FY16 Outlook: Logistics

Remains among the most resilient sectors of the economy

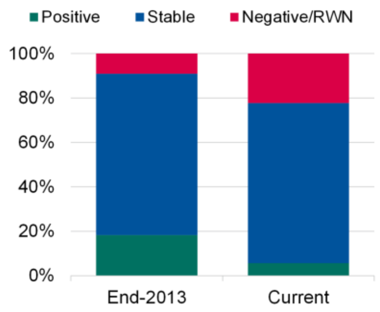
Outlook Report

Sector Outlook

STABLE

(2014: STABLE)

Rating Outlooks



Source: Ind-Ra

- Top line growth for most companies despite slowdown
- Asset-light business model provides operational flexibility during a slowdown
- Strong business potential in new segments such as agri and cold storage logistics and logistics related to e-tailing

Rating Outlook

STABLE

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Stable Outlook: India Ratings and Research (Ind-Ra) has maintained a stable outlook on the logistics sector for FY16. This is driven by continued low leverage in most industry segments (except the container freight station (CFS)/ inland container depot (ICD) segment), given the asset light business model adopted by established players. The low leverage enables them to withstand cyclical downturns.

The continued top line growth exhibited by most firms in the industry till FY15 reflects the robustness of the sector. The financial profiles of most logistics companies are unlikely to display a significant improvement in FY16, given the somewhat moderate pace of recovery in industrial activity and international trade.

Ratings Capture the Risk: Of the 19 logistics companies rated by Ind-Ra, 18 carry a rating outlook, with the remainder being a structured obligation which does not have an outlook. Of these 18 ratings, thirteen companies have a Stable Outlook, one carries a Positive Outlook and four have a Negative Outlook. The increase in the proportion of Negative Outlooks does not imply deterioration in industry prospects and is related to idiosyncratic developments specific to those corporates.

Revenue Growth may Stabilise: The agency believes that companies offering value-added road freight services will grow at a higher rate (5%-10%) in FY16 than those offering basic road freight services (0%-5%). Companies in the CFS/ICD segments might continue displaying modest growth of 3%-6% if a significant uptick in international trade volumes is not achieved in FY16. Third-party logistics (3PL) providers could grow at a low double-digit rate in FY16, given increasing private port operations and integrated logistics offerings.

Value-added Service Providers to Gain: Companies engaged in value-added services such as temperature controlled logistics, cash management services (CMS) as well as time definite deliveries related to e-commerce could display strong growth rates and wider margins in FY16. Service offerings that are linked to non-discretionary spending and driven by favourable legislation (such as ATM replenishment services) are likely to continue to display strong revenue growth and stable margins.

Undifferentiated Service Providers to Lag: Logistics companies offering commoditised basic services perform well only in scenarios of robust economic growth. Hence, they are likely to see a moderation in revenue growth and stagnation in profitability levels amid weak industrial activity. Those operating CFS/ICDs could also face challenges in revenue growth in FY16, with the persistence of muted international trade volumes.

New Logistics Opportunities in E-commerce: The spurt in e-tailing has increased the demand for specialised logistics services, which are a key support factor for the business. Considering the fast pace of growth in online retail, new modes of payment (such as cash on delivery, which is now predominant) and new sales models (such as ‘try and buy’), logistics firms have to not only rapidly scale up their operations but also adapt to the new business environment to benefit from the opportunities in this sector.

For the purpose of analysing industry trends, Ind-Ra has selected 30 companies from five different categories. Of these, 19 companies are rated by Ind-Ra and 10 companies are listed.

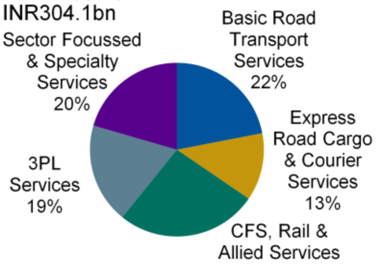
The logistics sector has been divided into the following five categories for the analysis:

