COMPANY UPDATE

BOBCAPS
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BUY
TP: Rs 120 | ⮝ 25%

ALLCARGO LOGISTICS | Logistics | 12 December 2019

Gati acquisition – deriving synergies an uphill task

Allcargo Logistics (AGLL) recently announced the acquisition of a 45% controlling stake in Gati (GTIC) for ~Rs 4.2bn (13.6x TTM H1FY20 EV/EBITDA). Though this helps AGLL foray into the fast-growing express logistics space, near-term prospects look challenging due to (1) deep-rooted problems at GTIC (sliding market share, eroding profits, levered balance sheet), and (2) a lack of immediate synergies given vastly different business dynamics and client profiles. Rising leverage for AGLL is also a concern. We maintain our estimates and Mar'21 TP of Rs 120.

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Acquisition lends foothold in growing express segment: AGLL has signed an all-cash deal that will see the company eventually acquiring ~45% in GTIC through direct stake purchase from promoters and a subsequent open offer. This provides AGLL a foothold in the fast-growing (~15%) express segment, along with access to an established hub-and-spoke model, wide geographic reach (99% of total districts) and clientele comprising corporate and SMEs.

GTIC turnaround an uphill task: GTIC has suffered steep market share loss and margin erosion in recent years. This coupled with a weak balance sheet and moderate return ratios implies a challenging task ahead for AGLL. Moreover, we see few immediate synergies due to vastly differing business and client profiles.

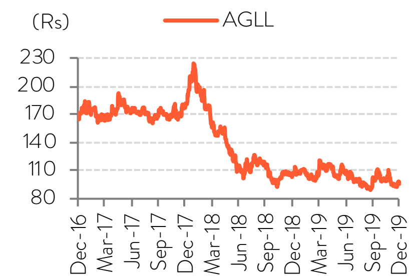
Rise in leverage a concern: The deal is likely to bump up AGLL's leverage, with the combined net debt/EBITDA ratio scaling past 2x (vs. 1x in H1FY20). Logistics park development will also raise debt levels intermittently. We are concerned about surging debt levels in a cyclical business. Management plans to divest non-core assets to reduce leverage by H1FY21, which is a monitorable.

Maintain BUY: We retain forecasts as we have not factored in the deal pending open offer and merger, but do flag the risks stemming from higher leverage.

Ticker/Price	AGLL IN/Rs 96
Market cap	US$ 332.1mn
Shares o/s	246mn
3M ADV	US$ 0.3mn
52wk high/low	Rs 124/Rs 87
Promoter/FPI/DII	70%/12%/4%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	60,492	68,949	75,616	85,413	96,486
EBITDA (Rs mn)	3,771	4,485	4,967	5,758	6,681
Adj. net profit (Rs mn)	1,808	2,478	2,519	2,847	3,205
Adj. EPS (Rs)	7.4	10.1	10.3	11.6	13.0
Adj. EPS growth (%)	(26.9)	42.5	1.6	13.0	12.6
Adj. ROAE (%)	9.6	12.5	12.1	12.5	12.9
Adj. P/E (x)	13.0	9.5	9.3	8.3	7.3
EV/EBITDA (x)	6.8	5.7	5.2	4.8	4.3

Source: Company, BOBCAPS Research

Acquisition offers foothold in growing express business

Purchase of 45% stake in GTIC for Rs 4.2bn

Acquiring 45% stake in GTIC for Rs 4.2bn

On 5 December, AGLL announced the acquisition of a controlling 45.5% stake in GTIC in a three-pronged transaction – (1) purchase of 10.4mn shares from existing promoters at Rs 75/sh (8.5% post dilution stake), (2) fresh issuance of 13.3mn shares by GTIC to AGLL on preferential basis (11%), and (3) a subsequent open offer to acquire an additional 26% stake. The total purchase consideration is Rs 4.16bn, including the Rs 1bn to be infused in GTIC through fresh share issuance.

