

**IRCTC IPO – A Matter of Convenience**

- Mid Cap: ₹ 5,120 cr. Mkt cap
- Industry – Railways

- Date 29th Sep; IPO Opens 30th Sep -3rd Oct at ₹315-320/share
- Valuations: P/E 18.8 times TTM
- Advice: **SUBSCRIBE** with a 2 year perspective



- **Overview:** Railways are undergoing a dramatic transformation to improve service levels, technology, outsource and grow faster. Subsidiaries like IRCTC are executing on the new initiatives. IRCTC is an Indian Railways owned PSU. It is the only entity authorized to provide catering services to railways, online railway tickets and packaged drinking water at stations and trains. It is financially well-managed and the return ratios and operating cash flows are robust. There is ample scope for growth in almost all business segments. Profits are expected to improve in FY20 given earnings tailwinds including restoration of **Convenience Fees**, lower corporate tax and lower bad debt provisions YoY.
- **Risks:** 1) removal of exclusivity for its business divisions 2) reduction in price of services, higher haulage or a removal of convenience charge for tickets portal 3) In the water business, a ban on single use plastic 4) Any adverse news flow on catering services or Ticket booking scams 5) GoI may list RailTel and IRFC soon, both are PSU railway firms. This can impact valuations.
- **Opinion:** At a P/E of 18.8 times, the valuation are attractive. Investors can **SUBSCRIBE** to this IPO with a 2 year perspective.

Here is a note on Indian Railway Catering and Tourism Corporation (IRCTC) IPO.

IPO highlights

- The IPO opens: 30th Sep -3rd Oct 2019 with the Price band: ₹315-320 per share.
- Shares offered to public number 2.01 cr. The FV of each is ₹ 10 and market Lot is 40.
- The IPO in total will collect ₹645 cr. while selling 12.6% of equity. The promoter group of Indian Railways (**IR**) owns 100% in IRCTC which will fall to 87.4% post-IPO.
- The IPO is an Offer for Sale (OFS) by IR, and will raise ₹645 cr. at UMP. The IPO share quotas for QIB, NIB and retail are 50:15:35. Retail and employees will get a ₹ 10 discount to listing price.
- The unofficial/ grey market premium for this IPO is ₹140-150/share. This is a positive.

Introduction

- IRCTC was conferred the status of Mini – Ratna (Category-I PSE) by the GoI, on May 1, 2008.
- IRCTC is a CPSE owned by the GoI under the Ministry of Railways. It is the only entity authorized by IR to provide 1) catering services to railways 2) online railway tickets and 3) packaged drinking water at railway stations and trains in India. IRCTC was incorporated with the objective to upgrade, modernize and professionalize catering and hospitality services, manage services at railway stations and on trains and to promote international and domestic tourism in India through PPP model.

- Revenues, EBITDA and profit for FY19 were ₹1,957 cr., ₹461 cr. and ₹273 cr. resp. It has 1,384 employees (Aug 2019). IRCTC has been profitable and debt free since incorporation in 1999.
- 55% of revenue was from catering services; internet ticketing was 13%, etc. See Fig 1(a)