1. **Basic road transport service providers:** Offer basic truck freight services – five companies
2. **CFS, rail and allied service (CFSRAS) providers:** Offer container terminal, rail freight, warehousing and related services – five companies
3. **3PL service providers:** Offer end-to-end logistics solutions to clients but not involving container terminal services – eleven companies.
4. **Express road cargo and courier service providers:** Offer time-definite express delivery solutions – three companies
5. **Sector focussed and specialised services (SFSS) providers:** Cater to the logistics requirements of specific sectors such as steel and oil & gas, or offer specialised services such as physical cash transfer – six companies

Figure 2

Revenue Contribution by Sub-segments for Ind-Ra Sample Set

FY14 aggregate revenues of INR304.1bn

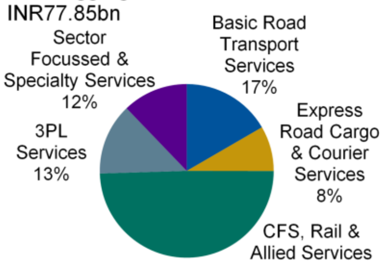


Source: Ind-Ra analysis

Figure 3

Debt Contribution by Sub-segments for Ind-Ra Sample Set

FY14 aggregate revenues of INR77.85bn



Source: Ind-Ra analysis

Outlook Sensitivities

Further Slowdown: India's persistent weak industrial activity and low international trade volumes impacting multiple segments of the industry could result in a negative outlook. A reduction in EBITDA margins significantly below FY14 levels could considerably weaken the credit metrics of industry players.

Faster Pace of Recovery: In FY16, the revival of manufacturing and mining activities could boost the logistics sector; however, the possible decline in agricultural output due to deficient rainfall could pose a drag.

Overview

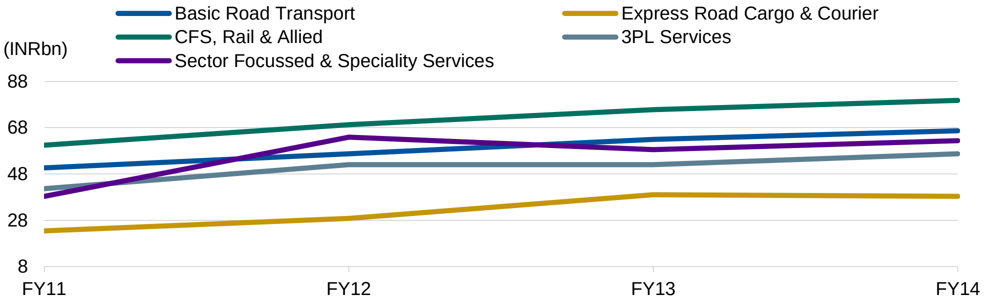
The revenue of the logistics industry is closely linked to the level of economic activity. GDP[1] evaluated at market prices (New Series base 2011:2012) increased consistently over the past three years (FY13: 5.1%, FY14: 6.9%, FY15: 7.3%). The revenue of Ind-Ra's representative set of 30 companies grew 5.4% on aggregate in FY14 and 6.6% the previous year. Their revenue is likely to have increased in the range of 5%-7% in FY15 and have an even higher growth rate in FY16 if the industrial activity improves, especially from 2HFY16.

However, CFSRAS providers' revenue growth rate moderated sharply to 5.3% on aggregate in FY14 compared with 9.4% the previous year. This was because of the slowdown in international trade volumes and competition from government-owned enterprises such as Container Corporation of India Ltd (Concor, a subsidiary of Indian Railways). Within the logistics space, this category is more capital intensive and not surprisingly accounts for the bulk of debt attributable to the sector.

Figure 1

Segmentwise Revenue Trend

Segment aggregates, FY11-FY14



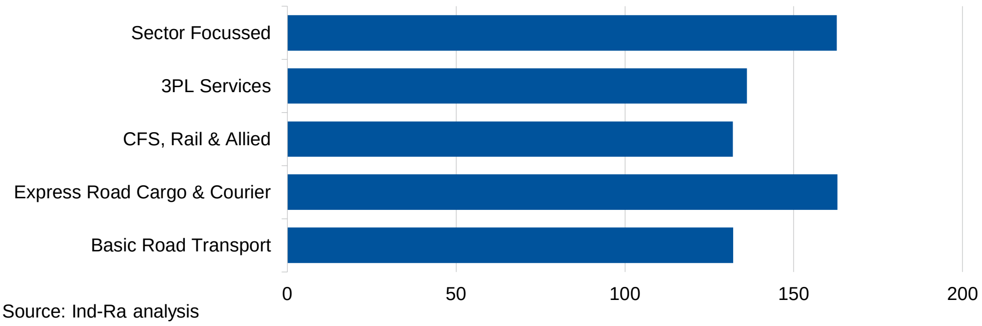
Source: Ind-Ra analysis

On the basis of the performance of listed companies in the sample set, Ind-Ra expects most logistics segments to have marginally higher profitability in FY15. Any further improvement in FY16 would be contingent on significant growth in industrial activity.

