JM JainMatrix Investments

A quality report by JainMatrix Investments

# Navkar Corp IPO – Location Challenges - Avoid	M/s Navkar Corporation Ltd Container Freight Stations & Rail Terminals
• Date Aug 25th, 2015 • Industry – Logistics • Advice: Avoid	• Mid Cap share – 2210 cr mkt cap • IPO Period: 24-26 Aug 2015

Navkar Corporation is logistics firm that provides container handling and storage services. It is established in the JNPT port region and has expansion plans locally and in Vapi Gujarat. The Income, EBITDA and Profits have grown at 7.2%, 10.2% and 15.9% CAGR over last 3 years. While current operations and margins are excellent, we are concerned about slow JNPT port traffic growth. Gujarat operations are also at least 2 years away from profitability. Free Cash flows are negative, and logistics businesses require large and early investments.

Here is a note on the Navkar Corporation IPO (NKC)

IPO highlights

- IPO Share Price range: Rs. 147-155 and Period: 24-26 Aug 2015
- Number of Shares: 3.9-4.1 cr. shares of face value 10, which are 28.3% of equity post issue.
- Retail quota is 35%, qualified institutions get 50% and 15% is for HNI. See Fig 1a for pattern.
- The IPO will raise Rs. 600 cr. to be used for:
  - Capacity enhancement of the Somathane CFS at a cost of 114 crores.
  - Development of the non-notified areas of their CFSs at a cost of 54 cr.
  - Establishment of a logistics park at Valsad (near Vapi) at a cost of 314 cr.
  - Encashing of stake by a promoter group company Siddhartha Corp of 90 cr.
- The P/E of NKC is 28.7 – 30.2 times at lower /upper price band, based on the FY15 financials.
- Post IPO, the market cap of the firm will be 2210 cr. (upper).

Introduction

- NKC is a Raigad, Maharashtra based firm which provides cargo handling and storage services.
- It has three Cargo Freight Stations (CFS), Ajivali CFS 1 & 2 and Somathane CFS, which are located in Panvel, Maharashtra, in close proximity to the JNPT, the largest container port in India.
- NKC's revenue and profit were Rs 330.9 cr. and 73.1 cr. respectively for FY15.
- It operates a private railway freight terminal, where loading, unloading and transfer of cargo takes place between container trains, CFSs and JNPT. NKC also owns and operates 516 trailers for the transportation of cargo between CFSs and the JNPT by road.
- The firm also offers cargo storage - including a buffer yard and warehouses; and services such as packing, labelling/bar-coding, palletizing, fumigation, etc.
- The employee strength is 808. The CFSs have an aggregate installed handling capacity of 310,000 TEUs (twenty-foot equivalent unit, a measure of cargo capacity) per annum.
- Leadership is Shantilal Mehta, Chairman, Anish Maheshwari CFO and Dinesh Gautama, President.
- Business segments are primarily cargo handling and cargo storage, see revenue segments in Fig 1b.

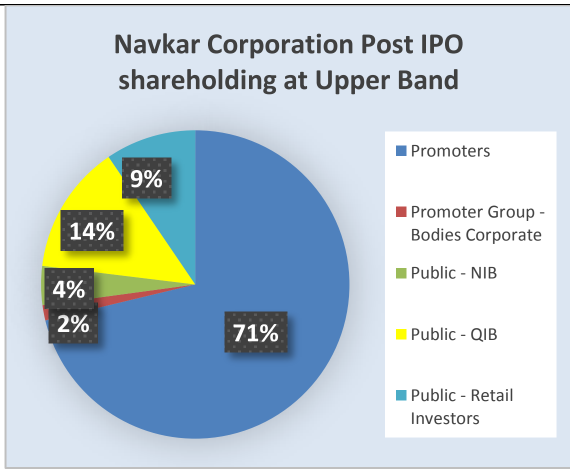

Fig1a – Shareholding post IPO

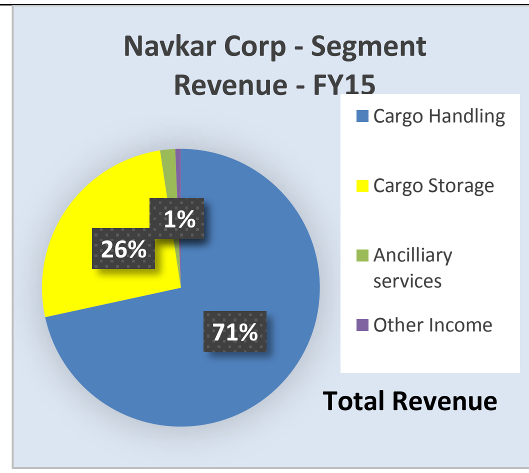

Fig 1b – Revenue Breakdown

Financials of NKC IPO

- The Income, EBITDA and Profits have grown at 7.2%, 10.2% and 15.9% CAGR over last 3 years.
- Margins are good with Operating and Profit margins at 36.8% and 22.1% for FY15, see Fig 2.
- The D/E of the firm pre IPO is 0.75. This will fall post IPO, and is a good level within the industry.
- RoNW and RoE metrics are at 14.7% and 11.8% in FY15, which is fair.
- The business does not have free cash flows since the last 3 years. See Fig 3.

