

BUY

TP: Rs 680 | ▲ 33%

FUTURE SUPPLY CHAIN SOLUTIONS

| Logistics

| 03 November 2019

Dull Q2 as demand slowdown deepens

Future Supply Chain's (FSCSL) Q2FY20 standalone earnings nosedived 64% YoY (ex. Ind-AS 116), dented by lower EBITDA (-13% YoY) and higher depreciation (+61%) & interest costs (+332%). The consumption slowdown and consequent deferral of warehouse space addition plans will continue to weigh on earnings in H2. Gradual transition of anchor customer operations to FSCSL's distribution centres and robust client addition are growth triggers beyond FY20. We slash FY20-FY22 EPS by 11-45% and roll to a Mar'21 TP of Rs 680 (vs. Rs 730).

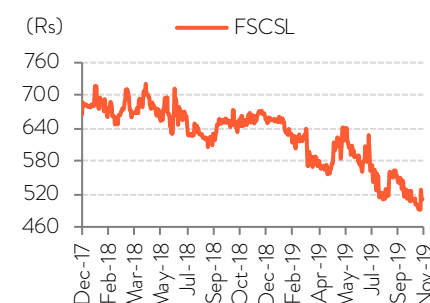
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Revenue growth weakens: Revenue growth slowed to 12% YoY as contract logistics moderated to 15% (despite ~30% YoY space addition). Warehouse utilisation was hit by (1) the consumption slowdown which led to lower customer throughput in some discretionary categories (e.g. fashion), and (2) anchor customer's delays in moving existing operations to FSCSL's distribution centres (DC). Express volumes fell 6% YoY, but better yields (+4.5%) capped the revenue decline at 1.5%.

Ticker/Price	FSCSL IN/Rs 510
Market cap	US\$ 287.8mn
Shares o/s	40mn
3M ADV	US\$ 0.1mn
52wk high/low	Rs 711/Rs 490
Promoter/FPI/DII	52%/5%/19%

Source: NSE

Margin pressure continues: A lower gross margin (-375bps YoY) pulled down the EBITDA margin by 290bps YoY to 10.5% (ex. Ind-AS 116), negating lower employee (-70bps YoY) and other expenses (-13bps) as a percentage of sales.

STOCK PERFORMANCE

Source: NSE

Material growth uptick unlikely in H2: Amid the slowdown, FSCSL has deferred its space addition plans (only 0.7mn sq ft added in H1 vs. 2.5mn planned in FY20). Festive season demand has been subpar and the tough demand climate is likely to weigh on H2 growth. Management expects space absorption in DCs by the anchor customer to pick up in Q3, lending some respite.

TP reduced: We cut FY20E/FY21E/FY22E earnings by 45%/26%/11% and move to a revised Mar'21 TP of Rs 680 set at 22x P/E (vs. 24x). Maintain BUY.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	8,319	11,128	13,135	16,343	20,171
EBITDA (Rs mn)	1,332	1,485	1,395	2,127	2,754
Adj. net profit (Rs mn)	903	964	515	838	1,237
Adj. EPS (Rs)	22.5	24.0	12.9	20.9	30.8
Adj. EPS growth (%)	92.8	6.7	(46.6)	62.6	47.5
Adj. ROAE (%)	21.8	17.0	8.2	12.1	15.7
Adj. P/E (x)	22.6	21.2	39.6	24.4	16.5
EV/EBITDA (x)	15.6	13.4	15.3	10.4	8.4

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE – STANDALONE (EXCL. IND-AS 116 IMPACT)