Figure 4

Sector Growth Over FY11 – FY14

FY11 revenue base as 100

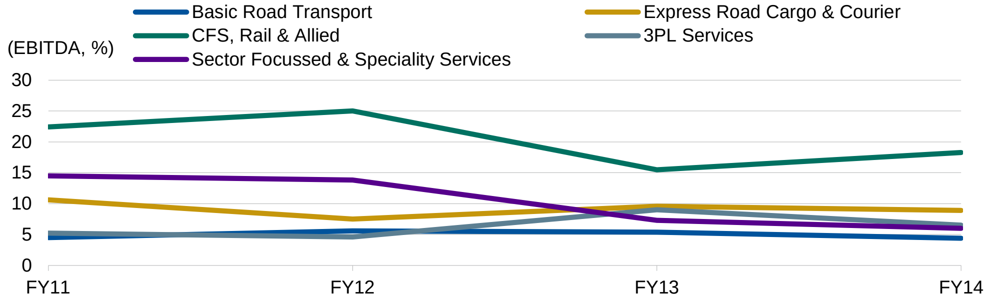


Source: Ind-Ra analysis

[1] The GDP numbers mentioned/used in this report refer to GDP at factor cost at 2004-05 prices.

Figure 5

Segment-wise Trend in Median EBITDA %
Median values, FY11-FY14



Source: Ind-Ra analysis

While leverage increased across all five segments in FY14, the weakening of metrics has been highest for CFSRAS and SFSS. The credit profiles of companies in these segments are likely to remain stressed in FY16. While the persistent slowdown in international trade volumes continues to impact the CFSRAS segment, poor performance of the steel industry has plagued the logistics companies catering exclusively to this industry. In Ind-Ra's sample set, the SFSS segment performance has been propped up by companies offering other specialised services such as relocations, CMS and helicopter charter services.

Road Transport Services

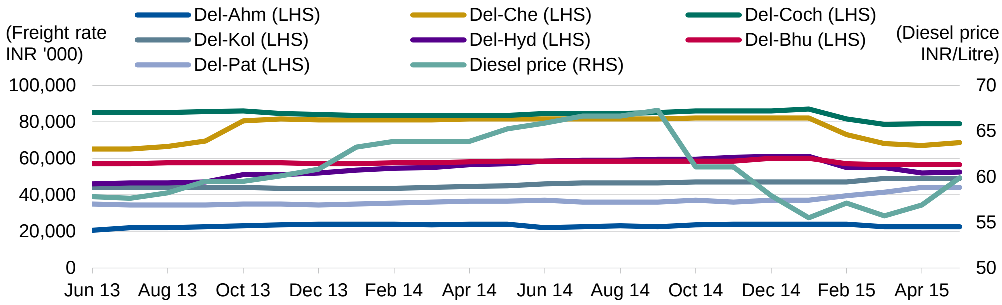
The road freight segment (basic services as well as allied, value-added services) might have registered a modest growth rate of 4%-7% in FY15 based on the financial performance of listed companies. For FY16, Ind-Ra believes that companies providing basic road transport services could report up to 5% yoy revenue growth while maintaining stable EBITDA margins. Companies offering value-added services in this sub-sector may report stronger revenue growth in the range of 5%-10% yoy, driven by demand from large e-tailers as well as large corporate clients seeking integrated solutions.

Freight Rates Unlikely to Strengthen

The bargaining power of freight providers remained quite weak up to September 2014, when in most routes higher diesel price was hardly passed on to freight users. Pricing power improved marginally in some routes between September 2014 and March 2015. However, the diesel price increase post March 2015 has not translated into higher freight rates, due to weak industrial activity. For FY16, Ind-Ra expects freight rates to be maintained at current levels. However if diesel price increases further at the current levels of industrial demand, then the upward revisions in freight rates would lag the revisions in diesel price during the year.

