Ratings

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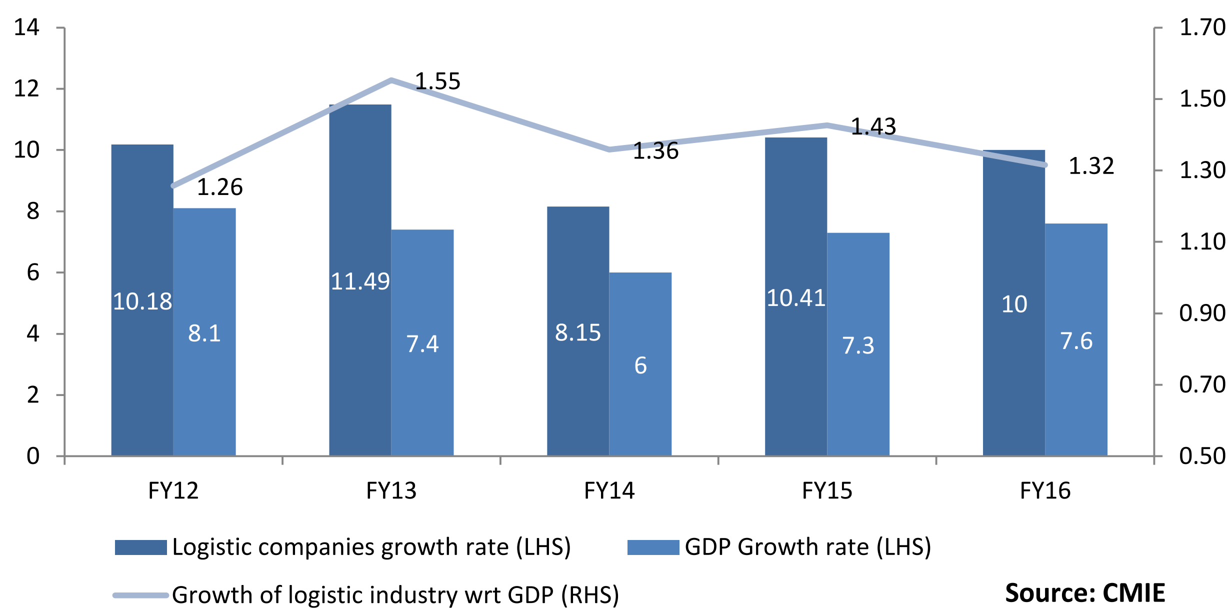
Indian Logistic Industry gaining the traction

Overview:

In the wake of globalization, the importance of logistics is increasing as more and more, both national and multi-national companies are sourcing, manufacturing and distributing their products and services on a global scale. Thus, the recognition of performance of logistics industry would become prime importance of economic development for India in long term.

The Indian logistic industry has been gaining traction, with e-commerce penetration, economy revival, proposed GST implementation and government initiatives like "Make in India", National Integrated Logistic Policy, 100% FDI in warehouses and food storage facilities, etc. Some of the aforementioned initiatives during FY12-FY16 (refers to the period April 1 to March 31) have led to significant improvement in functioning and operations of logistics companies in India which is reflected in multiple notching up of India's logistic performance index (LPI) rank by 19 places to 35th position from 54th position as per LPI 2016 report by World Bank.

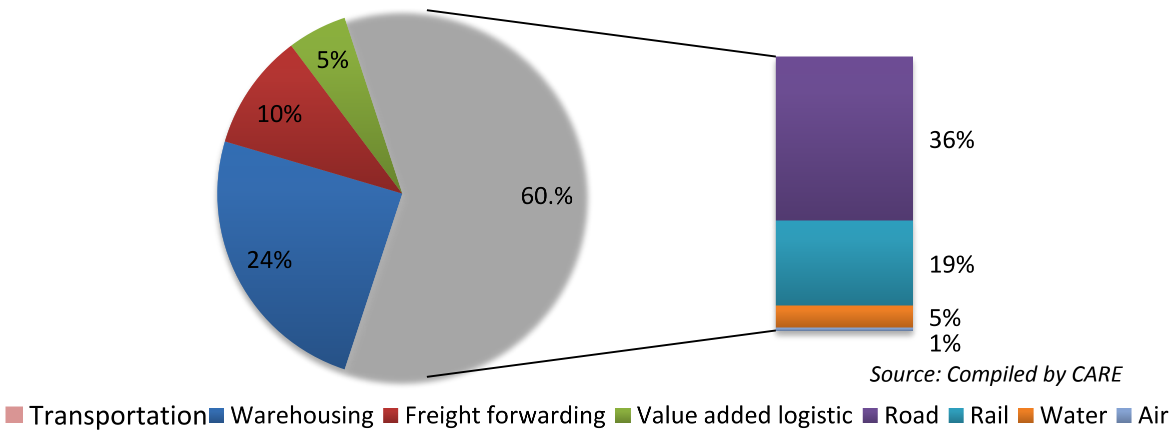
Furthermore, with respect to India's GDP growth the logistics industry is expected to grow at 1-1.5x as logistics business is directly correlated with economic activity. Considering the aforementioned aspect the Indian logistic industry is projected to grow at a CAGR of 15-20% during FY16~FY20.



