

Olga Belenkaya, belenkayao@sovlink.ru

TransContainer – planned privatization as a potential value driver

BUY
Target price GDR: US\$ 11.12
Upside: 17%
Stock data

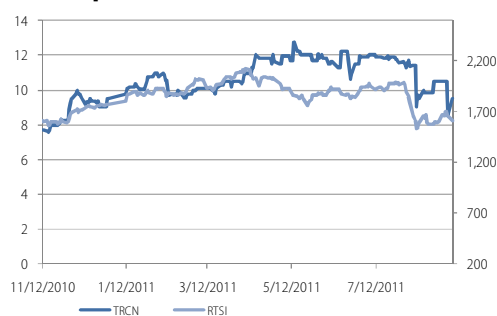
Ticker	TRCN	M.Cap, \$ mn	1320
Shares Outstanding	13894778	Free Float in GDRs, %	16.6
Shares Preferred		Free Float, \$ mn	219
Bid Ords, \$	97	Offer Ords, \$	102
Bid GDR, \$	9.4	Offer GDR, \$	9.9

Market performance

		1 month	6 months
Absolute, %	GDR	-16.7%	-5.9%
Relative to RTSI, %	GDR	-6.6%	14.2%
Price range, \$			
High	GDR	11.4	12.7
Low	GDR	8.5	8.5

Financials, 2011E

Revenue, \$ mn	812	EV/S	1.9
EBITDA, \$ mn	202	P/E	19.9
Net income, \$ mn	64	EV/EBITDA	7.4

Relative performance


Source: RTS

TRCN

Initiation of coverage

TransContainer is a core subsidiary of Russian Railways (RZD) with business focus on container transportation. The company owns a network of terminals in Russia and has a presence in Europe, CIS and Asia.

TransContainer holds 52% market share of all ISO containers transported via rail in Russian Federation. Company has illustrated solid transportation volume growth adding 9,5% in 2010, and 18,3% in 1H11. This upward trend was mainly driven by a hike in export and import transportation services.

Privatization plans assume sale of Russian Railways and its subsidiaries stakes in several years: Freight One – 75%-2 shares (planned for 2011), TransContainer – 25% or 50% (2011-12), RZD – up to 25%-1 share (after 2013). RZD Board of directors preliminary adopted sale of 25%+1 share at an auction with estimated value of stake standing at 10,7 bln Rub (close to current market value), subject to subsequent confirmation of the Russian government. However, Ministry of transport intends that RZD sells 50% of TRCN. In the most likely scenario, we expect for the stake sale to be initiated sometime next year.

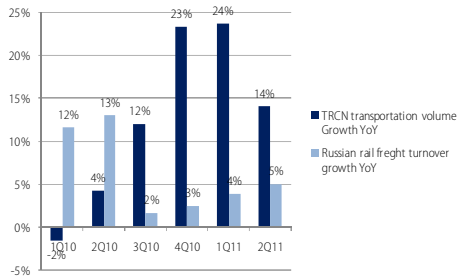
We deem the planned privatization of Russian Railways assets to become a robust value catalyzer for TransContainer shares, as the news indicate rather solid interest from the strategic investors in the control stake of Russian Railways subsidiaries. While the most probable bidder for a control stake in TransContainer is Far Eastern Shipping Company (FESCO), already retaining 12,5% of TRCN shareholders' capital, the other major rail freight operator, GlobalTrans, has also indicated its interest to acquire TransContainer's assets.

In November 2010 company launched an IPO of 36%-2 shares, stocks are currently listed on LSE, RTS, and MICEX. Key shareholders – RZD (50%+2 shares), EBRD (9,25%), FESCO (12,5%), others (11,6%), free float in GDRs is estimated at 16,6%. The current market price is 19% above the company's initial offering price level.