Y/E Mar (Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	H1FY20	H1FY19	YoY (%)
Total revenues	3,125	2,802	11.5	2,989	4.6	6,113	5,124	19.3
Cost of logistics services	2,277	1,937	17.6	2,211	3.0	4,489	3,540	26.8
% of sales	72.9	69.1	376bps	74.0	(112bps)	73.4	69.1	432bps
Employee expenses	250	244	2.3	264	(5.6)	514	467	10.1
% of sales	8.0	8.7	(72bps)	8.9	(86bps)	8.4	9.1	(71bps)
Other expenses	269	245	9.9	237	13.5	506	450	12.5
% of sales	8.6	8.7	(13bps)	7.9	68bps	8.3	8.8	(51bps)
Total expenditure	2,796	2,426	15.3	2,713	3.0	5,509	4,458	23.6
EBITDA	329	376	(12.7)	275	19.4	604	666	(9.3)
EBITDA margin (%)	10.5	13.4	(291bps)	9.2	131bps	9.9	13.0	(311bps)
Depreciation	159	98	61.4	148.2	7.2	307	199	54.6
EBIT	170	278	(38.9)	127	33.5	297	467	(36.4)
Interest expenses	87	20	332.4	74.6	16.1	161	38	323.8
Other income	14	9	54.5	13.1	9.6	27	21	33.0
PBT	97	267	(63.5)	66	48.5	163	450	(63.7)
PBT margin (%)	3.1	9.5	(641bps)	2.2	92bps	2.7	8.8	(611bps)
Income tax	-	-	-	-	-	-	-	-
Reported PAT – from continuing operations	97	267	(63.5)	66	48.5	163	450	(63.7)
PAT margin (%)	3.1	9.5	(641bps)	2.2	92bps	2.7	8.8	(611bps)
Profit from discontinued operations	-	(70)	-	-	NM	-	(155)	NM
Reported PAT	97	197	(50.6)	66	48.5	163	294	(44.6)

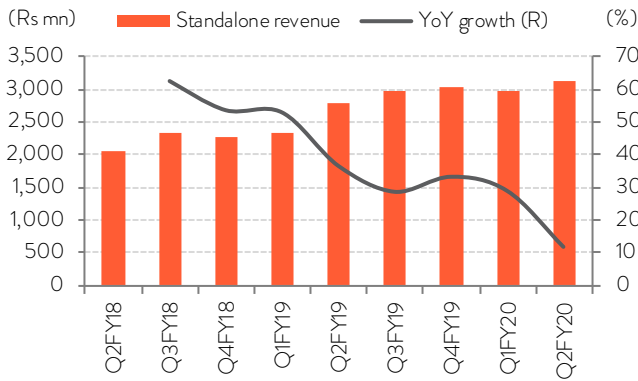
Source: Company, BOBCAPS Research

FIG 2 – QUARTERLY PERFORMANCE – STANDALONE (INCL. IND-AS 116 IMPACT)

Y/E Mar (Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	H1FY20	H1FY19	YoY (%)
Total revenues	3,125	2,802	11.5	2,989	4.6	6,113	5,124	19.3
Cost of logistics services	1,971	1,937	1.8	1,920	2.7	3,891	3,540	9.9
% of sales	63.1	69.1	(603bps)	64.2	(115bps)	63.6	69.1	(546bps)
Employee expenses	250	244	2.3	264	(5.6)	514	467	10.1
% of sales	8.0	8.7	(72bps)	8.9	(86bps)	8.4	9.1	(71bps)
Other expenses	263	245	7.5	232	13.3	496	450	10.1
% of sales	8.4	8.7	(31bps)	7.8	65bps	8.1	8.8	(68bps)
Total expenditure	2,484	2,426	2.4	2,417	2.8	4,901	4,458	9.9
EBITDA	640	376	70.2	572	12.0	1,212	666	82.1
EBITDA margin (%)	20.5	13.4	707bps	19.1	136bps	19.8	13.0	684bps
Depreciation	411	98	317.5	388.7	5.7	800	199	302.6
EBIT	229	278	(17.4)	183	25.3	413	467	(11.6)
Interest expenses	156	20	677.7	162.4	(4.1)	318	38	736.6
Other income	14	9	54.5	13.1	9.6	27	21	33.0
PBT	88	267	(67.1)	34	159.7	122	450	(72.9)
PBT margin (%)	2.8	9.5	(672bps)	1.1	168bps	2.0	8.8	(678bps)
Income tax	-	-	-	-	-	-	-	-
Reported PAT – from continuing operations	88	267	(67.1)	34	159.7	122	450	(72.9)
PAT margin (%)	2.8	9.5	(672bps)	1.1	168bps	2.0	8.8	(678bps)
Profit from discontinued operations	-	(70)	-	-	NM	-	(155)	NM
Reported PAT	88	197	(55.4)	34	160	122	294	(58.5)

