country risk. We have raised our DCF valuation by 4% to RUB5,400/share, from RUB5,200/share, reflecting the higher forecasts.

6 December 2018

Price	**RUB4,530**
Market cap	**RUB63bn**

Net debt (RUBbn) at end Q318	2.04
Shares in issue	13.9m
Free float	0.66%
Code	TRCN
Primary exchange	MICEX
Secondary exchange	LSE

Share price performance



%	1m	3m	12m
Abs	1.8	3.5	4.1
Rel (local)	(1.0)	(1.7)	(10.0)
52-week high/low		RUB5295	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 event

FY results publication	March 2019 (TBC)

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Edison profile page

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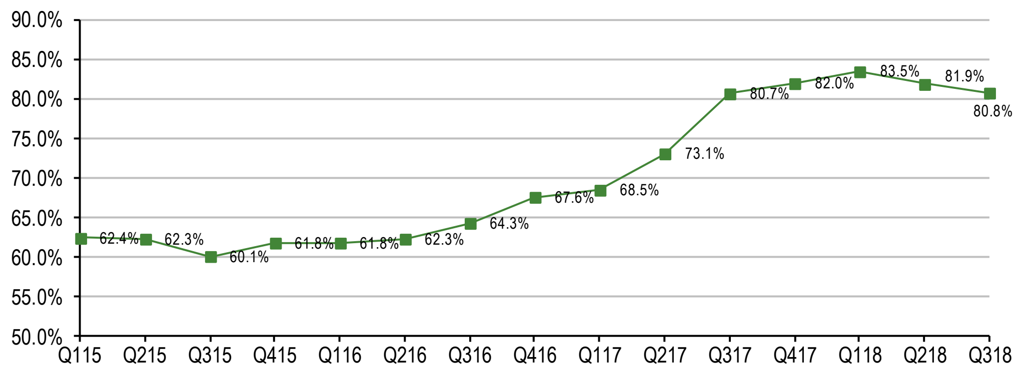
9M results show revenue/earnings growth acceleration

TransContainer presented its IFRS Q318 results on 28 November 2018, which showed revenue and profit growth accelerated over the course of the quarter. Q3 adjusted revenue growth was 13% y-o-y vs H1 growth of 8% y-o-y. Economies of scale, a more favourable revenue mix and efficiencies have also contributed to a large pick-up in margins, with a Q318 EBITDA margin of 64% vs 41% in H118. We detail the key takeaways below:

9M adjusted revenues of RUB22.4bn, +9.7% y-o-y benefitted from a 5% pick-up in overall transportation volumes and a shift in demand towards more value-added Integrated Freight Forwarding and Logistics Services (revenues up 20.7% y-o-y), away from basic point-to-point transportation. As of 9M18, the proportion of group revenues from Integrated Freight Forwarding and Logistics Services increased materially, to 82.0% vs 74.5% in the same period of FY17. However, looking at quarterly development, the trend softened in Q318 with the proportion of integrated logistics revenue at a similar level to Q317 (Exhibit 1)

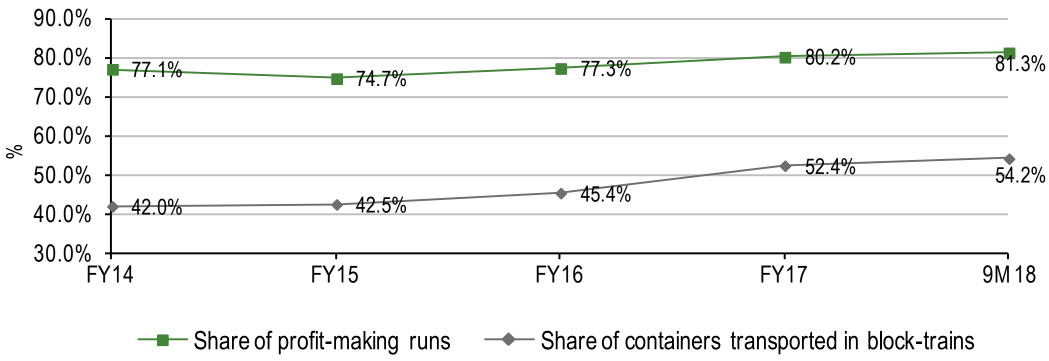
Exhibit 1: Integrated logistics revenues as a % of group revenues



Source: Company data

9M EBITDA increased by 25.4% y-o-y to RUB11.21bn. The 9M EBITDA margin increased to 50.0% from 43.7% at 9M17. We believe this expansion was driven by economies of scale (overall increase in transportation volumes of 5% y-o-y), a shift to higher-margin integrated services activities (representing 82% of group revenues from 74.5%) and efficiencies, including an increase in the share of 'profit-making' runs (81.3% in 9M18 vs 80.3% in 9M17), as well as 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 (Exhibit 2). Labour productivity has also improved with the number of personnel down 0.5% y-o-y. Overall adjusted operating expenses increased by 2.3%, well below adjusted revenue growth of 9.7%.