Source: CMIE

Indian logistic segment

The Indian logistic sector is primarily categorized into four segments comprising Transportation (rail, road, air, water-ways), warehousing (Container freight stations and Inland Container Depots), freight forwarding and value-added logistics. The transportation contributes maximum (60%) to the whole pie of logistic sector which comprises of various means such as road, rail, air and water. India being emerging country is primarily dependent upon transportation through land, ie, road and rail. The transportation through road and rail together contributes about 56% followed by Warehousing 24.5% comprising industrial and agricultural storage in the entire pie of logistics segment.



Source: Compiled by CARE

During last five years, the Government of India has been taking various initiatives in order to develop road infrastructure. The net road projects awarded by NHAI during FY16 have increased to 4368 km in comparison with 3250 km level of FY12.

NHAI plans to increase both awards and execution of road projects in FY17 by four times over FY16 levels, ie, with target execution of 8000 km (@21.92 km/day) and target awards at 15,000 km. Furthermore, on account of various government initiatives, focus on hybrid annuity as well as EPC contracts and structural changes in the concession agreement, CARE expects substantial increase in pace of award and execution of road projects during FY17 over FY16.

India's Infrastructure Snapshot

Roads	◊ 2nd Largest in world with a total of more than 3.34 mn Km road length ◊ National Highways/Expressway of 0.10 mn Km ◊ 0.15 mn Km of state highways and 4.98 mn Km of major & other district roads
Rail	◊ Covers almost all parts of the country with routes covering a total length of 67,312 km
Air	◊ 18 international airports ◊ 7 custom airports, 78 domestic airports and 26 civil enclaves at Military fields
Sea	◊ 6000 km of natural peninsular coastline ◊ 12 major ports and 187 minor ports

Source: Compiled by CARE

(Please refer to CARE Report on Indian Road Sector – Increase in pace of award and execution published on July 14, 2016)

As per the railway budget for the year 2016-17, the capital plan has been pegged at Rs.1.21 lakh crore. The railway ministry has given emphasis on rapid expansion of freight business to take up freight corridors: North-South connecting Delhi to Chennai, East-West connecting Kharagpur to Mumbai & East Coast connecting Kharagpur to Vijayawada. Apart from above, various initiatives such as setting up the broad gauge lines, capacity building plans and to improve the customer interface through IT systems to provide better quality of services have been taken up.

As a part of reviving the existing ports of the country, the Indian government has developed 10 coastal economic regions which led to improvement in the capacity of all the major ports to 892.92 MMT as on January 31, 2016 (871.52 MMT as on March 31, 2015). Furthermore, the government is taking up various initiatives such as investing Rs.70,000 crore under 'Sagarmala project' in 12 major ports in the next five years, allowing upto 100% FDI under automatic route for port development projects and providing income tax incentives.

India, although gearing towards logistic friendly on its performance index, has been facing inhibitions that primarily include higher logistic costs and complex tax structure. The implementation of Goods and Service Tax (GST) bill is expected to trim the logistic costs upto 20% from the current levels, however, the persisting high logistic costs could only be resolved by development of logistics infrastructure. Transportation alone holds 60% share of the logistic industry and rest 40% is contributed by warehousing, freight forwarding, value-added logistics, etc. Thus, the growth in logistic sector to a large extent depends upon successful implementation of the aforesaid initiatives taken by the government.

India as Investment destination for PEs and global logistic players:

Significant investment opportunities exist across every segment in Indian logistic industry and several leading international logistic companies such as Fedex, UPS supply chain, DHL, Kintetsu World express etc have already entered the Indian market, through green field projects, JVs and acquisitions. Over the last few years, India's logistics sector has received unprecedented interest among the global and domestic investor community. Specific segments like agriculture logistics, cold chain logistics and warehousing have received special attention from a wide range of global investors. For India to compete with other developing countries and attract Foreign Direct Investment, it certainly has to invest in logistics. With 100% FDI in warehouses and food storage facilities under the automatic route (where manufacturers can sell their products online directly), coupled with some zones to be tax-free (ie, free trade warehousing zones), has brought the sector under the foreign PE investment radar. In 2015, the government has allotted an $11 billion from the public budget to boost overall infrastructure.