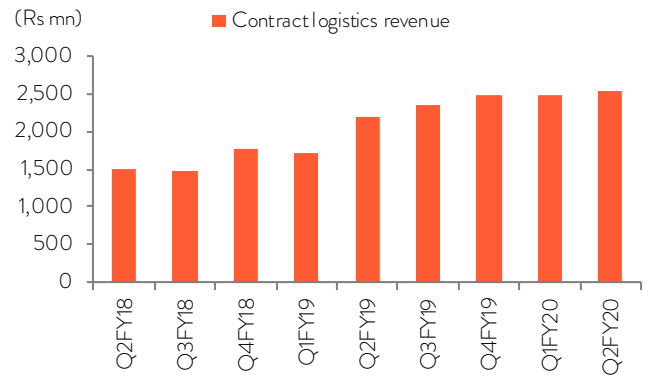
Source: Company, BOBCAPS Research

FIG 3 – REVENUE GREW AT 11.5% YOY IN Q2...



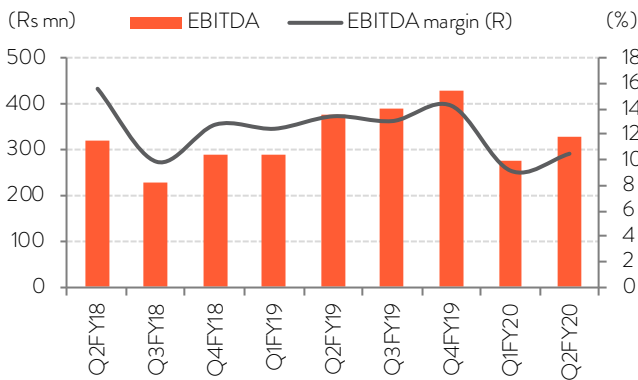
Source: Company, BOBCAPS Research

FIG 4 – ...LED BY CONTRACT LOGISTICS SEGMENT



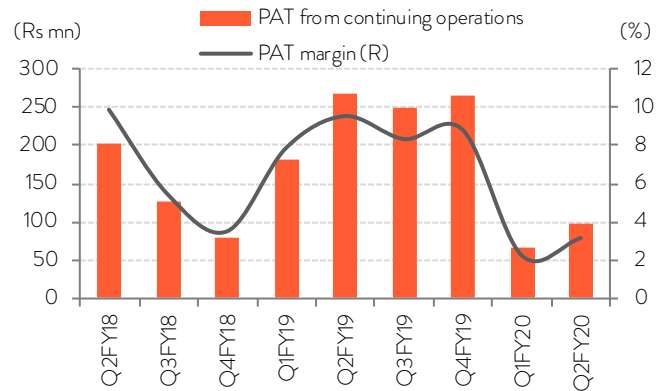
Source: Company, BOBCAPS Research

FIG 5 – EBITDA MARGIN CONTRACTED 291BPS YOY TO 10.5%



Source: Company, BOBCAPS Research

FIG 6 – ...DRIVING A SHARP YOY DECLINE IN PAT FROM CONTINUING OPERATIONS



Source: Company, BOBCAPS Research

Other key highlights

- **Nippon deal on track:** FSCSL has received shareholder approval and an in-principle nod from the stock exchanges for a 22% stake sale to Nippon Express of Japan (see our report ‘[Minority stake sale to strategic investor](#)’ dated 20 Sep 2019), with 8% to be sold through primary issuance and 14% to be acquired from existing investors. The company has filed for approval from the Competition Control of India.
- We view the deal as a positive development. The likely business collaboration will derive synergies from FSCSL’s robust presence in India and Nippon’s strong global heritage, including entrenched relationships with MNCs operating in India.
- **Capex plan deferred:** Management indicated that the addition of warehousing space in FY20 is likely to be lower than the previous target of 2.5mn sq ft (0.7mn added in H1), but did not share any revised target. Accordingly, we reduce our FY20 space addition assumption to 1.5mn sq ft and increase our FY21 estimate to 2.5mn sq ft from 2mn earlier.
- **Customer addition robust:** Despite the demand slowdown, FSCSL added three reputed corporates to its client roster in Q2 – an ethnic wear brand, a sportswear brand and an FMCG brand. New customer addition is expected to remain a key driver of growth going ahead.