Exhibit 2: Efficiencies contributed to margin expansion



Source: Company data

- **9M net income of RUB6.64bn, +28% y-o-y** was driven by EBITDA growth, in part offset by moderate growth in financial expenses and D&A.
- **9M net debt remained low at RUB2.04bn** (vs RUB2.25bn at H1), implying 0.14x net debt/EBITDA.

Outlook and forecasts changes

Containerisation should continue to support growth

Containerisation is a structural trend for the Russian market and should support revenue and profit growth for TransContainer, in our view. Currently, only 6.2% 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%). There are a number of factors that are boosting containerisation in Russia: 1) the switch from road transport to rail containers, especially over long distances; 2) growing international trade with countries where containerisation is more popular; 3) technological progress, eg handling technologies; 4) as old stock is upgraded, boxcars are being replaced with containers; and 5) the pricing policies of Russian Railways are making the switch to containers more attractive for certain products, such as aluminium and bulk liquids, and for some routes, such as Trans-Siberian.

In terms of economic backdrop, the outlook for the Russian economy is relatively positive. The World Bank expects Russia GDP to grow 1.8% in both 2019 and 2020 (vs +1.5% in 2018). However, recent renewed tension with the Ukraine poses one of the biggest risks to these forecasts, especially if the possibility of further sanctions re-emerges.

Forecasts: We raise our FY18/20 forecasts

Following Q3 results that were above our expectations, we have increased our forecasts for revenues and profits. For FY18e, we have incorporated the strong Q3 results and raised our Q4 expectations. Overall, our FY18 revenue, EBITDA, net income forecasts rise by 4%, 15% and 26% respectively. In addition, we have made more moderate increases to our forecasts for FY19 and FY20 (revenues up 1%, EBITDA up 4%, net income up 11%/12%), mainly to reflect higher margins than we expected previously following the very high levels achieved in Q3. Our forecasts continue to conservatively incorporate a slight reduction in margins going forward (EBITDA margins of 46% in FY19/20 vs the 50% achieved in 9M18).

Exhibit 3: Changes to forecasts

Year end December (RUBm)		2017	2018e	2019e	2020e
Adj. revenue	**NEW**	**27,782**	**30,249**	**33,313**	**36,822**
	OLD	27,782	29,031	32,890	36,458
	% change	*0%*	*4%*	*1%*	*1%*
EBITDA	**NEW**	**11,474**	**14,286**	**15,171**	**17,118**
	OLD	11,474	12,375	14,527	16,478
	% change	*0%*	*15%*	*4%*	*4%*
Operating profit (company definition)	**NEW**	**7,760**	**10,122**	**11,046**	**12,612**
	OLD	7,760	8,965	10,781	12,379
	% change	*0%*	*13%*	*2%*	*2%*
Net Income (company definition)	**NEW**	**6,534**	**8,242**	**7,841**	**8,228**
	OLD	6,534	6,534	7,019	7,439
	% change	*0%*	*26%*	*12%*	*11%*
Net debt	**NEW**	**2,241**	**5,331**	**17,564**	**27,566**
	OLD	2,241	8,179	19,989	30,025
	% change	*0%*	*(35%)*	*(12%)*	*(8%)*
DPS	**NEW**	**293**	**297**	**282**	**296**
	OLD	293	235	253	268
	% change	*0%*	*26%*	*12%*	*11%*

Source: Company data, Edison Investment Research

We now forecast adjusted revenue CAGR of 10% (2018-20e) and a slightly lower EBITDA CAGR of 9%, reflecting a normalisation in margins. At the bottom line, this growth is offset by an increase in financial expenses (we expect a material increase in net debt reflecting significant new investments) and a slightly higher tax rate. Management has previously said that capex will increase over the next three years, mainly invested in new flatcars, to support an improved trading outlook (spending on flatcars stopped during the last recession).

Exhibit 4: Revenue breakdown

Activity (RUBm)	FY16	FY17	FY18e	FY19e	FY20e
Integrated freight forwarding and logistics services			71,274	81,109	92,465
Agency fees			1,225	1,298	1,363
Other			2,822	2,737	2,600
Total (IFRS definition)	**51,483**	**65,567**	**75,320**	**85,144**	**96,428**
Growth		27%	15%	13%	13%
Third-party charges related to principal activities	(29,495)	(37,785)	(45,071)	(51,831)	(59,606)
Total (company definition)	**21,988**	**27,782**	**30,249**	**33,313**	**36,822**
Growth levels					
Integrated freight forwarding and logistics services			25%	14%	14%
Agency fees			N/A	6%	5%
Other			(57%)	(3%)	(5%)
Total (IFRS definition)		**27%**	**15%**	**13%**	**13%**
Third-party charges related to principal activities		28%	19%	15%	15%
Total (company definition)		**26%**	**9%**	**10%**	**11%**

Source: Company data, Edison Investment Research

Valuation increased to RUB5,400/share

Trading at 7.8x/8.0x P/E and 4.8x/4.5x EV/EBITDA for 2018e/19e, TransContainer is at a large discount to international peers, both in emerging markets and developed markets. We believe at least part of the discount reflects the limited liquidity of the stock as well as the higher perceived country risk, which results in Russian equities usually trading at a discount to global equities.