Some of the major private equity investments that took place during FY15 and FY16 are given below:

PE Player	Group/Company	Rs. Crore	Segment
Mandela Capital	GATI	120.00	Cold Logistics
Warburg Pincus	Embassy group	650.00	Warehouse
Warburg Pincus	Ecom Express	850.00	Logistic solution provider
Tiger Global Management	Delhivery	542.40	Logistics solution provider
Asia Climate Partners	Cold Ex	250.00	Cold chain logistics
Creation Investment and Everstone Capital	Agri Logistic firm	100.00	Warehouse management

Source: Compiled by CARE

Current Issues and challenges

India, despite being a low-cost country, has higher logistics cost due to various issues and challenges faced by the industry. Apart from being entangled in complex tax structure the industry is also affected by poor rate of customs efficiency of clearance processes and procedures thus affecting the international export logistics stratum. Furthermore, sub-optimal comfort provided by the existing Indian infrastructure combined with lack of implementation of efficient IT-enabled tracking and tracing mechanisms has affected the performance of logistics. A country's competitiveness is measured by the ease of doing business. India stands at 35th position in the logistics performance index (LPI) amongst 160 countries around the world, with Germany on top, Singapore, China and United States of America in 5th, 9th, and 10th positions, respectively, as per the World Bank report 2016.

Following table illustrates LPI of various countries based on various parameters

Country	LPI Rank	Customs	Infrastructure	International shipments	Logistics competence	Tracking & tracing	Timeliness
Germany	1	2	1	8	1	3	2
Singapore	5	1	6	5	5	10	6
Hong Kong, China	9	7	10	2	11	14	9
United States	10	16	8	19	8	5	11
Japan	12	11	11	13	12	13	15
South Africa	20	18	21	23	22	17	24
India – 2016	**35**	38	36	39	32	33	42
India - 2014	**54**	65	58	44	52	57	51
Brazil	55	62	47	72	50	45	66
Russian Federation	99	141	94	115	72	90	87

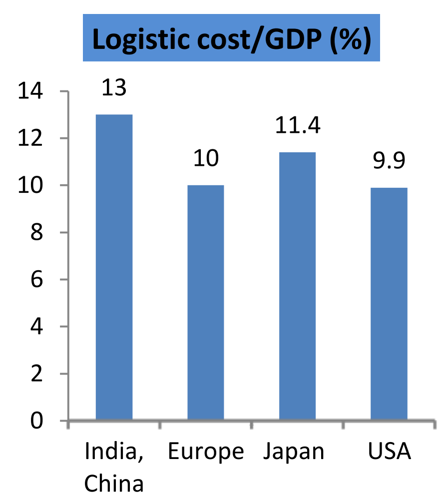
India's logistics performance has seen a rise in all the six key performance indicators used to compute international LPI. The factors which led to growth in improvement of LPI includes increase in infrastructure (especially Road, Railways and Ports) spending along with their successful commissioning, growth in investments and participation of international logistics players in Indian firms which attracted better technology along with rise in international shipments coupled with leveraging the established network of the investor and implementation of effective IT systems used for tracking and tracing the goods.

Congestion in connectivity has been leading to high turn-around time in supply chain:

The logistic competence although has improved by 19 notches as per World Bank Report 2016 on LPI, the delays due to roadblock, tolls, inter-state checkpoints and other stoppages are leading to increase in the logistic costs in India to 2 to 3 times global benchmarks. Transit times are higher owing to lower average speeds this is due to waiting times at toll stations, snail pace movement of the trucks during the day especially in prime cities and towns, port turnaround times, low priority accorded to freight trains and poor track infrastructure. For example, almost five to seven hours of transit time of trucks are wasted at the interstate check points. National Highways constitute just 2% of the Indian road network but carry 40% of the total traffic, resulting in severe congestion. Different aspects of the logistics industry falling under different ministries also create inefficiencies in the system.