FIG 1 – GATI ACQUISITION

Particulars	No. of share acquired (mn)	% of total shareholding (post dilution)	Purchase consideration per share (Rs)	Total consideration (Rs mn)
Share purchase agreement	10.4	8.5	75	779
Preferential issue	13.3	10.9	75	1,000
Open offer	31.7	26.0	75	2,381
Total	**55.5**	**45.5**		**4,160**

Source: Company, BOBCAPS Research

The transaction is to be mainly funded by debt – AGLL is issuing non-convertible debentures worth Rs 1.95bn to partially fund the transaction, at a coupon rate of 11.25%. The deal ascribes an equity valuation of Rs 9.1bn to GTIC. Adding back its H1FY20 net debt, the EV works out to Rs 14.1bn, implying a TTM EV/EBITDA multiple of 13.6x – expensive in our view considering GTIC's current earnings profile.

FIG 2 – AGLL-GTIC TRANSACTION MULTIPLES

(x)	Acquisition multiples of GTIC
TTM EV/Sales	0.8
TTM EV/EBITDA	13.6
P/E	145.1

Source: Company, BOBCAPS Research

GTIC among the top express logistics companies in India

GTIC is a prominent express player with a reach across ~99% of India's districts

GTIC, through its subsidiary Gati-KWE (70% owned by GTIC, 30% by Japanese player Kintetsu World Express), is among the top express logistics players in the country, though it has been losing market share to competitors in recent years. It has a large network comprising 16 express distribution centres, 61 warehouses, and 5,000+ vehicles, enabling a delivery reach to 99% districts in India.

Gati-KWE focuses on surface express (~80% of revenue) which is likely to grow faster than the air express segment. It has a well-rounded industry presence – pharma, IT hardware, auto ancillary, engineering, textiles, and FMCG – and a robust client base comprising corporate and SME customers.

Express segment in India forecast to log 15% CAGR

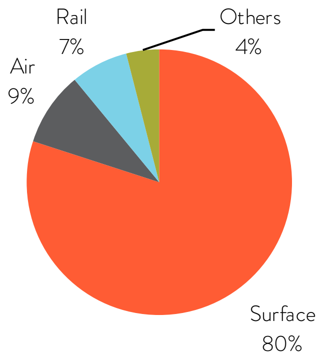
The acquisition thus gives AGLL a strong foothold in the express segment – one of the fastest growing domestic logistics verticals. The express business in India is forecast to log a 15%+ CAGR over the next few years vs. 10%/4% for AGLL's existing businesses of MTO/CFS. However, we note that making further inroads in a competitive industry may be difficult. GTIC's growth, profitability and return profiles have weakened in recent years – we opine that turning GTIC around and deriving adequate synergies in the next few years is likely to be a challenge.

FIG 3 – GTIC'S CORPORATE STRUCTURE AND SERVICE OFFERINGS

Entities		Service offerings
GTIC Standalone		E-commerce logistics
		Freight forwarding
		Fuel stations
Partially owned subsidiaries	Gati KWE (70% holding)	Surface express
		Air express
		Rail express
		Supply chain solutions
		E-fulfilment centres
	Gati Kausar (80% holding)	Cold chain
Wholly-owned subsidiaries	Gati Import Export	Trading
	Zen Cargo Movers	Custom house agent
	Gati Asia Pacific Pte	