The privatization efforts of the Freight One, planned for October 2011, have generated solid interest from strategic investors. Interfax had indicated 4 potential bidders for Freight One - NTK (owned by V. Lysin), Globaltrans, Neftetransservice, Transoil (G. Timchenko); Summa Group has also declared its interest in the stake. In April RZD Board of directors estimated the value of stake to stand at \$4 bln. On Sep 5 Russian Railways CEO Mr. Yakunin announced that the final estimate for Freight One is 10% higher than the initial appraisal. Nonetheless, in June the CEO of GlobalTrans, Sergey Maltsev stated his interest to potentially purchase 75% of the Freight One for 6 \$bln. It means that in case the competition for the stake will remain strong and Freight One will be sold at a significantly higher price than was originally estimated, it may serve as a benchmark for higher TransContainer valuation.

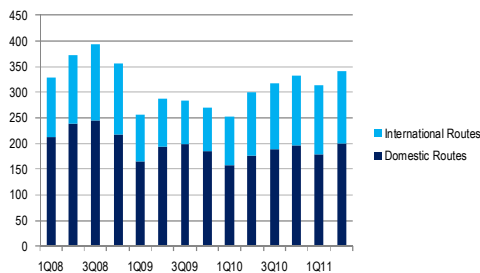
On a standalone basis, we estimate the target price of TransContainer at \$11.12 per GDR which implies 17,1% upside to current market price, recommendation "BUY"

Fig 1 TransContainer transportation volume and Russian rail freight turnover growth, YoY



Source – Rosstat, Company data

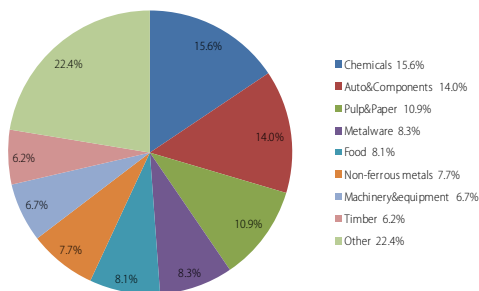
Fig 2 TransContainer transportation volume, 000 TEU



Source – Company data

* TEU - Twentyfoot Equivalent Unit

Fig 3 TransContainer transportation by types of cargo



Source – Company data

Operating results

Company's transportation volume increased by 18,3% in 1H11 as compared to 1H10, reflecting overall market recovery and growth in external trade volumes. The total domestic transportation volume increased by 13,4% in 1H11, whereas the export and import volumes went up by 26% and 31%, correspondingly.

In recent quarters the company has demonstrated transportation volume growth, exceeding the industry performance (Fig 1).

The key types of cargo – auto&components, chemicals, pulp and paper, food, metals. Among company's top clients are Volkswagen, RUSAL, Fintrans, UNICO, Sollers, TagAZ, and Lebedyanskiy.

TransContainer has also improved its asset utilization – empty-run ratio in 1H11 decreased comparing with 1H10: for containers – from 39,9% to 35,7%, for flatcars from 9,0% to 8,7%.

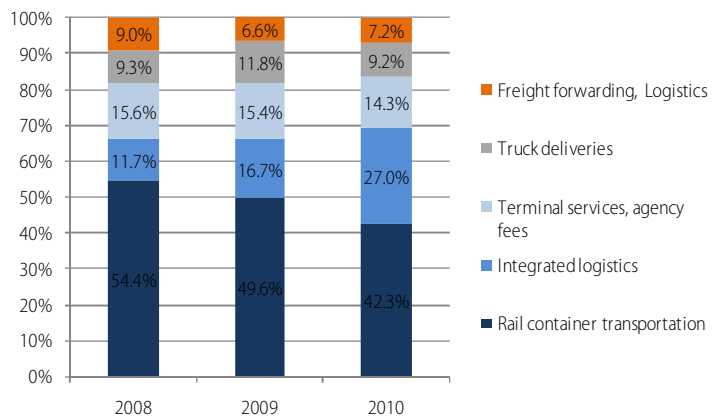
Company actively renews its flatcar fleet by lowering the average fleet age from 20,8 years as of the end of 2008 to 17,5 years by 1Q11. Simultaneously, the company improves the fleet capacity structure by increasing the share of most efficient 80 ft platforms, and via investing in container terminals modernization.