Figure 6

Trend in Freight Rates For 9 Ton Truck
June 2013 to March 2015



Source: Bloomberg

Small truck operators (owning up to five trucks) who constitute over 90% of truck volumes in the country are worst hit during economic showdowns as they have low bargaining power with clients and depend on freight brokers for business where they incur significant commission charges.

According to the Indian Merchants Chamber, on 8 May 2015, there were 221 operational CFS/ICDs in the country with an additional 39 CFS/ICDs under implementation. Of the total operational/under construction terminals, around 49 are in Maharashtra alone and 43 of these are located in the vicinity of Jawaharlal Nehru Port Trust (JNPT) port.

JNPT has the largest share (FY14: 55.8%) among all major ports in India in terms of container handling.

Size Contributes to Resilience

Larger players in the road freight business display fairly stable EBITDA margins. A significant portion of their vehicles may be debt free or they may face lower interest rates than small truck owners and thus offer more competitive freight rates. In addition, a more professional set-up and scale allows them to provide premium offerings such as dedicated capacity (for their large clients) and time-definite services

CFS, ICD and Private Rail Operators

The revenue growth of companies in this segment (FY12: 14.5%; FY13: 9.4%; FY14: 5.3%) mirrors the trend in India's exports and imports (Figure 8), which also slowed down FY13 onwards. Ind-Ra expects the segment's revenue to grow marginally at 3%-4% in FY16, led by a moderate uptick in trade volume.

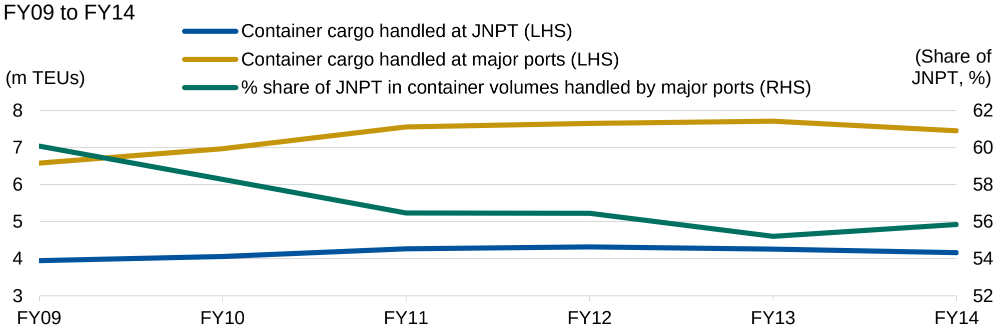
Several CFS/ICD players have tried to arrest the slowdown in their revenue by offering higher value-added services such as temperature-controlled and dust-free storage services which entail premium rates, as well as bundling of ancillary services such as transportation.

CFS/ICD Capacities Underused

Ind-Ra expects JNPT to continue to account for the bulk of India's container trade volumes. However, the port's share of trade volumes has reduced since FY09 due to the diversion of sea freight from Mumbai/JNPT ports to ports in Gujarat. The reason for shipping companies preferring Gujarat ports is the superior draft and superior infrastructure at some ports (notably Mundra), resulting in lesser waiting time.

Figure 7

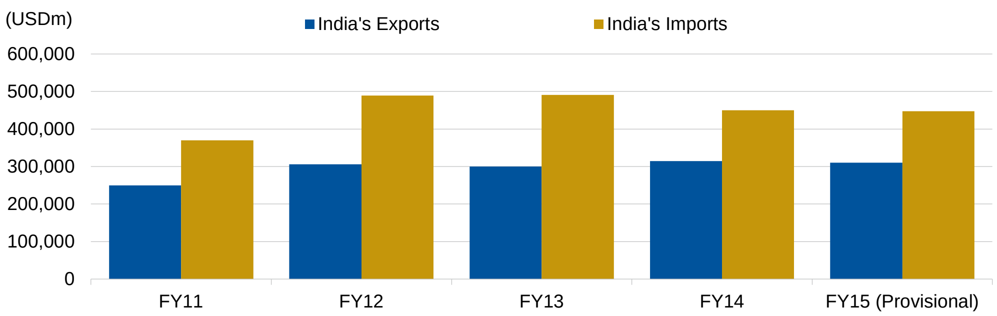
Trend in Share of JNPT in Container Volumes Handled by Major Ports
FY09 to FY14