- **Receivables inch up:** Facing a liquidity crunch, some customers have delayed payment to FSCSL, leading to a minor increase in debtor days (to 119 in H1 vs. 114 in FY19). The company has also raised long-term borrowings of Rs 2.6bn in H1FY20 to fund its future capex plan. However, it is likely to pare this debt post capital infusion through the Nippon deal.

Valuation methodology

We slash our FY20 earnings estimate by 45% factoring in the lower capex target for H2, below-anticipated demand, and underperformance in H1FY20. Consequently, we reduce our FY21/FY22 earnings estimates by 26%/11% as well. We have not factored the Nippon Express transaction into our estimates as key regulatory approvals are still awaited. Considering the demand slowdown, we also lower our one-year forward P/E multiple to 22x from 24x earlier. Rolling valuations over to Mar'22, we have a revised target price of Rs 680 from Rs 730.

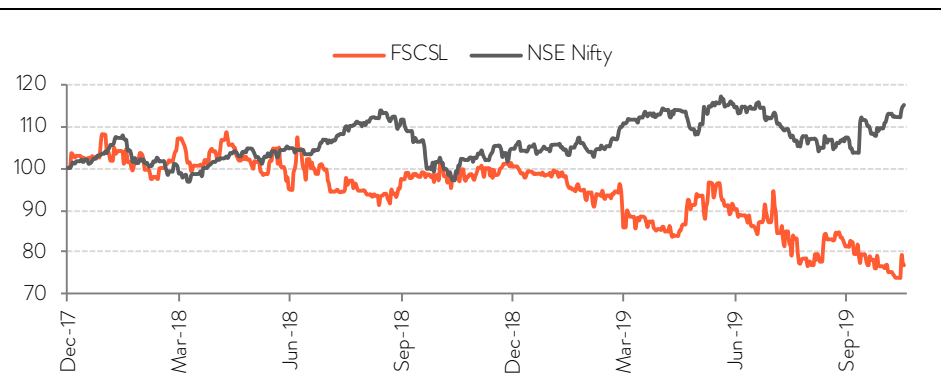
We remain positive on FSCSL's long-term prospects considering (1) its robust credentials in the Indian 3PL industry, (2) expertise in the rapidly growing consumer 3PL vertical, (3) growing anchor clients, and (4) possible synergies from the Nippon Express collaboration. Maintain BUY.

FIG 7 – REVISED ESTIMATES - STANDALONE

(Rs mn)	FY20E			FY21E			FY22E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenues	14,325	13,135	(8.3)	17,863	16,343	(8.5)	21,276	20,171	(5.2)
EBITDA	1,626	1,395	(14.2)	2,477	2,127	(14.2)	3,027	2,754	(9.0)
EBITDA margin (%)	11.4	10.6	(73bps)	13.9	13.0	(86bps)	14.2	13.7	(57bps)
PAT	933	515	(44.8)	1,136	838	(26.3)	1,381	1,237	(10.5)
PAT margin (%)	6.5	3.9	(259bps)	6.4	5.1	(123bps)	6.5	6.1	(36bps)

