Khambatta Securities Ltd. MEMBER OF EQUITY & DERIVATIVE SEGMENTS DEPOSITORY — THE STOCK EXCHANGE, MUMBAI; NATIONAL STOCK EXCHANGE OF INDIA LTD. CENTRAL DEPOSITORY SERVICES (I)

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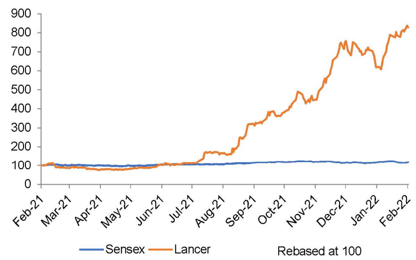
Lancer Container Lines Limited

02 February 2022

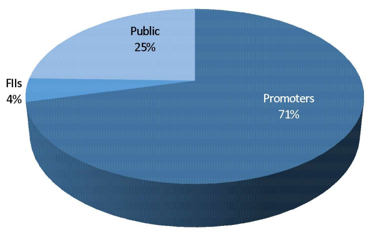
Leveraging historically-high freight rates, expansion to drive future growth — BUY

Sector	: Logistics
Target Price	: ₹306
Last Closing Price	: ₹238
Market Cap	: ₹717 crore
52-week High/Low	: ₹248/19
Daily Avg Vol (12M)	: 1,25,111
Face Value	: ₹10
Beta	: 0.94
Pledged Shares	: 0.0%
Year End	: March
BSE Scrip Code	: 539841
NSE Scrip Code	: N/A
Bloomberg Code	: LANCER IN
Reuters Code	: LANC.BO
Nifty	: 17,780
BSE Sensex	: 59,558
Analyst	: Research Team

Price Performance



Shareholding Pattern



Initiating Coverage

Investment Summary

- A shipping agency and logistics solution provider, Lancer's core business is liner service. As a Non-Vessel Operating Common Carrier (NVOCC), the company does not own or operate any ship but acts as a carrier by contracting vessels for shipping its containers.
- Lancer operates an asset-light business with a mix of 10,000 owned and leased containers, offering services to 74 ports as well as inland destinations through 14 offices in India and a subsidiary in Dubai, covering more than 30 countries. The company's principal geographies of operations include the Indian subcontinent, Southeast Asia, Gulf, Europe and the Mediterranean.
- Lancer plans to expand its container fleet by 25% to 30% (2,500 to 3,000 TEU) by the end of FY22. Management looks to penetrate into new geographies, mainly covering the European region. To this end, the company has initiated the process of setting up a branch in the UK as it also seeks to explore the Mediterranean market more aggressively.
- We believe container freight rates are going to remain at elevated levels over the next 12-18 months, driven by a slowdown in newbuilding orders in 2020 with the order growth in 2021 not leading to material commissioning of new capacities in the near term.
- Container freight rates have risen by ~3x since the beginning of CY21. Lancer looks to take advantage of the existing under-supply situation across major ocean freight routes with its fleet and route expansion strategically well-paced and tactically well-timed.
- Lancer's revenue growth will be driven by capacity addition and expansion into new geographies over the next couple of years. The Lancer stock currently trades at an attractive forward P/E level of 15.6x FY24E EPS. Assigning a target multiple of 20.0x FY24E EPS, our valuation generates a price target of Rs 306, informing an upside potential of 28%, as we initiate coverage on Lancer with a BUY rating.