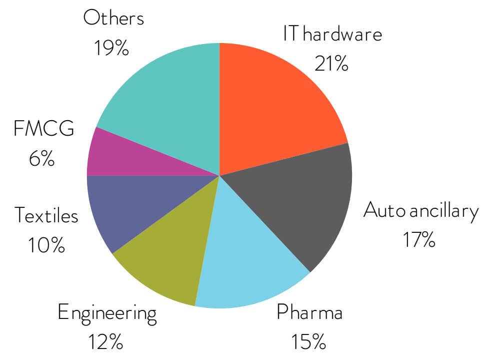
Source: Company, BOBCAPS Research

FIG 4 – FAST-GROWING SURFACE EXPRESS IS THE MAIN REVENUE SEGMENT FOR GATI-KWE, FY16



Source: Company, BOBCAPS Research

FIG 5 – REVENUE BASE DIVERSIFIED ACROSS VERTICALS, FY16



Source: Company, BOBCAPS Research I * Note: Data after FY16 is not available

Turning GTIC around looks to be an uphill task

Differing businesses leave little scope for immediate synergies

AGLL's management remains confident of deriving substantial synergies from the acquisition, including (1) building a bouquet of end-to-end service offerings for global clients in the MTO segment, (2) direct service overlap in the freight forwarding business with GTIC, and (3) collaboration opportunities with Kintetsu, the Japanese partner of GTIC's express venture. However, we believe material synergistic benefits may be elusive in the near term, especially in GTIC's core express business.

Business dynamics of the target and acquirer are vastly different

AGLL's existing operations of LCL consolidation (MTO), container freight stations (CFS), and project & engineering (P&E) are vastly different from the segments GTIC is present in – mainly express logistics and supply chain management. CFS/P&E are asset-oriented businesses, whereas express/supply chain are focused on transportation/warehousing activities.

The client profile is also dissimilar – AGLL's MTO business has ties with leading global freight forwarders, corporates and shipping majors, while GTIC mostly counts domestic corporates and SMEs as its clients. This makes management's aim of cross-selling service offerings to existing clientele a challenge. Deriving synergies in the smaller freight forwarding segment is likely to be easier.

Deep-rooted problems at GTIC may not be easily remedied

GTIC's express revenue has grown at a meagre 2% CAGR in recent years

Our analysis of GTIC's financial performance over the past few years reveals continual market share loss, profit erosion, high leverage and subdued return ratios. Despite having a robust franchise in the express logistics space, the company's express revenue has grown at a meagre 2% CAGR over FY15-FY19, owing to slowdown in end-user industries and increased competitive intensity from pan-India and regional players. Cost increases led to an 11% decline in EBITDA, whereas PAT decreased by 17% CAGR. Following profit erosion in its most profitable business, GTIC's consolidated EBITDA/PAT also fell at a 9%/20% CAGR over FY15-FY19.

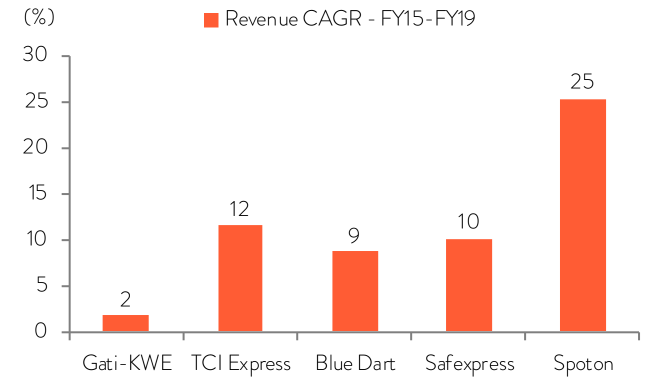
FIG 6 – GTIC'S CONSOLIDATED PERFORMANCE HAS WEAKENED IN RECENT YEARS

(Rs mn)	Gati-KWE					GTIC Consolidated				
	FY15	FY16	FY17	FY18	FY19	FY15	FY16	FY17	FY18	FY19
Revenue	11,387	11,399	11,103	11,663	12,288	16,481	16,670	16,910	17,365	18,632
YoY growth	45.6	0.1	(2.6)	5.0	5.4	11.4	1.1	1.4	2.7	7.3
EBITDA	1,123	936	731	711	707	1,393	1,308	959	771	943
YoY growth	36.3	(16.6)	(21.9)	(2.7)	(0.6)	1.3	(6.0)	(26.7)	(19.6)	22.3
EBITDA margin	9.9	8.2	6.6	6.1	5.8	8.4	7.8	5.7	4.4	5.1
Adj. PAT	575	440	315	310	270	595	492	172	627	230
YoY growth	55.7	(23.4)	(28.4)	(1.8)	(12.8)	3.7	(17.3)	(65.2)	265.6	(63.3)
Adj. PAT margin	5.0	3.9	2.8	2.7	2.2	3.6	3.0	1.0	3.6	1.2