Source: Company, BOBCAPS Research

FIG 8 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Growth moderation in anchor customer's business
- High churn in the non-anchor client segment
- Prolonged slowdown in consumption spending

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E*	FY21E*	FY22E*
Total revenue	8,319	11,128	13,135	16,343	20,171
EBITDA	1,332	1,485	1,395	2,127	2,754
Depreciation	456	417	623	757	932
EBIT	876	1,068	772	1,369	1,822
Net interest income/(expenses)	(87)	(161)	(339)	(331)	(248)
Other income/(expenses)	114	56	82	88	87
Exceptional items	0	0	0	0	1
EBT	903	964	515	1,126	1,662
Income taxes	0	0	0	(288)	(425)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	903	964	515	838	1,237
Adjustments	0	0	0	0	0
Adjusted net profit	903	964	515	838	1,237

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E*	FY21E*	FY22E*
Accounts payables	1,764	2,367	2,735	3,144	3,880
Other current liabilities	707	1,169	749	997	1,156
Provisions	78	113	133	166	205
Debt funds	346	2,187	4,687	3,687	2,687
Other liabilities	0	0	0	0	0
Equity capital	401	401	401	401	401
Reserves & surplus	4,948	5,603	6,118	6,914	8,075
Shareholders' fund	5,348	6,003	6,519	7,314	8,475
Total liabilities and equities	8,244	11,839	14,823	15,308	16,403
Cash and cash eq.	797	1,177	2,938	867	361
Accounts receivables	2,591	3,488	4,139	4,701	5,250
Inventories	0	55	54	67	83
Other current assets	256	534	237	295	364
Investments	631	631	631	631	631
Net fixed assets	3,151	4,110	5,506	7,109	7,697
CWIP	25	639	0	0	0
Intangible assets	22	12	12	12	12
Deferred tax assets, net	0	0	0	0	0
Other assets	771	1,192	1,306	1,625	2,005
Total assets	8,244	11,839	14,823	15,308	16,403

Source: Company, BOBCAPS Research | *Excluding Ind-AS 116 impact

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E*	FY21E*	FY22E*
Net income + Depreciation	1,359	1,381	1,138	1,595	2,168
Interest expenses	87	161	339	331	248
Non-cash adjustments	(101)	0	0	0	0
Changes in working capital	322	(554)	(497)	(264)	(80)
Other operating cash flows	1	0	0	0	0
Cash flow from operations	1,669	988	980	1,663	2,336
Capital expenditures	(1,660)	(1,980)	(1,380)	(2,360)	(1,520)
Change in investments	(631)	0	0	0	0
Other investing cash flows	1	0	0	0	0
Cash flow from investing	(2,290)	(1,980)	(1,380)	(2,360)	(1,520)
Equities issued/Others	9	0	0	0	0
Debt raised/repaid	(481)	1,841	2,500	(1,000)	(1,000)
Interest expenses	(87)	(161)	(339)	(331)	(248)
Dividends paid	(48)	(60)	0	(42)	(74)
Other financing cash flows	1,554	(248)	0	0	0
Cash flow from financing	947	1,372	2,161	(1,373)	(1,323)
Changes in cash and cash eq.	326	380	1,761	(2,070)	(506)
Closing cash and cash eq.	797	1,177	2,938	867	361

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E*	FY21E*	FY22E*
Reported EPS	22.5	24.0	12.9	20.9	30.8
Adjusted EPS	22.5	24.0	12.9	20.9	30.8
Dividend per share	1.0	1.3	0.0	1.0	1.5
Book value per share	133.5	149.8	162.6	182.5	211.5

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E*	FY21E*	FY22E*
EV/Sales	2.5	1.8	1.6	1.4	1.2
EV/EBITDA	15.6	13.4	15.3	10.4	8.4
Adjusted P/E	22.6	21.2	39.6	24.4	16.5
P/BV	3.8	3.4	3.1	2.8	2.4