Key Financial Metrics (Consolidated)

Rs lakh	FY20A	FY21A	FY22E	FY23E	FY24E
Net operating revenue	26,526	31,261	56,028	80,423	95,526
Growth		*17.8%*	*79.2%*	*43.5%*	*18.8%*
EBITDA	2,232	2,438	3,838	6,072	7,527
EBITDA margin	*8.4%*	*7.8%*	*6.8%*	*7.5%*	*7.9%*
PAT	801	971	2,034	3,525	4,607
PAT margin	*3.0%*	*3.1%*	*3.6%*	*4.4%*	*4.8%*
Diluted EPS (Rs)	7.97	9.66	6.75	11.69	15.28

Note: FY22E EPS is on a pro-forma basis reflecting the 2:1 stock split for the full financial year
Source: Company data, Khambatta Research

Company Profile

Lancer owns a container yard spread over 20,000 square metre in Panvel near JNPT

Lancer Container Lines is a shipping agency and logistics solution provider, offering liner or Non-Vessel Operating Common Carrier (NVOCC) services to Gulf, Southeast Asia, Europe and the Mediterranean. The company also provides freight and project forwarding (including ocean freight, air freight, and inland transport), and container trading services. It owns a container yard spread over 20,000 square metre in Panvel near JNPT. Lancer's operations are supported by a network of associates in the Indian subcontinent, Southeast Asia, the Far East, MENA and the CIS countries. Starting out in 2011 as a liner service, the company subsequently added other verticals in shipping and freight forwarding. Lancer has introduced Less-than-Container Load (LCL) or cargo consolidation, and breakbulk cargo solutions in its portfolio of services. The company also manufactures portable cabins (prefabricated structures) for use in places where permanent construction is not feasible such as construction sites, factories, security cabins, toll booths, and other similar applications.

Lancer is led by a team of seasoned professionals with robust experience in the shipping and logistics sector. Chairman & Managing Director Mr. Abdul Khalik Chatiawala possesses over 31 years' experience in the logistics, transport and shipping spaces. Finance Director Mr. Praful Jain is experienced in the areas of trade, finance and investments, while Whole Time Director Mr. Mohan Shirke, with experience in shipping, logistics and international trade, leads business operations.

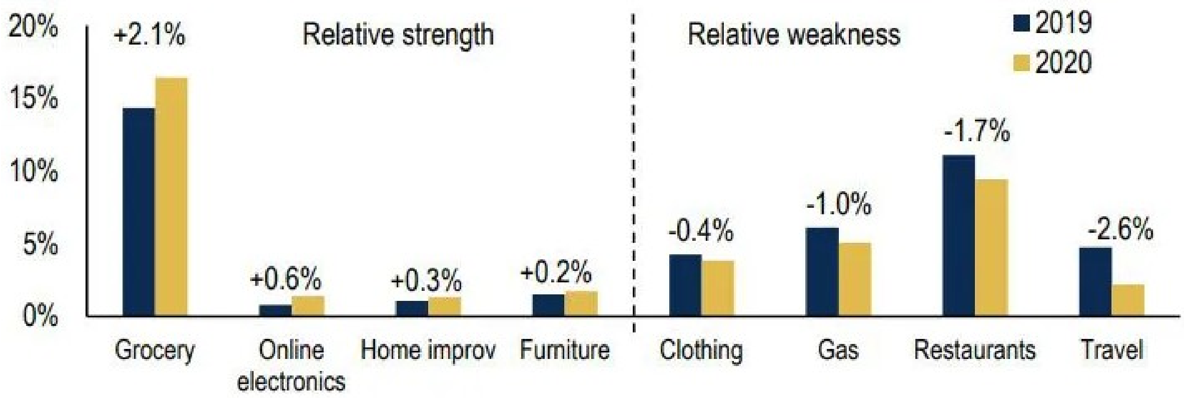
Lancer's geography of operations

Source: Company presentation

Industry Overview

The covid-19 pandemic, which started in early 2020, resulted in lockdowns, travel curbs, and restrictions on the operation of restaurants and leisure/entertainment establishments. Work-from-home became a norm for a large section of the working population with people suddenly spending higher amounts of time at the home while schools, colleges and universities adopted the online teaching medium. Both business and leisure travel nosedived. This led to a boom in the demand for consumer electronic products for home-based entertainment and computing devices for work and online study as well as other consumer goods. The consumer spend mix in the US, which historically averaged around 67% services and 33% goods, realigned sharply in favour of goods to 60%/40% in 2020 *(source: FreightWaves)*.