Source: Company, BOBCAPS Research

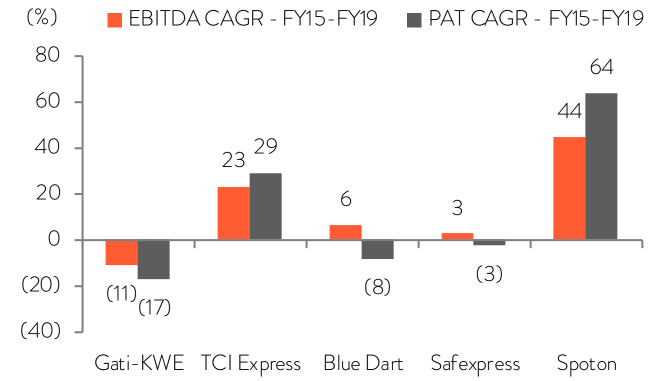
GTIC's revenue, EBITDA and PAT CAGR over FY15-FY19 have been substantially below that of other leading express logistics players such as TCI Express, Blue Dart Express, Safexpress, and Spoton Logistics, as illustrated below.

FIG 7 – GATI-KWE'S REVENUE GROWTH HAS BEEN SUBSTANTIALLY BELOW PEERS…



Source: Company, BOBCAPS Research

FIG 8 – …TRANSLATING TO UNDERPERFORMANCE IN EBITDA AND PAT



Source: Company, BOBCAPS Research

Leveraged balance sheet reduces scope for aggressive business expansion strategies

GTIC's skewed capital structure is also a cause for concern. Its leverage has consistently been high, with the net debt/EBITDA ratio standing at 3.5x in FY19. Declining profitability has taken a toll on return ratios as well – ROE and ROCE have been in low single digits over the past few years. While gross tangible asset turn is healthy at ~3x, high intangible assets, debtors and current assets mar total asset turn. Though AGLL aims to reduce leverage by debt restructuring, we believe turning GTIC around would be an uphill task given its weak balance sheet and deteriorating market standing.

FIG 9 – GTIC'S RETURN RATIOS REMAIN LOW, LEVERAGE HIGH

	FY15	FY16	FY17	FY18	FY19
Net debt to EBITDA (x)	3.2	3.9	5.2	4.3	3.5
Interest coverage (x)	3.3	3.1	1.9	1.6	2.1
Debtor days	59.1	53.5	46.3	51.1	46.8
Gross asset turn (x)	5.7	3.2	3.0	3.1	3.3
Total asset turn (x)	0.8	0.9	0.9	0.8	0.8
ROE (%)	9.5	6.4	2.3	7.4	2.7
ROCE (%)	7.9	6.1	4.5	3.2	4.3

Source: Company, BOBCAPS

AGLL has a rich history of acquisitions but mostly in global markets

In the past, AGLL has demonstrated its dexterity in managing large and small acquisitions, though most of the large deals were in global markets. Over the last decade and a half, AGLL has emerged as one of the top three players globally in the LCL consolidation (MTO) segment. A series of acquisitions in this space enabled the company to quickly achieve this strong market standing.

In FY06, it acquired Belgium-based ECU Worldwide (erstwhile ECU-Line), which had 4.3x AGLL's revenue at the time – this move propelled it into the league of prominent players in the global LCL landscape. The company further expanded its reach through several bolt-on acquisitions, which helped consolidate its position in a fragmented LCL market and expand its geographic presence.