Source: Ministry of Shipping

Figure 8

Recent Trend in India's Imports and Exports

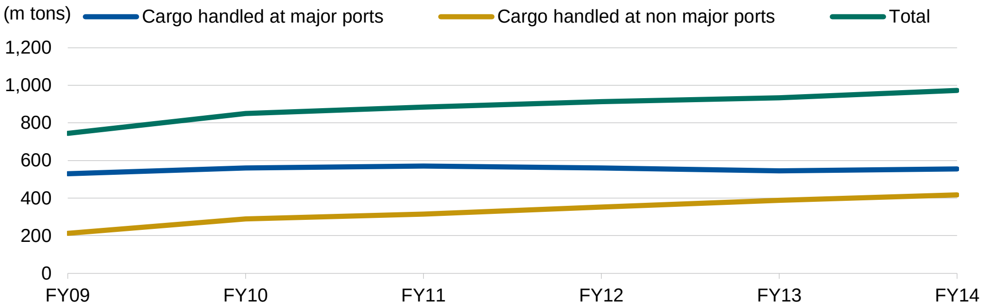


Source: Ministry of Commerce & Industry, GoI

Many logistics companies have invested heavily in setting up large CFS facilities in proximity to JNPT considering the port's consistently high container volume share in the past decade. These companies are struggling to achieve break-even volumes with lower twenty foot equivalent unit (TEU) volumes being distributed over 43 CFSs around JNPT.

Figure 9

Trend in Cargo Handled at Indian Ports



Source: Ministry of Shipping

Sub-optimal Capacity Utilisation for Private Train Operators

Container Train Operators (CTOs) operate freight trains that run on the rail network of the Indian Railways. Haulage charges payable by these companies to the Indian Railways forms over 70% of their operating cost.

The companies operating private freight trains are often CFO/ICD players offering rail transportation services as part of their bundled logistics services. The November 2014 announcement of a 25%-41% hike in haulage charges by the Indian Railways caused a significant shift in freight movement from rail to road in Ind-Ra's assessment.

Due to considerable opposition to the hike from CTOs, the Indian Railways subsequently decided to increase haulage charges over two phases, with 66% of the hike being implemented from December 2014 and 100% of the hike being implemented from March 2015.

The Indian Railways signed an agreement with around 16 private CTOs in 2006, however only a few of them are operational.

These CTOs paid high license fees (valid for 20 years) ranging from INR100m to INR500m per route for operating rakes on the all-India network of Indian railways.

CTOs, already facing large under-utilised capacities, saw their utilisation levels dropping further due to the hike. The delay by Concor in hiking freight charges post the increase in haulage charges also restricts the ability of CTOs to increase freight charges. In addition, CTOs have to pay the Indian Railways a 10% congestion charge on cargo originating at ports.

Additionally, private CTOs are burdened with high borrowing levels in case they have to purchase land to set up a CFS/ICD or have to pay substantial lease rentals in instances where the land is leased. In this aspect also, they are unfavourably placed compared with Concor, whose container terminals are mostly on land leased from the parent, often at below market rates. Ind-Ra therefore expects the credit profiles of CTOs to continue to be under pressure in FY16.

Sector Focussed Services

Ind-Ra's sample set in this sub-segment comprises two companies – which provide logistics services to the oil and gas and steel sectors, respectively. The sample set displayed a sharp decline in combined revenue in FY14 largely on a slowdown in the steel sector. Although the company catering to the oil and gas sector reported modest revenue growth and margins in FY14, that catering to the steel sector suffered a sharp decline in revenue and EBITDA profits and thus deterioration in overall credit metrics. Only a sustained revival in steel demand is likely to lead to a revival for logistics companies catering to this sector.

