FitchRatings

Fitch Revises Globaltrans's Outlook to Positive; Affirms at 'BB+'

Fitch Ratings - Moscow - 13 December 2018: Fitch Ratings has revised freight rail transportation company Globaltrans Investment Plc's (GLTR) Outlook to Positive from Stable while affirming the company's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BB+'.

The Positive Outlook reflects Fitch's expectations that GLTR will maintain its robust financial profile with funds from operations (FFO) adjusted net leverage at below 1.5x, despite high capex and shareholder distributions as well as expected market rates correction from 2020. The ratings incorporate GLTR's position as one of the leading commercial rolling-stock operators, with a market share of around 7% of Russian freight rail turnover in 1H18, and its exposure to cyclical commodity industries. An upgrade is likely if the company maintains its prudent financial policy in spite of the highly cyclical nature of the sector.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
Globaltrans Investment Plc	LT IDR BB+ Affirmed		BB+
	LC ST IDR B Affirmed		B
	LC LT IDR BB+ Affirmed		BB+
	ST IDR B Affirmed		B
Joint-stock company New forwarding company			
senior unsecured	LT BB+ Affirmed		BB+

KEY RATING DRIVERS

Robust Financial Profile: We expect GLTR to maintain a robust financial profile with an estimated funds from operations (FFO) net adjusted leverage well below 1.5x (0.9x in 2017) on average and strong FFO fixed charge coverage over 2018-2022, due to a low debt burden. This is based on Fitch's assumptions of moderate growth of freight rail turnover and expected decline in freight rates from 2020, together with average annual investments above the company's maintenance capex and continued payment of high dividends from 2018, above the company's dividend policy.

Positive FCF Before Dividends: We expect GLTR to continue generating positive free cash flow (FCF) before dividends in 2018-2022, due to significantly flexible capex, which we still expect to be significant. We assume slightly higher-than- average annual investments of around RUB10 billion over 2018-2022, which is well above the historical annual average of RUB3 billion over 2014-2017. We also assume a dividend payout ratio of above 70% over 2018-2022 , which is above the company's dividend policy and could result in FCF (after dividend) turning negative.

Prudent Financial Policy: GLTR's dividend policy provides a clear formula-linked mechanism, which is leverage-driven and flexible depending on the company's financial needs. GLTR is not exposed to FX fluctuations as only a negligible share of operating expenses is denominated in foreign currencies. At end-1H18, all of its debt was denominated in roubles and interest rates were fixed, eliminating FX or interest rate risk. Following the placement of a RUB5 billion five-year bond issued by joint-stock company New forwarding company (100% subsidiary of Globaltrans) in February 2018, GLTR's overall effective interest rate improved to 7.9% at end-1H18 (9.4% in 2017).

Profitability Offsets Turnover Declines: GLTR's adjusted EBITDA margin improved to 55% in 1H18 (1H17: 48%). In 1H18, adjusted revenue increased 19% yoy to RUB30.1 billion while total operating cash costs increased only 2%. Despite faltering turnover (tonnes per km), earnings growth was supported by the continued recovery of gondola rates from 2016, together with an improving capacity balance in the market. GLTR benefited from the ban on the use of old railcars from 2016 as its railcars are relativity young with an average age of 10.1 years and 14 years for gondolas and rail tank cars at end-1H18, respectively, compared with an average useful life of 22 years and 32 years.

Volumes and Turnover Temporarily Weaken: Given the healthy dynamics of the Russian freight rail market, Fitch expects GLTR's freight rail turnover and volumes will grow in the medium term, albeit at a slower rate than during 2016-2017 as we forecast Russian GDP to increase 1.5%-1.9% in 2019-2022. Its turnover and volumes have been weak in 2018 due mainly to the company's fleet rebalancing, which saw GLTR return leased-in railcars in a decision to expand own fleet instead. The timing difference in the delivery of railcars led to a temporary drop in average operated rolling stock by 3% yoy in 1H18, exacerbated by changed client logistics. Overall, the Russian freight rail market continued to grow 4.3% and 2.4% yoy in turnover and volume, respectively, in 10M18.