FIG 10 – NOTABLE ACQUISITIONS BY AGLL

Year	Company	Geography	Deal value (US$ mn)	Comments
2005-06	ECU Worldwide	Belgium	60	One of the leading LCL players globally with 4.3x revenue and 10x office network of AGLL; originally a customer of AGLL's services
2007	Hindustan Cargo	India	NA	Air-freight and logistics arm of Thomas Cook India
2005	Econocaribe	USA	50	A leading LCL players in the US with a presence across the world; also provided FCL services. Fortified AGLL's position in the US market
2010	China Consolidation Shipping; Ningbo Star Express	Hong Kong/PRC	NA	Strengthened presence in China and Eastern region
2013	FCL Marine	Netherlands	NA	Leading NVOCC service provider in the FCL segment operating in Europe, US and Canada. Helped AGLL enter the FCL segment

Source: BOBCAPS Research, Company

While we acknowledge the company's proven track record of making acquisitions effective, we do note that a majority of these transactions have been in global markets. A large acquisition of the size of GTIC in India may pose a different set of integration challenges to AGLL.

Increase in leverage a concern

Net debt/EBITDA to double to >2x post open offer

Leverage for the combined entity post transaction would be >2x on TTM basis

The company is funding the acquisition through a mix of NCD issuance, incremental borrowings and divestment of non-core assets. If the open offer is successful, AGLL's leverage is likely to balloon, with the net debt/EBITDA ratio scaling past 2x vs. ~1x on TTM basis for the combined entity. Leverage may further increase as the company continues to invest in development of warehouses, which are currently not yielding any revenue. Moreover, all of AGLL's three existing businesses – MTO, CFS and P&E – are cyclical in nature. We are concerned about the increasing leverage profile of a cyclical business.

We believe there are some levers for AGLL to reduce the debt burden – (1) ramping up GTIC's EBITDA profile sharply – a big ask as we see no immediate revenue/cost synergies, and (2) monetisation of the warehousing assets under development, a key monitorable.

FIG 11 – AGLL'S CONSOL LEVERAGE SET TO INCREASE

(Rs mn)	AGLL	GTIC	Combined
H1FY20 net debt	5,883	4,909	13,952*
TTM EBITDA (H1FY20)	4,907	1,032	5,939
Net-debt/EBITDA (x)	1.2	4.8	2.3

Source: Company, BOBCAPS Research | *Including increase in outside liability (total purchase consideration excl. fresh issuance consideration) of Rs 3.16bn

Mega logistic park development further inflating debt

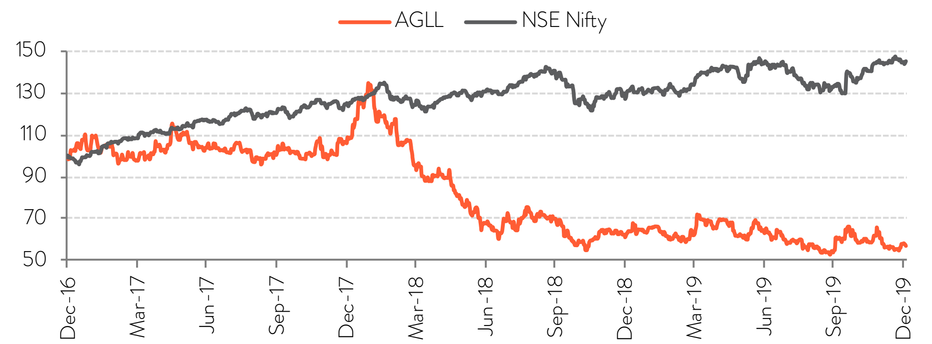
We highlight that the increase in leverage coincides with AGLL's already rising debt levels stemming from the development of logistics parks. Despite gaining 0.8mn sq ft from the acquisition of GTIC, AGLL remains committed to its plan of developing ~5mn sq ft of logistics parks space by end-FY21 – this will require a capital outlay of Rs 10bn, most of which is to be funded through debt. Peak revenue is expected to be Rs 1bn p.a. The company plans to monetise the logistics parks once completed.