We have raised our valuation by 4% to RUB5,400/share, from RUB5,200/share, reflecting our higher forecasts. The valuation is based on a DCF methodology, with unchanged assumptions of a WACC of 10.4% and a terminal growth rate of 1% (we obtain an EV of RUB80.4bn and an equity value of RUB75.0bn). As sensitivity, a WACC that is higher/lower by two percentage points reduces/increases the valuation to RUB4,100/7,500 per share. Key risks to our valuation are a stronger/weaker economic environment, higher/weaker than expected earnings margins and higher/lower than expected structural growth of the industry.

Exhibit 5: Financial summary

December year end (RUBm)	2016	2017	2018e	2019e	2020e
	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	21,988	27,782	30,249	33,313	36,822
EBITDA (company definition)	7,099	11,474	14,286	15,171	17,118
EBITDA	7,046	11,196	13,589	14,871	16,818
Operating Profit (before amort. and except.)	3,849	7,735	9,848	11,046	12,612
Intangible Amortisation	0	0	0	0	0
Exceptionals	(223)	25	274	0	0
Other	669	704	659	494	524
Operating Profit	4,295	8,464	10,781	11,540	13,136
Net Interest	(216)	(333)	(474)	(1,222)	(2,310)
Profit Before Tax (norm)	4,302	8,195	10,033	10,318	10,826
Profit Before Tax (FRS 3)	4,079	8,172	10,307	10,318	10,826
Tax	(835)	(1,638)	(2,219)	(2,476)	(2,598)
Profit After Tax (norm)	2,798	5,764	7,155	7,347	7,704
Profit After Tax (FRS 3)	3,244	6,534	8,088	7,841	8,228
Average Number of Shares Outstanding (m)	13.8	13.9	13.9	13.9	13.9
EPS - normalised (RUB)	247.5	471.6	577.6	564.3	592.2
EPS - normalised and fully diluted (RUB)	247.5	471.6	577.6	564.3	592.2
EPS - (IFRS) (RUB)	234.7	470.2	582.1	564.3	592.2
Dividend per share (RUB)	46.8	293.0	296.6	282.2	296.1
EBITDA Margin (%) (company definition)	32.3	41.3	47.2	45.5	46.5
Operating Margin (before GW and except.) (%)	17.5	27.8	32.6	33.2	34.3
BALANCE SHEET					
Fixed Assets	40,822	45,983	55,058	71,381	86,110
Intangible Assets	290	384	384	384	384
Tangible Assets	37,847	42,196	51,271	67,594	82,323
Investments	2,685	3,403	3,403	3,403	3,403
Current Assets	11,006	9,756	10,264	10,880	11,585
Stocks	209	287	312	344	380
Debtors	1,605	1,323	1,440	1,586	1,753
Cash	5,603	4,171	4,183	4,183	4,183
Other	3,589	3,975	4,328	4,766	5,268
Current Liabilities	(8,372)	(7,493)	(7,898)	(8,401)	(8,977)
Creditors	(5,592)	(6,068)	(6,473)	(6,976)	(7,552)
Short term borrowings	(399)	(457)	(457)	(457)	(457)
Long Term Liabilities	(8,947)	(7,879)	(10,981)	(23,214)	(33,216)
Long term borrowings	(6,357)	(4,987)	(8,089)	(20,322)	(30,324)
Other long term liabilities	(2,590)	(2,892)	(2,892)	(2,892)	(2,892)
Net Assets	34,509	40,367	46,443	50,645	55,501
CASH FLOW					
Operating Cash Flow	7,421	10,670	13,433	14,994	16,976
Net Interest	(165)	(440)	(474)	(1,222)	(2,310)
Tax	(781)	(1,483)	(2,219)	(2,476)	(2,598)
Capex	(2,277)	(6,974)	(12,100)	(19,655)	(18,411)
Acquisitions/disposals	28	33	0	0	0
Financing	1,024	92	2,329	247	262
Dividends	(4,830)	(650)	(4,071)	(4,121)	(3,921)
Net Cash Flow	420	1,248	(3,102)	(12,233)	(10,002)
Opening net debt/(cash)	3,663	3,534	2,241	5,331	17,564
HP finance leases initiated	0	0	0	0	0
Other	(291)	45	12	0	(0)
Closing net debt/(cash)	3,534	2,241	5,331	17,564	27,566

Source: Company accounts, Edison Investment Research

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