Share of US consumer spend on goods and services using Bank of America cards



Source: FreightWaves

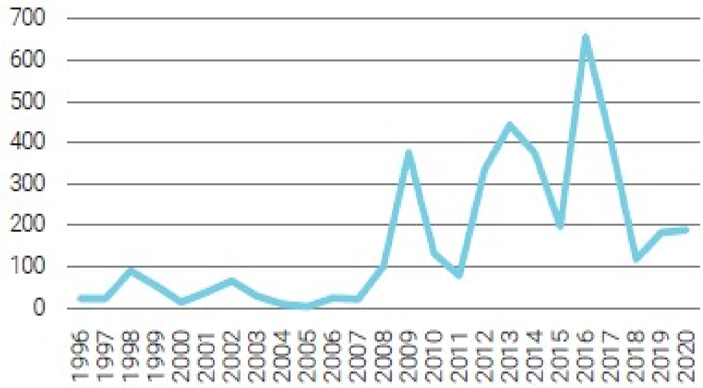
The Freightos Baltic Index appreciated to over 5x in a year to September 2021

Consequently, the demand for shipping containers surged, pushing up freight rates, reflecting the relative shortage of container supply. The situation was aggravated by congestions across major ports across the globe due to partial shutdowns and port workers reporting sick as countries experienced multiple waves of covid outbreaks. The Freightos Baltic Index, which measures global container freight rates, topped USD 11,000 per 40-foot container in September 2021, compared to just over USD 2,000 a year earlier, rising more than 5x during the period. The index has moderated since to hover above USD 9,000 in January 2022 but remains at significantly elevated levels compared to average containers rates in 2020.

Based on its Global Liner Performance (GLP) and Trade Capacity Outlook (TCO) databases, Sea-Intelligence estimated that 3.1 million TEU or 12.5% of the global shipping capacity was out of service due to delays in August 2021, surpassing a previous high of 11.3% in February 2021. Port congestions during 2021, which started in the US's West Coast, spread over to other parts of the world by the end of the year. Given the current operational challenges, Sea-Intelligence predicts the container supply shortage to stretch to up to at least the end of 2022. While Maersk expects market imbalance to continue until 1Q CY22 or longer with the upcoming Chinese New Year anticipated to present further challenges to global supply chain woes, Goldman Sachs expects backlogs and elevated shipping costs to persist at least through mid-2022, driven by the lack of near-term mitigating factors for the underlying supply-demand disruptions at US ports. Morgan Stanley expects the global shipping market to stay peaked for some time.

Global container ship fleet growth (% y-o-y)

Global container vessel scrappage ('000 TEU)



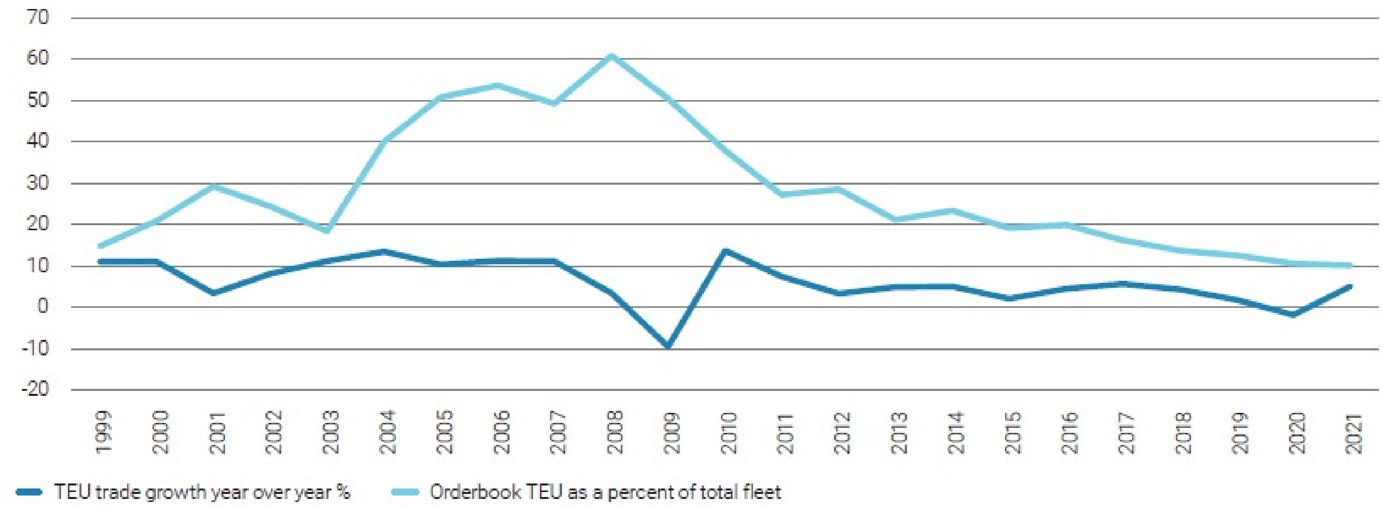
Source: 2021 Container Shipping Outlook, March 2021, AlixPartners