Valuation methodology

Maintain BUY on attractive valuations of 7.5x FY22E EPS

We have not incorporated the GTIC acquisition into our estimates as we await the closure of open offer and the closure of the deal. Thus, we maintain our FY20-FY22 estimates and our Mar'21 target price of Rs 120. We continue to value AGLL's core business at 9x FY22E EPS and associate ACCI (AGLL's stake 61%) at 10x. Maintain BUY as the current market price yields an attractive trading P/E multiple of 7.5x on FY22E EPS.

FIG 12 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key downside risks to our estimates are:

- integration risks stemming from the GTIC acquisition,
- inability to monetise non-core assets and logistics parks at desired valuation,
- sharp downturn in global trade, and
- continued slowdown in container traffic at major ports.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	**60,492**	**68,949**	**75,616**	**85,413**	**96,486**
EBITDA	3,771	4,485	4,967	5,758	6,681
Depreciation	1,591	1,559	1,737	2,093	2,504
EBIT	2,181	2,926	3,230	3,665	4,176
Net interest income/(expenses)	(299)	(295)	(351)	(387)	(401)
Other income/(expenses)	391	338	319	328	276
Exceptional items	0	0	0	0	0
EBT	2,273	2,969	3,197	3,607	4,052
Income taxes	(513)	(542)	(710)	(803)	(904)
Extraordinary items	(69)	0	0	0	0
Min. int./Inc. from associates	48	52	32	43	57
Reported net profit	**1,739**	**2,478**	**2,519**	**2,847**	**3,205**
Adjustments	69	0	0	0	0
Adjusted net profit	**1,808**	**2,478**	**2,519**	**2,847**	**3,205**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	7,184	7,916	8,690	9,914	11,251
Other current liabilities	1,693	4,110	4,508	5,092	5,752
Provisions	556	604	662	748	845
Debt funds	4,801	6,319	6,855	7,355	7,355
Other liabilities	0	0	0	0	0
Equity capital	491	491	491	491	491
Reserves & surplus	19,324	19,703	21,494	23,527	25,823
Shareholders' fund	19,816	20,195	21,986	24,018	26,314
Total liabilities and equities	**34,049**	**39,144**	**42,701**	**47,126**	**51,516**
Cash and cash eq.	3,553	2,658	1,932	1,726	1,607
Accounts receivables	8,386	9,422	10,333	11,671	13,184
Inventories	96	89	97	110	124
Other current assets	2,073	4,562	5,010	5,659	6,393
Investments	2,598	2,586	2,586	2,586	2,586
Net fixed assets	10,877	11,368	15,777	18,184	20,179
CWIP	97	1,645	0	0	0
Intangible assets	4,273	4,161	4,161	4,161	4,161
Deferred tax assets, net	931	1,082	1,082	1,082	1,082
Other assets	1,164	1,571	1,723	1,946	2,198
Total assets	**34,049**	**39,144**	**42,701**	**47,126**	**51,516**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	3,399	4,038	4,255	4,940	5,710
Interest expenses	299	295	351	387	401
Non-cash adjustments	(210)	(152)	0	0	0
Changes in working capital	133	(727)	(289)	(330)	(420)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	**3,620**	**3,454**	**4,317**	**4,996**	**5,691**
Capital expenditures	(690)	(3,486)	(4,500)	(4,500)	(4,500)
Change in investments	(541)	12	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	**(1,231)**	**(3,474)**	**(4,500)**	**(4,500)**	**(4,500)**
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(1,140)	1,519	535	500	0
Interest expenses	(299)	(295)	(351)	(387)	(401)
Dividends paid	(491)	(860)	(759)	(858)	(966)
Other financing cash flows	453	(1,222)	32	43	57
Cash flow from financing	**(1,478)**	**(859)**	**(543)**	**(702)**	**(1,310)**
Changes in cash and cash eq.	**912**	**(879)**	**(726)**	**(205)**	**(119)**
Closing cash and cash eq.	**3,553**	**2,658**	**1,932**	**1,726**	**1,607**

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	7.1	10.1	10.3	11.6	13.0
Adjusted EPS	7.4	10.1	10.3	11.6	13.0
Dividend per share	2.0	3.5	2.6	2.9	3.3
Book value per share	80.0	81.4	88.5	96.6	105.7