In March 2011 company acquired 67% of JSC KedenTransService (railway terminals operator in Kazakhstan). Transaction is to be closed by the end of 2011. The strategic focus of the deal – significant increase in container transportation to and from China.

Financial results

As illustrated on Fig 4, company earns the bulk of its revenue from rail container transportation and integrated logistics segments.

Fig 4 Adjusted revenue composition



Source – Company data

Table 1 – Financial results, based on IFRS

mIn Rub	2007	2008	2009	2010
Adjusted Sales	13270	17806	13262	16502
Operating income	2688	4924	1674	2093
Adjusted Ebitda	4493	7211	3963	4427
Net Income	1934	3570	590	928
Operating margin, %	20.3%	27.7%	12.6%	12.7%
Adjusted Ebitda margin, %	33.9%	40.5%	29.9%	26.8%
Net margin, %	14.6%	20.0%	4.4%	5.6%
ROE, %	7.0%	21.8%	3.2%	4.9%
ND/Ebitda		0.5	1.5	1.3

Source – Company data, SOVLINK

As compared to its key domestic peers, TransContainer's profitability is rather moderate (Table 2). The key cost drivers in 2010 – payrolls and maintenance and repair expenses.

Table 2 – Profitability in comparison with peers, 2010 IFRS

	Operating margin, %	Adjusted EBITDA margin, %	Net margin, %	Net debt/Ebitda
TransContainer*	12.7%	26.8%	5.6%	1.3
GlobalTrans*	36.5%	43.0%	25.0%	0.7
Freight One**	23.8%	31.2%	18.0%	0.5

Source – Company data, SOVLINK estimates
*adjusted data provided by companies, **IFRS

Shareholders structure (post IPO):

RZD	50.0%
EBRD	9.3%
FESCO	12.5%
Other	11.6%
Free float in GDRs	16.6%

Source – Company data

FESCO (Far East State Shipping Company, largest Russian private intermodal transportation group), is represented by two directors sitting in the TRCN Board. FESCO management has continuously declared its' interest in control stake of TransContainer as it sees strong synergy in aforementioned M&A deal. GlobalTrans has also declared an interest in acquiring TransContainer assets.

SWOT analysis:

Strengths:

- The market leader in container freight in Russia
- Strong operational results and solid transportation volume growth, exceeding the industry performance
- Low debt burden
- Debt repayments can be financed by internally generated cash flows

Weaknesses:

- Relatively old fleet, requiring large Capex in subsequent years
- Relatively moderate profitability, compared to its' peers

Opportunities (growth drivers):

- Planned privatization as a driver for competitive bid for block/control stake
- Support for freight demand driven by large infrastructure projects in Russia and rapid import trade growth
- Further improvement in asset utilization and profitability
- Potential synergy in case of control stake acquisition by FESCO

Threats:

- Russian economy slowdown in case of global economy shocks may negatively affect the industry and company's performance
- Postpone of the large Capex program for 2012-13 (more than 6 bln Rub annually) may affect future post-crisis growth
- Potential worsening of corporate governance in case of acquisition by some of strategic shareholders