Container ship newbuilding order book as a percentage of the global fleet hit historical lows in 2021

Driven by record orders, the global container shipping market witnessed a period of oversupply during 2009 to 2015. Thereafter, high vessel scrappage since 2016 and restrained fleet growth helped avoid a supply glut in the current shipping cycle. Container ship newbuilding order book as a percentage of the global fleet declined steadily since 2015, hitting historical lows in 2021. The covid-19 pandemic also contributed to this supply-side rationalisation with operators slashing capacity and holding back new vessel orders, leading to a favourable rate environment. While a number of carriers placed large orders last year, it will take several years to replace the tonnage that was demolished over the past few years, keeping the supply in check in the medium term. Higher blank sailings, reduced sailing speeds, and suspended service on some routes have resulted in improvements in capacity management. Further, analysis of data from the three recessionary periods since 2001 indicates that while carriers are able to pass on higher fuel costs to shippers up to a certain extent, fuel prices have little correlation with rates. As a matter of fact, shipping rates react more immediately to demand and capacity. *(Source: 2021 Container Shipping Outlook, AlixPartners).* Therefore, with limited fleet expansion in the medium term, notwithstanding some normalisation, rates should not witness strong downward pressures.

IHS Markit estimated the global containerized export volume to increase by 4.8% in 2021, primarily driven by strength in US container imports (15.7%). It is seen to further grow by 2-3% in 2022 on the back of record high backlog and gradual recovery of the global economy. Container freight rates are expected to normalise from the record-high levels in the coming years, driven by supply-side pressure including reduced congestion and a large number of new vessel deliveries. IHS Markit forecasts an acceleration in annual container fleet growth from 3.0% in 2020 to 4.3% in 2021, 4.5% in 2022 and 7.5% in 2023.

Global container ship newbuilding order book and growth in international trade



Source: 2021 Container Shipping Outlook, March 2021, AlixPartners

Investment Thesis

Lancer's container fleet has grown at a CAGR of 86% in 10 years to 2021

Operating on an asset-light model, Lancer has grown exponentially over the 10 years it has been in business. Lancer's core business is liner service. As an NVOCC, the company does not own or operate any ship but acts as a carrier by contracting vessels for shipping its containers. The company owned approximately 10,000 containers at the end of 1H FY22 that it employs to service customers globally. Following an asset-light business model, Lancer has scaled up its container fleet through a mix of owned and leased containers with future expansions planned through the same route. The company has further expanded its business through the addition of related verticals offering solutions such as freight forwarding, container trading, yard operation, and agency network. Growing at an exponential rate since its incorporation in 2011 and commencing operations with 20 containers, Lancer's fleet has grown at a CAGR of 86% in the 10 years to 2021. Lancer offers its services to 74 ports as well as inland destinations across the globe through 14 offices in India and a wholly-owned subsidiary in Dubai, covering more than 30 countries with over 80 registered global partners. The company's principal geographies of operations include the Indian subcontinent, Southeast Asia, the Far East, MENA and CIS countries. Lancer's headquarters are located in a three-storey building of over 20,000 square feet in Belapur, Navi Mumbai as the team has grown from 12 members to more than 200 currently.