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	0.4	0.4	0.3	0.3	0.3
EV/EBITDA	6.8	5.7	5.2	4.8	4.3
Adjusted P/E	13.0	9.5	9.3	8.3	7.3
P/BV	1.2	1.2	1.1	1.0	0.9

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	79.6	83.5	78.8	78.9	79.1
Interest burden (PBT/EBIT)	104.2	101.5	99.0	98.4	97.0
EBIT margin (EBIT/Revenue)	3.6	4.2	4.3	4.3	4.3
Asset turnover (Revenue/Avg TA)	2.5	2.7	2.7	2.8	3.0
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.3	1.3	1.3
Adjusted ROAE	9.6	12.5	12.1	12.5	12.9

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	8.3	14.0	9.7	13.0	13.0
EBITDA	(19.7)	18.9	10.7	15.9	16.0
Adjusted EPS	(26.9)	42.5	1.6	13.0	12.6
Profitability & Return ratios (%)					
EBITDA margin	6.2	6.5	6.6	6.7	6.9
EBIT margin	3.6	4.2	4.3	4.3	4.3
Adjusted profit margin	3.0	3.6	3.3	3.3	3.3
Adjusted ROAE	9.6	12.5	12.1	12.5	12.9
ROCE	8.9	11.4	11.7	12.2	12.8
Working capital days (days)					
Receivables	51	50	50	50	50
Inventory	1	0	0	0	0
Payables	46	45	45	45	46
Ratios (x)					
Gross asset turnover	4.1	4.5	3.9	3.5	3.3
Current ratio	1.5	1.3	1.3	1.2	1.2
Net interest coverage ratio	7.3	9.9	9.2	9.5	10.4
Adjusted debt/equity	0.1	0.2	0.2	0.2	0.2

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

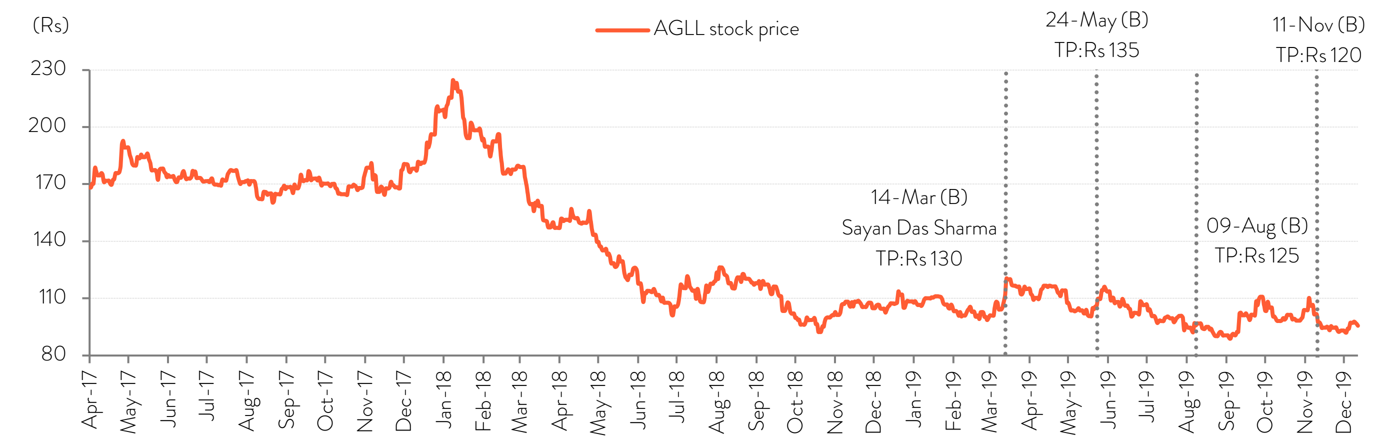
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: ALLCARGO LOGISTICS (AGLL IN)



B – Buy, A – Add, R – Reduce, S – Sell

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