3PL Solution Providers, Freight Forwarding, Warehousing, Supply Chain Management, Port Logistics (other than CFS/ICD)

The increasing trend of corporates outsourcing their entire logistics requirements to a single party has led to the growth of this segment in the recent past. Particularly, Ind-Ra's sample set showed revenue growth of 14% yoy in FY14 and is likely to maintain a low double-digit growth rate in FY15 and FY16. The agency expects revenue growth in this sample set to be driven by the companies offering integrated 3PL services as well as those involved in port logistics at Gujarat ports such as Kandla (which are displaying strong growth in volumes handled at the expense of Mumbai/JNPT Ports).

Companies offering limited bouquet of services such as standalone freight forwarding services could witness revenue stagnation in FY16.

This segment comprises companies that offer either a part of or an entire range of 3PL services. Although most companies in Ind-Ra's sample set do not have the in-house capability to offer all services ranging from port logistics to warehousing, transportation and freight forwarding, they are able to fulfil their clients' logistics requirements through tie-ups with other service providers. The business model adopted by the firms in this space could be a combination of asset-heavy and asset-light models depending on the range of services offered.

Temperature-controlled Logistics Segment Still Under Penetrated

Besides agriculture, the temperature-controlled logistics segment benefits from demand from other industries as well such as processed foods, quick service restaurants, fisheries, dairy and pharmaceuticals. The segment has attracted a large chunk of investment from private equity players in India during the past three years, given the large growth potential and profitable investment opportunity.

GST to Shape 3PL Logistics in Medium Term

The Lok Sabha has already cleared the Constitutional Amendment Bill for the rollout of GST, and the Rajya Sabha has referred the same to a select committee for scrutiny.

The Goods and Service Tax (GST), which is likely to be implemented from FY17, is likely to have a profound effect on the way logistics companies operate. The structure of GST will determine the expansion strategy for logistics players, especially those in the 3PL space seeking to venture into/expand operations in warehousing.

Specialty Services

Ind-Ra's assessment shows that there continues to be strong demand for specialty logistics services linked to non-discretionary spending. Although revenue contribution from these niche segments is small, the growth potential remains strong. Among the fastest growing sector-focused segments are CMS and information management services which are targeted primarily at banks, financial services and insurance segments.

The weak economic conditions prevailing in FY14 resulted in low utilisation levels for the companies offering logistics services such as air charter services, driven by discretionary spending by corporates. Within the air charter space, this trend was more pronounced for the companies offering services to external clients (clients outside the corporate group to which they belong).

CMS Continuing to See Strong Demand

According to the Ministry of Finance's Directive to banks, for every three ATMs being set up in tier 2–tier 4 towns, banks will be allowed to set up one ATM in metros/tier 1 cities. While Public Sector Unit banks are likely to establish 65,000 ATMs, the ministry has granted approval for 50,000 ATMs under 'White Label', while another 15,000-20,000 ATMs could be established by various private banks.

CMS entail replenishment of cash in ATMs and transporting cash for clients. Demand for CMS in the next two years will be driven by a large increase in the ATM-using population in the country to over 250,000 by FY16 from around 185,000 currently.

The top players in this industry segment include CMS Securitas Ltd, Writer Safeguard Pvt Ltd, Brinks Arya India Pvt Ltd and Task-4 Securitas (India) Pvt Ltd. The trend of banks to outsource ATM services to managed service providers (MSP) has led to the proliferation of small cash management companies. MSPs try to maximise margins by outsourcing cash management to small players. In some instances, they may be compelled to do this to reduce the risk of dependence on a single vendor.

White Label ATMs are those set up by an independent private party such as Tata Communications Payment Solutions Ltd where the debt/credit card of any bank can be used.

In October 2014, the Indian Banks Association submitted recommendations to the Reserve Bank of India for laying down minimum eligibility standards for the companies engaged in replenishing cash in ATMs. If such standards are adopted, large organised players could see improved margins due to industry consolidation.

High Growth Potential for Information Management Services, Document Storage

These services involve secure storage of client documents, for which the service provider charges monthly rentals. The growth drivers of the business are high lease rents and space constraints for offices in urban areas, which would compel customers to rely on outsourced document storage services. The need to have disaster management systems in place is also leading large banks and corporates to store one set of all critical documents at an alternate secure location. Entry barriers to the business are infrastructure, credibility and track record, besides a large scale of operations which would enable service providers to cater to the document storage requirements of their clients on a pan-India basis.