Lancer's marquee clients

Source: Company presentation

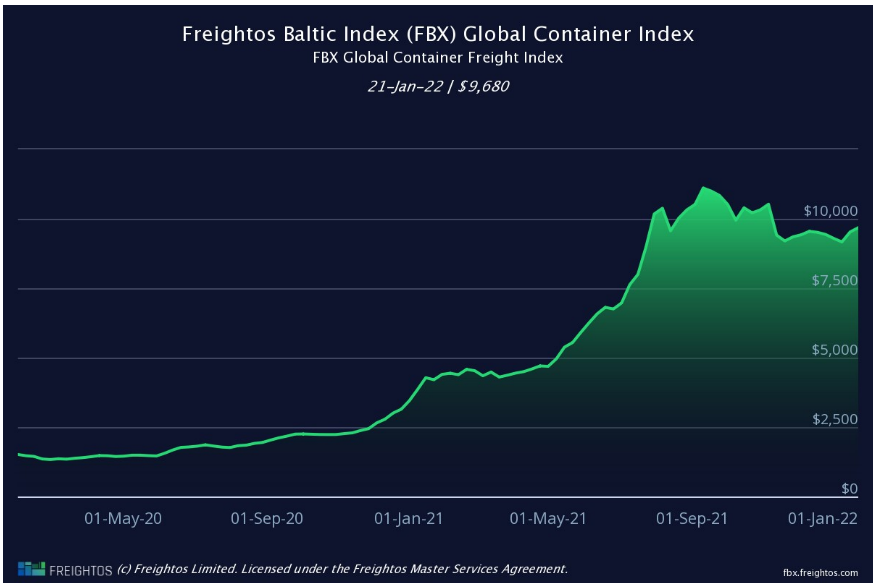
Lancer plans to expand its container fleet by 25% to 30% by the end of FY22

Expansion plans comprising container additions in the near term and longer-term goals to enter into upstream and allied services underpin management's ambitions for growth. Lancer plans to expand its container fleet by 25% to 30% by the end of FY22. The addition of 2,500 to 3,000 TEU is planned to be executed in line with the company's current operational model comprising a mix of owned and leased assets. Management looks to penetrate into new geographies, mainly covering the European region. To this end, the company has initiated the process of setting up a branch in the UK as it also seeks to explore the Mediterranean market more aggressively. Lancer's long-term plans include setting up a container manufacturing unit as management engages a consultant to look into its feasibility. Its other long-term plans include setting up a cold chain storage service as part of the company's strategy to broaden its presence across the value chain while also seeking opportunities to move upstream by acquiring or leasing vessels upon expansion of its container fleet to 30,000 TEU. The company is open to following the inorganic route to realise some of its long-term goals as it looks to engage with market participants while the consulting firm it is working with also assists management to this end. To finance these initiatives, Lancer plans to issue foreign currency convertible bonds up to USD 100 mn as and when the projects take a firm shape and management is ready for their execution.

We expect container freight rates to remain at elevated levels over the next 12 to 18 months

Freight rates are seen to remain high for the next couple of years, positively impacting the topline and absolute profits for liner services. We believe container freight rates are going to remain at elevated levels over the next 12-18 months, driven by a slowdown in newbuilding orders in 2020 in the wake of the covid-19 pandemic while whatever order growth that was seen in 2021 will not lead to material commissioning of new capacities in the near term. Further, with the pandemic still around leading to intermittent outbreaks around the world, leading to temporary imposition of restrictions on travel and other activities, we expect consumer preference to continue to be in favour of consumption of products while growth in demand for services is expected to remain slow over the coming months. Further, with the minimum duration of contracts in the charter market around 3 years, the higher charter rates, and consequently higher freight rates charged by vessel operators and liner services are seen to sustain in the near-to-medium term. While freight rates move in tandem with charter rates with little scope for liner services generating incremental margins from higher rates, elevated freight rates positively impact the topline and absolute profits for liners.