Focus on Higher-Priced Cargoes: GLTR focuses on transportation of higher-priced cargo categories, including oil products & oil and metallurgical cargoes, which accounted for 72% of net revenue from operation of rolling stock and 68% of total freight rail turnover in 1H18. However, we expect oil and oil products transportation to remain under pressure from increased competition from new/existing pipelines and decrease in overall volumes of oil products. Transportation of coal accounted for 16% of revenue and 21% of turnover.

Long-Term Contracts Add Visibility: The operations under medium- to long-term contracts with good credit quality counterparties contributed 55% of net revenue as of 1H18, which increases cash-flow visibility and secures the use of the company's rail fleet. However, GLTR remains exposed to volume risk as several agreements fix only the percentage of customer freight rail transportation needs, but not actual volumes. GLTR's key customers are the large Russian industrials, such as Rosneft, OJSC Magnitogorsk Iron & Steel Works (MMK, BBB-/Stable) and AO Holding Company Metalloinvest (BB/Positive). The company has recently signed five-year service contracts with two other clients, TMK and PJSC Chelyabinsk Pipe Plant (BB-/Stable). However, the company remains fully exposed to price risk.

Large Operator: GLTR is one of the largest freight railcar transportation groups in Russia by volume (tonnes-km) with around a 7% market share in 1H18. It focuses on transportation of higher-priced cargo, including metallurgical cargo and oil products, and owns a relatively young rail fleet of over 62,000 railcars, with lower maintenance and fleet renewal costs than sector peers.

DERIVATION SUMMARY

GLTR's close competitor is Fitch-rated Russian rolling stock operator JSC Freight One. Freight One benefits from both a larger size and market share of 13% vs. GLTR's around 7% in total Russian freight rail transportation. However, GLTR's rating benefits from the company's competitive position due to the focus on transportation of higher priced cargo, including metallurgical cargo and oil products, and from ownership of a relatively young rail fleet (11 years vs. almost 16 years for Freight One). This results in higher efficiency and an adjusted EBITDA margin for GLTR of above 40% on average over 2014-2017, compared with Freight One's average 30%. Both GLTR's and Freight One's ratings are supported by the companies' similar forecast financial profiles and medium- to long-term contracts with major clients. We view GLTR's group structure as more complex than that of Freight One.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Domestic GDP growth of 1.5%-2% over 2018-2022
- Inflation of 2.9%-4.6% over 2018-2022
- Freight transportation rates to increase above inflation in 2018 but to decline 10% in 2020 and a further 5% in 2021
- Elevated capex to continue in 2018-2022
- Dividends above company's dividend policy over 2H18-2022
-We applied a blended 4x multiple for railcars and 6x multiple (standard for Russia) for other assets. For railcars we capitalised a lower, base level of operating lease expenses reflecting the flexibility of operating-lease contracts, which can be dissolved at relatively short notice and the company's demonstrated ability to manage lease costs to match the stage of the business cycle. This resulted in a lower blended multiple of 4x for railcars.
- Adjustments to 2017 financials relate primarily to non-cash items such as loss on sale of PP&E and impairment of PP&E.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- Further diversification of the customer base, lengthening of contract duration with better volume visibility and lower rate volatility
- Sustainable market share in fleet numbers and consequently transported volumes and revenue, allowing greater efficiency
- Maintenance of FFO net adjusted leverage below 1.5x and FFO fixed charge cover above 5x on a sustained basis

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- Inability to maintain FFO lease-adjusted net leverage below 1.5x and FFO fixed charge coverage

above 5x would lead to a revision of the Outlook to Stable from Positive
- A sustained rise in FFO lease-adjusted net leverage above 2x and FFO fixed charge cover of below 3x
- Unfavourable changes to the Russian legislative framework for the railway transportation industry

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: We view GLTR's liquidity position as adequate. As of 1H18 GLTR's cash and cash equivalents were RUB6.2 billion and, together with unused credit facilities of RUB4.2 billion available to subsidiaries with a drawdown period over one year, were sufficient to cover short-term maturities of RUB5.5 billion. We estimate that FCF (after dividends) may turn negative in 2018-2019 due to high dividend payment, although the company's dividend policy remains flexible.

Additional information is available on www.fitchratings.com

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Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018) (/site/re/10023785)
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018) (/site/re/10024585)
Country-Specific Treatment of Recovery Ratings Criteria (pub. 16 Apr 2018) (/site/re/10026835)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (/site/dodd-frank-disclosure/10055449)

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