JM JainMatrix Investments

A quality report by JainMatrix Investments

VRL Logistics IPO – Winner Takes All	
• **Date 14th April 2015** • **Price range: Rs. 195-205 and IPO Period: 15-17th Apr 2015** • **Advice: BUY, with a 2 year holding period.**	• **Mid Cap – Rs 1900 cr Mkt Cap** • **Industry – Transportation, Goods and Passengers**

Summary

- The transportation sector is recognized as a leading indicator of the economic cycle of the country. We expect this sector to do well over the next few years.
- VRL Logistics is one of the larger organized players of this sector. The firm represents several high potential businesses, built over many years by the first and now second generation entrepreneur.
- Management quality appears good. Like the real estate sector, doing business in transportation too involves many legal issues and disputes, the resolution of which may take many years due to our glacial judicial process. We downplay the large number of pending cases involving VRL.
- VRL appears to be business wise aggressive while financially sound, using PE funding for new ventures, and ensuring positive FCF for 5 of the last 6 years. This is a good combination.
- The VRL Logistics IPO is rated medium risk, but a BUY, with a 2 year holding period.

Here is a note on the VRL Logistics IPO (VRL).

IPO highlights

- IPO is open from 15-17th Apr 2015 with Issue Price band: Rs.195-205 per share
- Shares offered to public: 2.27 crores of Face Value: Rs.10 per share
- Shares offered as portion of equity post issue: 25%. Post IPO, promoters stake would reduce to 70%, another 25% would be sold in IPO to numerous parties and the rest 5% held by private investors.
- Amount proposed to be raised: Rs.467 crores (at upper end). The IPO proceed will be used for:
    - Rs 350 crore - exit by New Silk Route, PE firm and promoters Dr. Vijay and Anand Sankeshwar.
    - Rs 67 crore on acquisition of new fleet.
    - Rs 28 crore for repayment of debts and
    - The rest of about Rs 22 cr. would be spent for corporate purposes.
- These objects appear to be reasonable for investor exit and to grow the core business of VRL.

Introduction

- VRL is a surface transport and parcel delivery service provider with a 39 year history. It runs a fleet of 4000 trucks and buses (3,546 owned), the single largest truck fleet by an Indian private operator.
- Based in Hubbali in North Karnataka, it has 14,100 employees, and an operational infrastructure of 624 branches (604 leased & 20 owned) and 346 agencies all over India.
- FY15 revenues till Q3FY15 were Rs 1504 cr and Profits 57 cr.

- These revenues are from the business segments of goods transportation (76%), luxury bus services (20%) and wind power, air charter services and hospitality (4%). Goods transportation further includes a car carrier service for transportation of cars, vehicles for liquid transportation, as well as a courier service business across Karnataka.
- VRL has a hub and spoke operating model which enables them to transport various parcel sizes and provide customers with access to multiple destinations for booking and delivery of goods.

Financials of VRL

- We can see that the financials of VRL in Fig 1 are good …..