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E*	FY21E*	FY22E*
Tax burden (Net profit/PBT)	100.0	100.0	100.0	74.4	74.4
Interest burden (PBT/EBIT)	103.1	90.2	66.7	82.2	91.2
EBIT margin (EBIT/Revenue)	10.5	9.6	5.9	8.4	9.0
Asset turnover (Revenue/Avg TA)	1.7	1.6	1.3	1.5	1.8
Leverage (Avg TA/Avg Equity)	1.6	1.8	2.1	2.2	2.0
Adjusted ROAE	21.8	17.0	8.2	12.1	15.7

Source: Company, BOBCAPS Research | Note: TA = Total Assets | *Excluding Ind-AS 116 impact

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E*	FY21E*	FY22E*
YoY growth (%)					
Revenue	48.2	33.8	18.0	24.4	23.4
EBITDA	79.2	11.5	(6.1)	52.5	29.5
Adjusted EPS	92.8	6.7	(46.6)	62.6	47.5
Profitability & Return ratios (%)					
EBITDA margin	16.0	13.3	10.6	13.0	13.7
EBIT margin	10.5	9.6	5.9	8.4	9.0
Adjusted profit margin	10.9	8.7	3.9	5.1	6.1
Adjusted ROAE	21.8	17.0	8.2	12.1	15.7
ROCE	18.3	15.4	8.0	12.3	16.4
Working capital days (days)					
Receivables	114	114	115	105	95
Inventory	0	2	2	2	2
Payables	92	90	85	81	81
Ratios (x)					
Gross asset turnover	2.9	2.4	2.1	1.9	1.9
Current ratio	1.5	1.5	2.1	1.4	1.2
Net interest coverage ratio	10.1	6.6	2.3	4.1	7.3
Adjusted debt/equity	(0.1)	0.2	0.3	0.4	0.3

Source: Company, BOBCAPS Research | *Excluding Ind-AS 116 impact

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

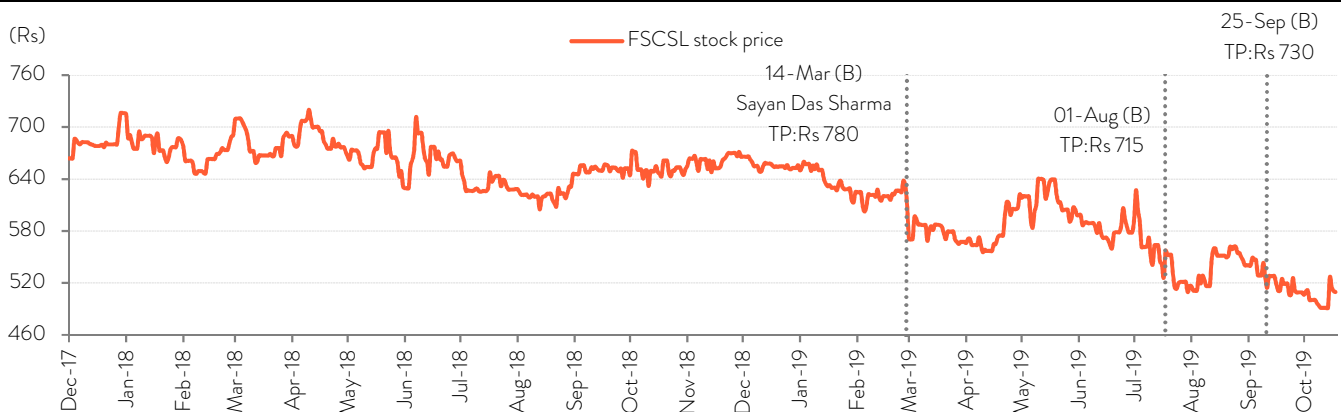
ADD – Expected return from >+5% to +15%

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: FUTURE SUPPLY CHAIN SOLUTIONS (FSCSL IN)



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

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