FBX weekly prices



Source: fbx.freightos.com

So far this calendar year, benchmark container rates as measured by the FBX have hovered just under USD 10K

Revenues will be driven by the steep increase in container freight rates during CY21 and incremental volumes. Container freight rates have risen by ~3x since the beginning of CY21. The Freightos Baltic Index (FBX), which stood at USD 3,452 on 1st January 2021, increased to USD 4,442 on 2nd April 2021, and topped USD 11,000 by the second week of September. So far this calendar year, the benchmark container rates have hovered just under USD 10K with the FBX recording a rate of USD 9,680 on 21st January 2022. While the exponential rise in freight rates has been the principal driver of Lancer's robust revenue growth during 1H FY22, the company's planned container capacity expansion by 25-30% by the end of FY22 and entry into new geographies, particularly in Europe will enable robust topline growth through FY24. Lancer looks to take advantage of the existing under-supply situation and lack of vessel/container availability across major ocean freight routes with its fleet and route expansion strategically well-paced and tactically well-timed. With the company having completed 75,000 shipments in FY21, management expects the number of shipments

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to cross 1 lakh during the current financial year. Further, management looks to exploit the excess demand in the market by increasing advance slot booking and benefit from rate discounts offered by vessel operators, potentially enabling the company to generate incremental operating margins.

Peer Comparison

We compare Lancer with the following companies operating in the logistics and freight shipping services spaces.

Peer Comparison: Key Financials Metrics, FY21

Rs crore	Lancer	Blue Dart	Allcargo Logistics	Shreyas Shipping	Tiger Logistics
Net operating revenue	312.6	3,288.1	10,498.1	560.0	167.9
EBITDA	24.4	706.6	689.1	68.3	(8.5)
EBITDA margin	*7.8%*	*21.5%*	*6.6%*	*12.2%*	*-5.1%*
PAT	9.7	101.8	172.9	44.3	(12.4)
PAT margin	*3.1%*	*3.1%*	*1.6%*	*7.9%*	*-7.4%*
EPS (Rs)	9.66	42.90	7.00	20.20	(10.20)
ROCE	21.4%	17.2%	10.1%	10.3%	N/A
ROE	21.8%	17.2%	7.6%	10.5%	N/A
Current market cap	717.4	16,490.9	8,372.1	642.8	286.9

Note: Standalone financials for Tiger Logistics, consolidated financials for others
Source: Company data, Trendlyne, Khambatta Research

Valuation

The Lancer stock currently trades at an attractive forward P/E level of 15.6x FY24E EPS

At 20.0x FY24E EPS, we initiate Lancer with a BUY based on a price target of Rs 306 and an upside potential of 28%. Lancer nearly doubled its operating revenues in 1H FY22 on a y-o-y basis on the back of a steep increase in container freight rates. The company is progressing well on its plans of expanding its container count by 2,500-3,000 TEU with approximately 950 TEU already added, comprising 650 TEU of leased containers and 300 TEU owned containers. Management confirmed that it is aggressively adding capacity on an ongoing basis to reach the expansion target by the end of FY22. Subsequently, the company looks to continue expanding its container fleet through FY23. Following the opening of a subsidiary in the UK and commencing operations in Europe and the Mediterranean, management expects revenues from these new regions to witness healthy growth going forward. We do not see freight rates correcting sharply over the next 12-18 months as capacity addition and expansion into new geographies will drive revenue growth for Lancer over the next couple of years. The Lancer stock currently trades at an attractive forward P/E level of 15.6x FY24E EPS. Assigning a target multiple of 20.0x FY24E EPS, our valuation generates a price target of Rs 306, informing an upside potential of 28%, as we initiate coverage on Lancer with a BUY rating.