Peer comparison

Company	Country	Price, \$	Mcap, mln \$	EV, mln \$	P/E			P/BV			EV/S			EV/Ebitda		
					2010	2011E	2012E	2010	2011E	2012E	2010	2011	2012	2010	2011	2012
TRANSCONTAINER	RUSSIA	9.5	1320	1508	47.3	19.9	12.5	2.5	2.5		2.6	1.9	1.6	10.4	7.4	5.8
GLOBALTRANS-GDR	CYPRUS	15.0	2372	2753	13.4	9.5	7.9	2.7	2.7	2.1	2.0	2.1	1.8	7.0	5.7	4.9
Average					30.3	14.7	10.2	2.6	2.6	2.1	2.3	2.0	1.7	8.7	6.5	5.3
International peers - DM																
UNION PACIFIC CORP	UNITED STATES	88.3	43084	50967	15.5	13.4	11.4	2.4	2.3	2.1	3.0	2.6	2.4	7.9	7.0	6.1
CANADIAN NATL RAILWAY CO	CANADA	71.1	32038	38040	15.7	14.3	13.1	2.9	2.7	2.4	4.7	4.2	3.9	10.2	8.9	8.1
CANADIAN PACIFIC RAILWAY LTD	CANADA	55.0	9325	13401	14.8	15.9	11.5	1.9	1.7	1.6	2.8	2.5	2.3	8.6	8.6	7.0
RAILAMERICA INC	UNITED STATES	12.7	664	1122	34.7	17.0	13.7	1.0	0.9	0.9	2.3	2.1	1.9	5.7	6.7	6.1
GROUPE EUROTUNNEL SA	FRANCE	8.4	4549	9421		187.5	69.6	1.1	1.1	1.1	9.6	7.8	7.5	19.9	16.0	14.9
CSX CORP	UNITED STATES	20.6	22519	29915	14.4	11.7	10.4	2.6	2.5	2.4	2.8	2.5	2.3	7.4	6.5	5.9
NORFOLK SOUTHERN CORP	UNITED STATES	65.1	22647	28727	15.1	12.3	11.0	2.2	2.1	1.9	3.0	2.6	2.4	8.2	7.0	6.3
Average					18.4	14.1	11.8	2.0	1.9	1.8	4.0	3.5	3.3	9.7	7.5	7.8
Median					15.5	14.2	11.7	2.1	2.0	1.8	3.0	2.6	2.4	8.4	7.2	6.7
International peers - EM																
CHINA RAILWAY TIELONG CONT-A	CHINA	1.5	2010	1904	28.6	22.1	17.0	4.2	3.6	3.0	6.1	4.3	3.3	17.2	12.3	8.6
DAQIN RAILWAY CO	CHINA	1.1	16844	18873	11.1	8.3	7.6	1.8	1.7	1.5	3.4	2.6	2.4	7.1	5.9	5.5
ALL AMERICA LATINA LOGISTICA	BRAZIL	5.4	3692	6589	27.1	25.7	17.4	3.2	1.4	1.3	4.2	3.4	3.0	8.3	7.0	6.1
CONTAINER CORP OF INDIA LTD	INDIA	20.2	2625	2636	16.0	14.6	13.1	2.7	2.5	2.2	3.3	3.1	2.9	13.0	11.9	11.3
Average					20.7	17.7	13.8	3.0	2.3	2.0	4.3	3.3	2.9	11.4	9.3	7.9
Median					21.5	18.4	15.0	3.0	2.1	1.8	3.8	3.3	3.0	10.6	9.4	7.3
Global Average					18.8	15.0	17.0	2.4	2.1	1.9	3.9	3.3	3.0	10.0	8.0	7.6

Source: Bloomberg, companies data, SOVLINK estimates.

Valuation on peer comparison basis (2011E)

	P/E	P/BV	EV/S	EV/Ebitda
Global average	15.0	2.1	3.3	8.0
Fair Mcap, \$ mln	993	1300	2479	1409
Target price for ordinary share, \$	71	94	178	101
weight	25%	25%	25%	25%
Target price for ordinary share, \$	111.20			
Target price for GDR, \$	11.12			
Current market price of GDR 05.09.2011, \$	9.5			
Upside	17.1%			

According to valuation on peer comparison basis we assign TransContainer a target price of \$11.12 per GDR which implies 17,1% upside to current market price, recommendation "BUY"

Stock recommendations

STRONG BUY:	Upside over 25%; confidence level – high / upside over 100%; confidence level - low
BUY:	Upside between 15 and 25%; confidence level – high / upside between 25% and 100%; confidence level – low
HOLD:	Upside of less than 15%; confidence level – high / upside of less than 25%; confidence level – low
SELL:	Target price at or below current price levels

SOVLINK LLC

Tel.: +7 495 967-1300

Fax: + 7 495 967-1311

Kremlin embankment 1. bld. 2.

Moscow. 119019. Russia

www.sovlink.ru

research@sovlink.ru

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