Express Road Cargo and Courier Services

New Opportunities from E-commerce

The exponential growth in e-tailing in India is likely to provide large growth opportunities to courier, road transportation and 3PL companies. The demand for specialised delivery systems related to e-tailing has also led to the emergence of a new breed of dedicated logistics firms. Conventional courier/logistics companies may not have the systems and process in place to efficiently handle 'try and buy' option, which is almost a norm in the e-tailing industry.

Logistics companies are facing the challenge of rapidly scaling up their infrastructure and operations to cater to the large surge in demand from e-tailers.

High Competition, Lack of Integration at Low End in Courier Industry

The largest courier companies in the country either have their own fleet of aircraft or have tie-ups with various airlines to ensure the overnight inter-city delivery of cargo. The superior infrastructure allows large players to offer value-added services (such as time-definite delivery and tracking of consignments), leading to higher and more resilient margins than for small players.

On the other hand, small courier companies are typically restricted to a city or a region, and rely on road transporters and airlines for the inter-city movement of loads. Lack of service differentiation, intense competition and low bargaining power with clients lead to weak margins and stretched working capital for small courier companies.

2014 Review

Ind-Ra's sample set of listed companies displayed revenue growth of around 6% in the basic road freight segment and a significantly higher-than-expected growth in the express road freight segment. Operating margins in FY15 have been maintained at FY14 levels. These trends can be attributed to the continued muted industrial activity during the year and a surge in e-tailing. Another factor leading to demand for express road freight is the recent shift in freight from air to road, typically witnessed during an economic slowdown.

The CFSRAS segment registered revenue growth of around 11% in FY15 based on the performance of listed companies in the segment. This segment also displayed a strong improvement in profitability, attributed to the strong financial recovery posted by one company in this sub-set.

CFS/ICD companies with linkages to major global container shipping lines performed better than most peers, given their access to TEU volumes from the container lines which have invested in these entities. Most private CTOs continued to bleed in 2014 as their operations were unviable due to the dual impact of the steep hike in haulage charges by the Indian Railways in December 2014 as well as competitive rates charged by Concor.

Certain specialty logistics segments such as CMS, temperature-controlled logistics and document storage services continued to exhibit strong growth rates in FY15 due to reasons mentioned earlier in the report.

Appendix

Figure 10
Issuer Ratings

Issuer	Rating/Outlook (Current)	Rating/Outlook (End-2013)
AR Airways Private Limited	IND BB-/Stable	IND BB-/Stable
Continental Warehousing (Nhava Sheva) Pvt Ltd	IND A-/Stable/IND A2+	Not rated
Gateway Distriparks Limited	IND AA-/Stable/IND A1+/	IND A+/Positive/IND A1+
Gateway Rail Freight Limited	IND AA-/Stable/IND A1+	IND A+(SO)
Gati Limited	IND A-/Stable/IND A1	Not rated
Gati-Kintetsu Express Private Limited	IND A+/Stable/IND A1+	Not rated
Leeway Logistics Limited	IND BBB+/Stable/IND A2+	Not rated
MJ Logistics Services Limited	IND BB/Stable	IND BB-/Positive
Patel Integrated Logistics Limited	IND BBB-/Positive/IND A3	IND BBB-/Stable/IND A3
Pawan Hans Limited	IND A+/Stable	IND A+/Stable
Snowman Logistics Limited	IND A+/Stable/IND A1+	IND A+(SO)
P.N.Writer & Company Private Limited	IND A-/Negative/IND A2+	IND A-/Stable/IND A2+
Blue Dart Express Limited	IND AA/Stable/IND A1+	IND A1+
Dachser India Private Limited	IND A-/Negative/IND A1	IND A-/Stable/IND A1
Seaways Shipping & Logistics Limited	IND BBB/Stable/IND A2	IND BBB/Stable/IND A2
Regal Shipping Private Limited	IND BB+/Negative	IND BBB-/Stable
Writer Safeguard Private Limited	IND A-(SO)/IND A2+(SO)	Not rated
TVS Logistics Ltd	IND A+/Negative/IND A1+	IND A+/Stable/IND A1+
Caravel Logistics Private Limited	IND BB-/Stable/IND A4+	IND D

Source: Ind-Ra

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