Profit & Loss Account (Consolidated)

Rs lakh	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E
Net revenue from operations	**19,741**	**26,526**	**31,261**	**56,028**	**80,423**	**95,526**
Growth		*34.4%*	*17.8%*	*79.2%*	*43.5%*	*18.8%*
Cost of sales	16,562	22,731	27,588	50,481	72,220	85,592
Gross profit	3,179	3,795	3,672	5,547	8,203	9,935
Gross margin	*16.1%*	*14.3%*	*11.7%*	*9.9%*	*10.2%*	*10.4%*
Operating expenses	1,128	1,563	1,235	1,709	2,131	2,407
EBITDA	**2,051**	**2,232**	**2,438**	**3,838**	**6,072**	**7,527**
EBITDA margin	*10.4%*	*8.4%*	*7.8%*	*6.8%*	*7.5%*	*7.9%*
Depreciation & amortization	699	924	954	977	1,273	1,307
EBIT	1,352	1,309	1,484	2,861	4,799	6,220
Interest expense	238	304	315	262	209	184
PBT	1,170	1,085	1,311	2,719	4,710	6,156
Tax expense	347	284	340	684	1,186	1,550
PAT	**822**	**801**	**971**	**2,034**	**3,525**	**4,607**
PAT margin	*4.2%*	*3.0%*	*3.1%*	*3.6%*	*4.4%*	*4.8%*
Diluted EPS (Rs)	**8.18**	**7.97**	**9.66**	**6.75**	**11.69**	**15.28**

Note: FY22E EPS is on a pro-forma basis reflecting the 2:1 stock split for the full financial year

Source: Company data, Khambatta Research

Abridged Balance Sheet (Consolidated)

Rs lakh	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E
Total shareholders' equity	2,714	3,484	4,459	6,493	10,018	14,625
Long-term debt	2,919	2,420	1,707	1,299	1,002	731
Short-term debt	541	602	510	656	722	428
Trade payables	1,339	2,264	4,551	6,224	8,904	10,552
Total equity & liabilities	**8,353**	**9,633**	**12,558**	**16,768**	**23,612**	**29,838**
Fixed assets	6,326	6,597	6,499	7,811	9,298	8,641
Inventory	-	94	112	202	289	342
Trade receivables	1,139	1,786	3,071	5,066	7,271	8,637
Cash & cash equivalents	371	541	1,884	2,186	4,618	9,530
Total assets	**8,353**	**9,633**	**12,558**	**16,768**	**23,612**	**29,838**

Source: Company data, Khambatta Research

Ratio Analysis

	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E
ROA	9.8%	8.3%	7.7%	12.1%	14.9%	15.4%
ROCE	23.7%	20.5%	21.4%	31.7%	37.6%	35.7%
ROE	30.3%	23.0%	21.8%	31.3%	35.2%	31.5%
Debt-to-equity ratio	1.28x	0.87x	0.50x	0.30x	0.17x	0.08x

Source: Company data, Khambatta Research

Key Risks

- Our growth forecasts are primarily driven by freight rates remaining at elevated levels over FY23 and FY24 and Lancer's successful execution of its expansion plan. An unexpected crash in freight rates and/or Lancer falling short on executing the panned expansion of its operations will lead to underperformance of our expectations.
- Lancer operates in a highly competitive market where a large number of service providers operate and the entry barrier is low. Given this scenario, the possibility of underperformance of our expectations is high owing to intensification of competition.
- Further severe waves of COVID-19 or it remaining around for an extended period of time, can potentially dampen demand and/or disrupt global supply chains, leading to the underperformance of our forecasts.

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Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

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Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Hold recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

Sell recommendations are expected to improve up to 5% or deteriorate, based on consideration of the fundamental view and the currency impact (where applicable).

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