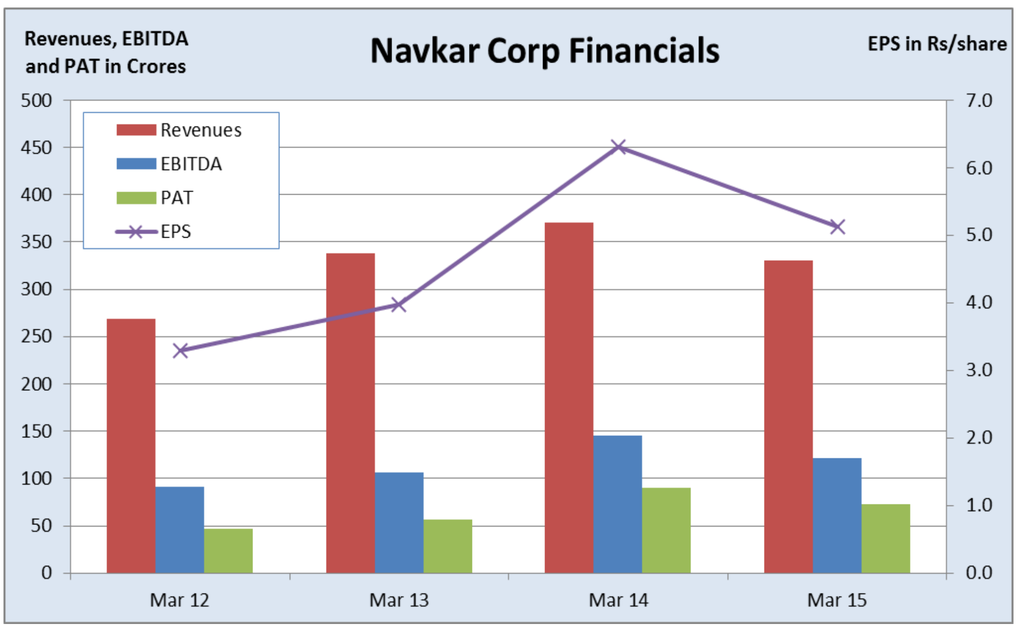

Fig 2 – Financials, Source: RHP

Business Notes, Industry Notes and Trends

- The CFS business in India is highly fragmented and competitors include Gateway Distriparks, Allcargo Logistics, Hind Terminals and the Container Corporation of India.
- NKC has planned a new logistics park at Valsad (near Vapi) with capacity of 474,000 TEU p.a.
- **JNPT saturation:** The volumes handled at JNPT increased at a CAGR of 5.9% from 2.37 TEU's to 4.47 TEU's over the period FY06-15. But much of this growth came in the initial 5 years with the growth stagnating in the next 5, due to diversion of traffic from JNPT to ports like Mundra and Pipavav.

- JNPT port container capacity is 3.8 million TEU's/annum and it is operating at over 100% capacity leading to congestion. The capacity is not expected to increase for 4-5 years as the fourth container terminal project (capacity 4.8 million TEUs) is delayed due to regulatory and procedural hurdles.