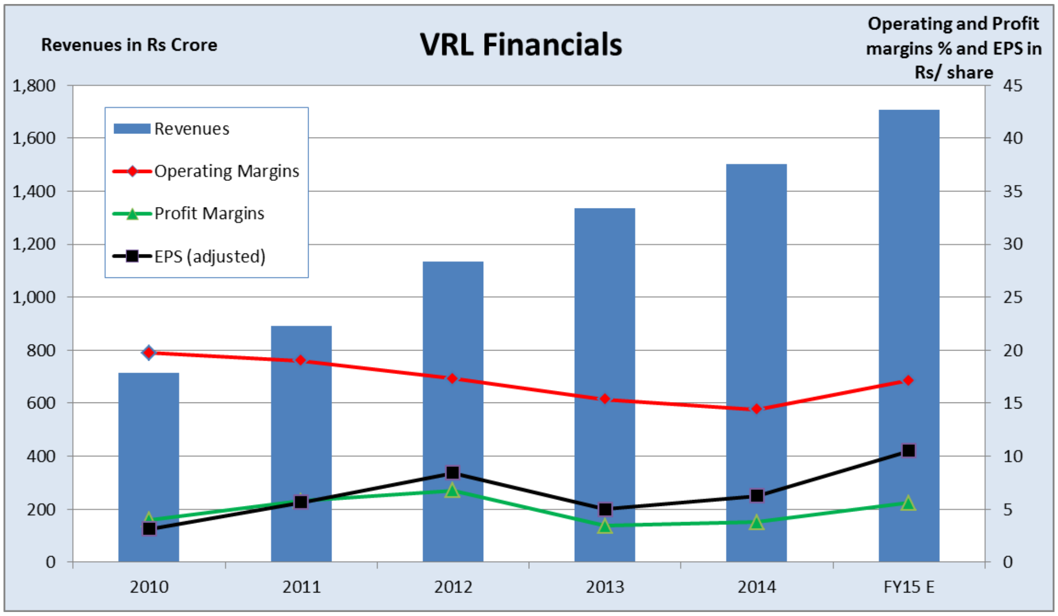

Fig 1 – Financials

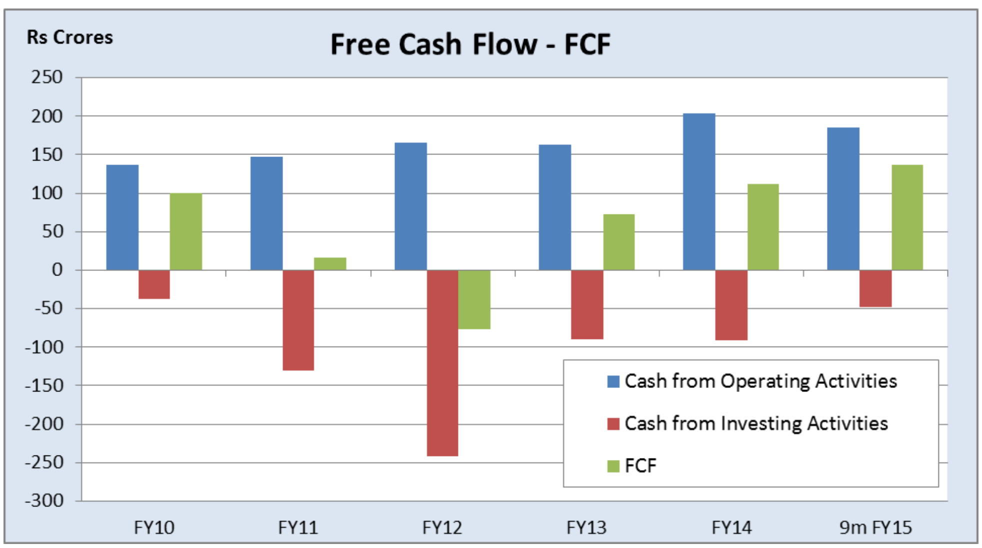

Fig 2 – Cash Flow

- Note that we have estimated FY15 financials simply proportional to the 9 month performance. Actual performance may differ especially since lots of revenues are booked in Q4 for such firms.

- The Revenues, EBITDA and PAT of VRL have grown at 20%, 11% and 19% CAGR in 5 years till FY14.
- Margins are improving in FY15 compared to previous years, reversing the trend.
- The Free Cash Flow is positive, see Fig 2. This is a very good sign of conservative financials.
- The debt-equity ratio has reduced from over 2.5 in FY2012 to 1.09 in 9m FY15. But this was done through both usage of Free Cash Flow to pay back debt, and also by raising funds/ diluting equity.
- Valuations for VRL are at a P/E of 18.6-19.5 times estimated FY15 EPS.

Benchmarking

Particulars	VRL	TCI	Blue Dart	Allcargo	GATI	Snowman
Market Capitalization	1,870	2,160	16,455	4,460	2,100	1550
Revenues (FY14)	1,503	2,230	1,937	4,840	1,270	153
P/E	19.5	31.1	164.0	22.5	47.8	67.0
Net Profit Margin (%)	5.6	3.22	6.3	3.1	0.8	2.1
3 year Revenue Growth %	15.1	6.4	19.0	19.3	-2.5	0.0
Debt-equity ratio (x)	1.10	0.77	0.00	0.50	0.76	0.28
EBITDA margin (%)	17.1	8.0	10.9	8.9	7.2	8.5

Fig 3 – Benchmarking Analysis

- In this benchmarking exercise we compare VRL with listed Transport & Logistics and Courier firms.
- We can see that VRL is attractively valued in terms of P/E; Profit & EBITDA margins and Revenue growth are also on the higher side.
- Debt/Equity is high and reflects heavy recent investments in growth and assets. The annual trend on this is a reduction so there is a comfort for investors here.

A SWOT Analysis …… Strengths

- Good solid 39 year brand in Indian transportation.
- Excellent operations of hub-and-spoke model, and the infrastructure of branches, trans-shipment centers and own fleet of trucks and buses.
- Being Hubbali based, VRL enjoys lower costs of operations while also being centrally located in terms of Indian logistics. The firm also focuses on in-house development of software, vehicle maintenance and body design facilities which help maintain operating efficiency in business.
- Solid financials with revenue growth, good margin trends and falling debt.
- Fuel costs are falling in FY15, which will benefit the margins and profits.
- The company will benefit from growing demand of high margin LTL (Less-than Truck Load) business due to its large scale and wider reach.

Weaknesses

- There are a number of legal cases pending against or by VRL. This indicates a certain cloudy or dispute prone operating environment, that can distract management from their tasks. It can also have unintended and large losses depending on the results of the proceedings.
- Fuel constitutes almost 30% of costs. They were high in FY14, but falling in FY15. Thus fuel is a large component of VRL costs, that is out of control of management, similar to the airplane industry.

Opportunities

- One of the oldest, but now newly emerging and high potential industry in India.

- The economic cycle in India is on the recovery path after a trough /bottom in FY 2013. In such a recovery period, commercial activity accelerates and transportation sector can do exceedingly well.
- A significant trend in the goods transportation sector in India is the transition of the sector from the small and unorganised firms to large reputed organized players. This is a positive for VRL.
- Road freight constitutes 63% of the overall freight movement in the country, and is growing. The major competition to VRL's business is the Indian Railways, which has shown lethargic capacity addition, and has lost market share consistently over the last few decades.
- Its easy for new competition to enter this sector, but growing beyond a mid-sized firm needs a national scale, infrastructure and network. We feel that VRL is a leader in a sector where 'winner takes all' will prevail and the top 2-3 players will dominate the all India market shares.
- Recent new initiatives such as GST and Golden Quadrilateral/ highway improvements will significantly improve productivity at VRL.

Threats

- Intense competition from PSUs and other private sector road transport players.
- Road safety is an issue in India with congestion on highways, poor driver skills, obstructions and poor vehicle controls and governance. Rising accidents can impact costs and morale.

Overall Opinion

- The transportation sector is recognized as a leading indicator of the economic cycle of the country. We expect this sector to do well over the next few years.
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- Management quality appears good. Like the real estate sector, doing business in transportation too involves many legal issues and disputes, the resolution of which may take many years due to our glacial judicial process. We downplay the large number of pending cases involving VRL.
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