Higher logistic cost:

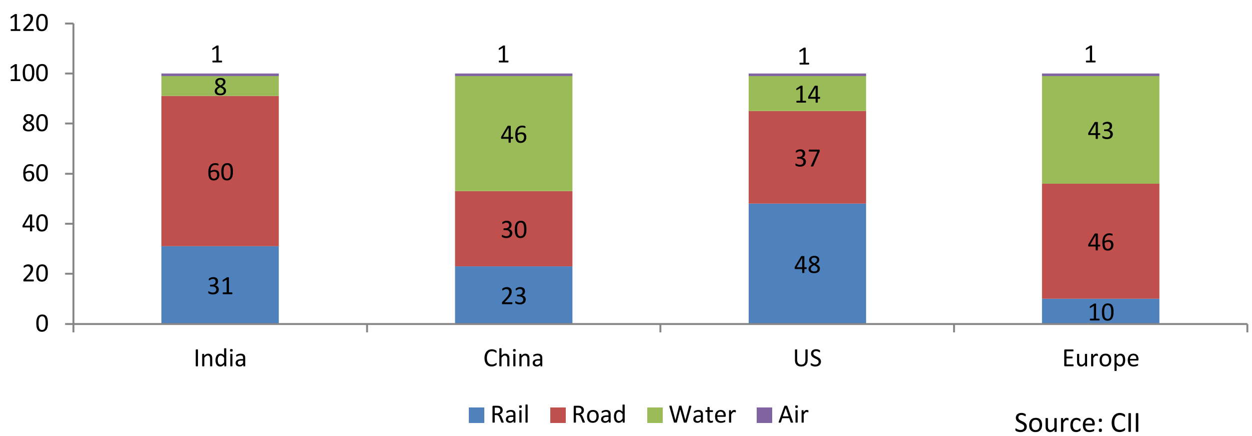
India's outgo on logistic cost/GDP is about 13-14% of value of goods, whereas for other developed/developing economies the average cost stands at 10-11% value of goods as shown in the figure. The key reasons for this is higher transit time due to infrastructural bottlenecks across different modes (Road, Rail, and Water), administrative delays, extra indirect taxes levied for inter-state transport and inefficiencies in the system.



Unfavorable modal mix

There is an unfavorable modal mix that is skewed toward roads as a major mode of transportation, along with underutilization of other modes — rail, air, shipping and coastal shipping. Despite being inefficient mode, road transportation has the highest goods traffic share in India, whereas railways being economic mode of goods transport has lost market share in India due to under investments leading to capacity constraints. Air is the quickest possible way but shares just about 1% of the means of logistics. Even though India lags behind its global peers it is increasing its spending in airport infrastructure through various air projects across the country. The freight travel although is more suitable through rail and waterways but due to high tariffs, less flexibility in wagons, uncertain transit times and poor terminal quality in railways and inadequate infrastructure for coastal shipping and inadequate depths at ports in India has led to high reliance on road transport.

The following table illustrates the logistics flow through various means such as Air, Water, Road and Rail in India, China, US and Europe



Source: CII

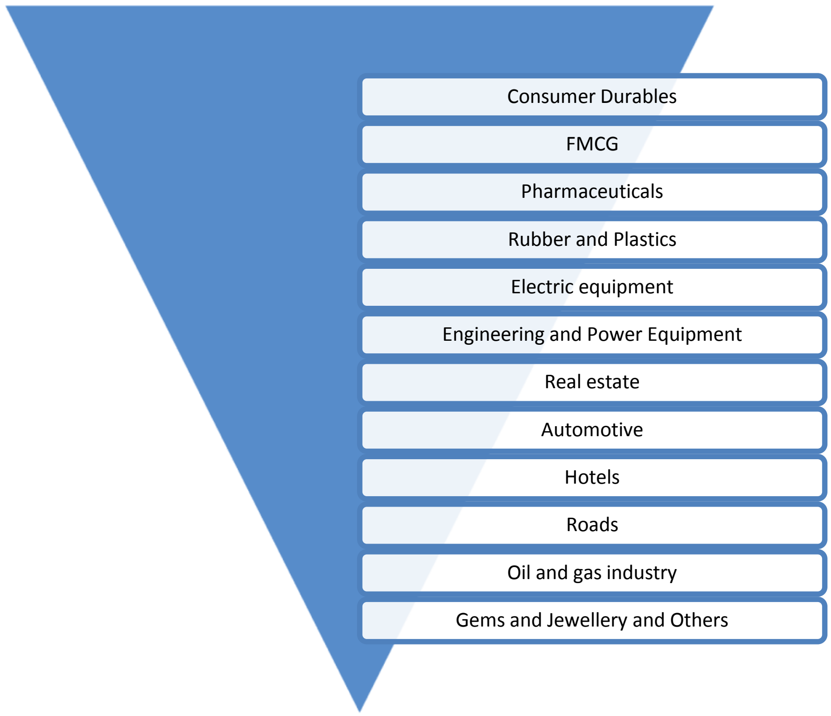
Complex tax structure:

Currently, each of India's 29 states taxes goods that move across their borders at various rates. As a result, freight that moves across the country is taxed multiple times.