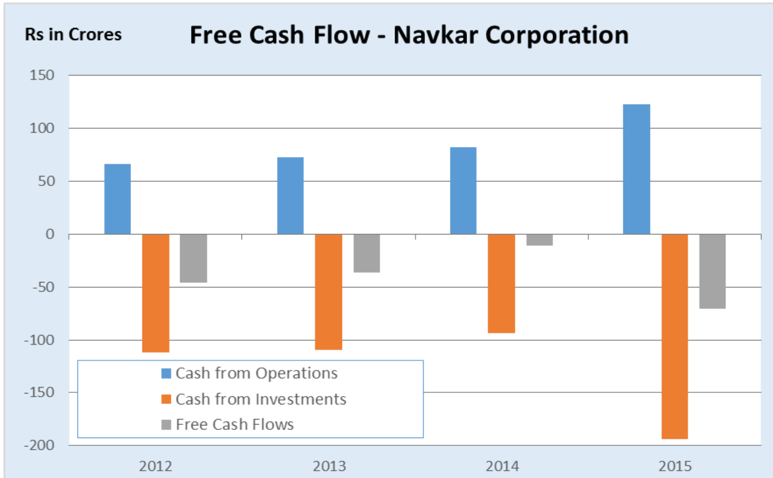

Fig 3 – Cash Flows of NKC

- **Demand drivers:** The introduction of GST will increase demand from sectors like cement, steel and auto. A lot of logistics parks are being set up by players within the industry which would help in meeting incremental demand. The GST bill may be implemented by the second half of FY2016
- The non-major ports (private or state-owned) continued to fare better than the major government-owned ports, with a growth of 24% in 2014-15. These non-major ports have grown due to good container handling capacities, road and rail connectivity, deeper draft levels, and modern equipment and technology for fast cargo evacuation.
- **Competition**: With volumes and realization of CFS players around JNPT stagnating, and with the global shipping industry going through a rough time since FY09, the shipping lines are demanding a nomination premium from the CFS operators for getting the import containers nominated to their CFSs. The CFS operators are not able to pass on this nomination premium to their end customer due to increasing competition and global slowdown.
- In FY15, there were 30 CFS operators around JNPT with capacity of 3 million TEU's per annum with another 16 CFS to begin operations in the next 2-3 years. Thus there is high competition expected which may bring down the margins.

Positives for the IPO and firm NKC

- NKC has good operating and net profit margin of 22% which is the best within this industry.
- NKC's expansion plan of setting up a logistics park and ICD at Valsad and capacity expansion plan at Somthane CFS will significantly increase its capacity and lead to higher volumes and earnings.
- NKC's top management has highly qualified and experienced personnel which includes Mr Dinesh Gautama, Mr Ashish Chandna, Mr Jayesh Kothari and Ms Ekta Chuglani.
- Good business momentum and capabilities.

Negatives and Internal Risks

- NKC's business operations are concentrated and are dependent on the JN Port. Any decline in the container traffic handled or any significant social, political, economic or geological disruption in the region could have an adverse effect on their business.
- NKC faces regulatory risks of licenses and approvals including environment regulations, from several government organizations, which could adversely affect their business.

- Their operations are dependent upon the Private Freight Terminal, which was set up with approvals from Central Railway, the termination or non-renewal of which will affect their business.
- In FY2015, NKC discontinued the trading of agro products, and so is seeing a fall in revenues YoY.
- Their services involve handling and storage of hazardous goods which can cause injury or damage.

External Risks

- NKC's business is dependent on economic growth in India, and overall Export - Import growth.
- Transportation and logistics sector bears risks of accidents, and long pending legal disputes.
- Natural or man-made disasters could adversely affect NKC operations and financial condition.

Benchmarking

We will benchmark NKC against its peers of listed logistics firms.

Particulars	Navkar	Snowman	Concor	Allcargo	GATI	Sical	Aegis
P/E	30.22	33.7	28.7	18.8	34.2	45.6	17.0
Price to Book Value	2.29	3.50	3.79	1.67	1.48	1.23	3.10
3 year Revenue Growth	7.16	55.5	9.4	19.3	11.2	1.8	40.6
Debt-equity ratio (x)	0.75	0.54	0.00	0.50	0.76	1.35	0.86
EBITDA margin (%)	36.8	25.7	28.4	8.9	7.2	13.9	2.4
Net Profit Margin (%)	22.10	15.0	18.59	3.1	0.8	0.9	1.2
Return on Equity (%)	11.8	10.1	14.5	9.0	3.1	2.0	20.7
Return on Capital Employed (%)	10.06	6.5	19.0	9.8	6.7	5.5	15.4

Fig 4 – Benchmarking

Based on Fig 4, we note our observations:

- Margins are the best within the industry, which is a big positive for NKC.
- Valuation look stretched, and at the higher end on both P/E and P/B ratios.
- The 3 year revenue growth of NKC is low.

Overall Opinion

- The logistics sector is part of infrastructure and these are crucial building blocks for India's growth. With an economic recovery in India, we certainly expect a massive growth in this sector in terms of demand, investments, technology upgradation and revenues.
- However the NKC current operations are dependent on JNPT port, which along with other large Central ports have shown poor capacity enhancement and growth in 3-4 years. The capacity expansion at Somathane may not directly result in revenues growth due to this.
- NKC's move to build a logistics park and ICD capacities in Gujarat is a big positive with good prospects here. But these will take over 1 year to create and longer to contribute to the bottom line.
- The infrastructure/ logistics sector is a poor generator of cash flows, and it takes large initial investments and a good gestation period before it is able to create free cash flows.
- The pricing of the IPO is average, and does not leave enough on the table to be attractive.
- Based on all this, we advise investors to avoid the NKC IPO. Instead they may watch for completion of these capital investments and enter the stock through secondary markets after about 1 year.