How the introduction of Goods and Service Tax (GST) would benefit the Indian logistic industry?

Goods and service tax is a colligation of multiple taxes levied by both Central (ie, excise duty, countervailing duty and service tax) and state (value-added tax, Octroi and entry tax, luxury tax, etc) governments when an end user purchases goods or services. It means same level of taxation would be charged on a specific product or service across the entire country irrespective of being manufactured and sold in different states. The planned dual GST model (central GST and state GST) proposes to replace around 29 state and federal taxes and tariffs for a single tax at the point of sale. The current combined Centre and State statutory rate works out to be 26.5% (Cenvat of 14%, and VAT of 12.5%), whereas post GST implementation the same is expected to reduce to standard rate of about 18-21% which will be levied on most goods and all services.

The industries which have high and low impact on their logistic cost post rolling out of GST



Credit Perspective:

In the coming year, expectation of revival of manufacturing and mining activities could boost the logistic industry, further helping the companies to have better credibility. The proposed implementation of GST would also benefit the companies operating in this industry though not during the current financial year considering slow movement of the GST Bill and actual implementation along with fructification of the same.

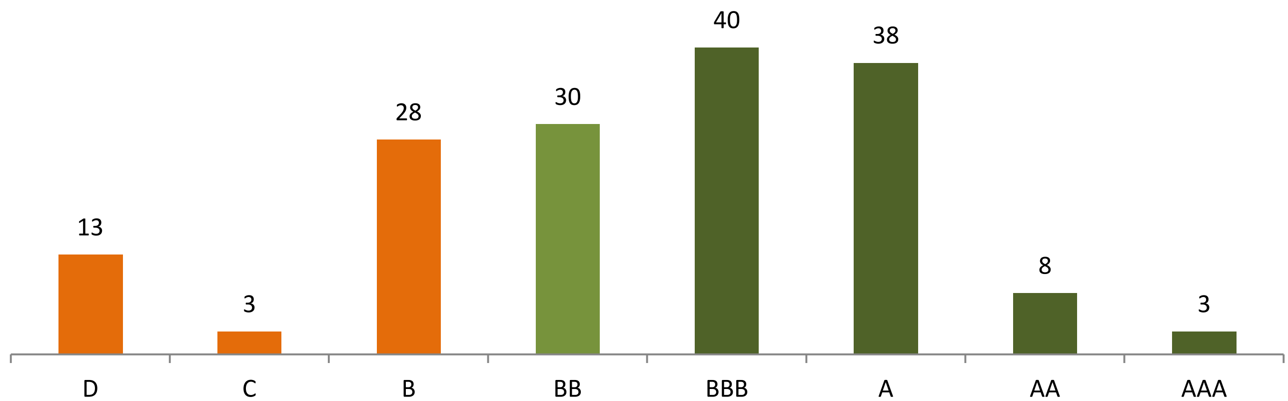
Indian road transport industry is cyclical in nature and the presence of a large number of organized and unorganized players makes the sector highly competitive which leaves little headroom for margin improvement. The demand for warehousing facilities has constantly been on the rise due to factors like increase in government procurement, rise in contract farming, development of organized retail sectors. The aforesaid developments would require large storage capacity to achieve economies of scale as well as capacity constraints at existing facilities would pose a major challenge for the players in unorganized segment. Thus, the implementation of GST, would benefit immensely the players in organized sectors in terms of consolidation and merging of smaller players with larger organized players to leverage the mutual benefits. Furthermore, the sector would also attract interest from international logistic players through FDI, JVs or acquisitions, which in turn propels the industry to march towards the developed market standards of logistic performance index.

Outlook:

The long-term outlook of the companies operating in Indian logistics industry is favorable on expectation of implementation of proposed GST, successful commissioning of the infrastructure projects (especially in road, railways and ports), increase in participation and investment of international logistics players and adoption to global standards of tracking and tracing mechanism.

The near-term outlook for the logistics companies is expected to be stable on back of steady growth in consumer durables, FMCG, pharmaceutical, engineering and other industries.

Cases rated by CARE Ratings



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