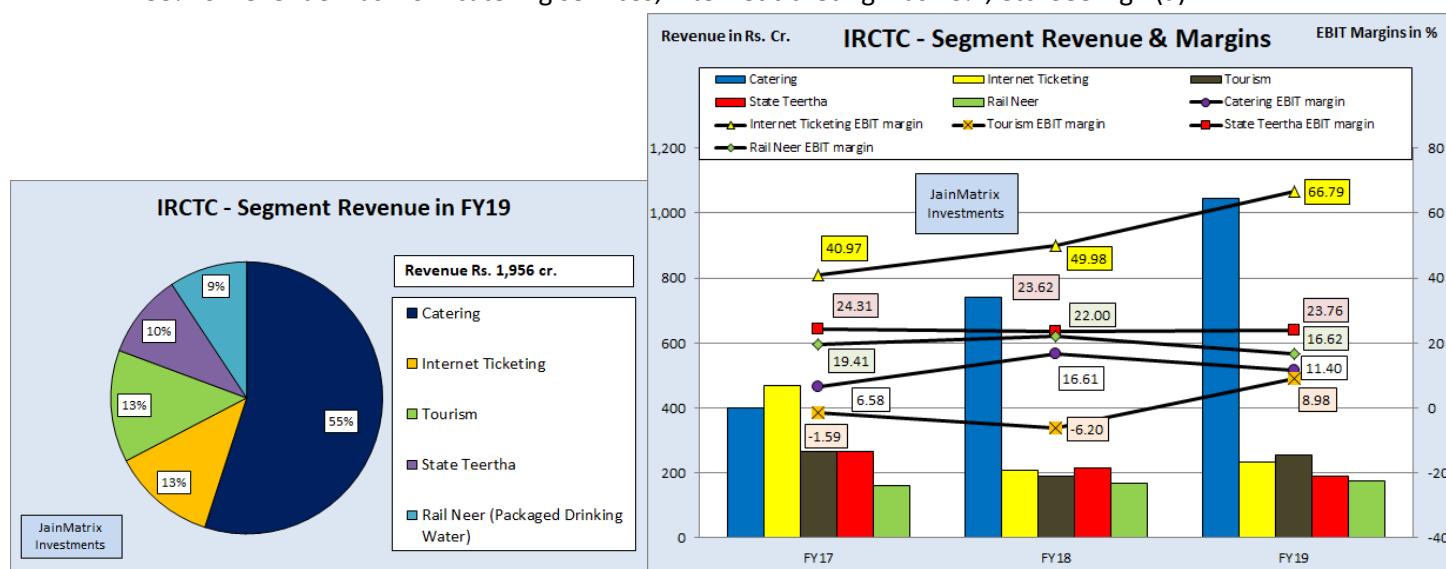


Fig 1(a) – Revenue by Segments and Fig 1(b) Margins

- IRCTC operates in 4 business segments of Catering, Internet Ticketing, Tourism, State Teertha (travel packages) and packaged drinking water under the “Rail Neer” brand.
- **Internet Ticketing:** IRCTC is the only entity authorized by IR to offer railway tickets online. As of Aug 2019, more than 14 lakh passengers travel on IR on a daily basis, of which 72.6% are booked online. As a result, there are more than 8.4L tickets booked through www.irctc.co.in and “Rail Connect” on a daily basis. IRCTC operates one of the most transacted websites, www.irctc.co.in, in the APAC region with volumes averaging 25-28 m. transactions/month.
- **Catering:** IRCTC provides food catering services to IR passengers on trains (mobile catering) and at stations (static catering). IRCTC provides catering services for 350 pre-paid and post-paid trains and 530 static units. They provide catering services through mobile catering units, base kitchens, cell kitchens, refreshment rooms, food plazas, food courts, train side vending, and Jan Ahaars over the IR network. All other catering units, such as refreshments rooms at stations categorized at B or below, AVMs, milk stalls, and trolleys are managed by zonal railways. IRCTC offers catering services to passengers through a mobile app "Food on Track" and a website, www.ecatering.irctc.co.in. They also operate executive lounges, budget hotels, and retiring rooms for railway passengers.
- **Packaged Drinking Water (Rail Neer):** IRCTC is the only entity authorized by Ministry of Railways to make and distribute packaged drinking water at all railway stations and on trains. They have a packaged drinking water brand ‘Rail Neer’. Currently IRCTC operates ten Rail Neer plants located at Nangloi, Danapur, Palur, Ambernath, Amethi, Parassala, Bilaspur, Hapur, Ahmedabad and Bhopal, with an installed production capacity of 1.09 m. liters/day, which caters to 45% of demand for packaged drinking water at railway premises and in trains.
- **Travel and Tourism:** IRCTC have been mandated by IR to provide tourism and travel related services. IRCTC has footprints in across all major tourism segments such as hotel bookings, rail, land, cruise and air tour packages and air ticket bookings. Additionally, it has a service the SBI IRCTC Credit Card.

- Leadership is Mahendra Mall (CMD), Narendra (Dir. Finance), Rajni Hasija (Dir. Tourism & Marketing)

News, Updates and Strategies

- IRCTC will launch 2 new Tejas Express trains, an initiative where the train services will be managed by IRCTC rather than IR. It will offer upgraded services including food, have advertising rights to on these trains but will pay a lease to IR. The Delhi-Lucknow Tejas will begin services in Oct 2019 and the Mumbai-Ahmedabad train is expected to start in Dec 2019.
- With effect from 1st Sept 2019, IRCTC will charge a convenience fee of ₹ 15 and ₹ 30 for booking railway tickets online for non-AC and AC classes, resp. This is expected to boost revenues; it had witnessed a revenue loss due to withdrawal of service charges after demonetisation, impacting top line over the past two years. The new fee is 25% lower than the earlier service charge, but it would help bump up revenues in the current fiscal itself. IRCTC earned ₹ 362 cr. service charges in FY17, prior to Gol withdrawing the same from Nov 23, 2016, in a bid to drive digital transactions. In place of this, the Ministry of Finance had reimbursed IRCTC ₹ 80 cr. and ₹ 88 cr. for FY18 and FY19 resp. for operational costs such as cost of server, IT staff and other IT costs. This may stop now.
 - IRCTC's business strategy is - To diversify and offer new services to the passengers of IR, etc.
 - To develop their IRCTC iMudra wallet to promote digital payment options to customers/users. This is a prepaid card which allows users to book train tickets, shop online and transfer money.
 - To offer better services as a private train operator.
 - To continue to leverage the Government's policy relating to their business; To strengthen products and services offering online and To strengthen operational efficiencies.

Railways Sector, Industry & Market Outlook in India

- The Gol announced a planned outlay of ₹ 1.59 tn. for IR in the Interim Union Budget 2020, 14% higher than last year's revised estimate of ₹ 1.39 tn., thus driving investment in the sector.
- Total railway passenger traffic has remained nearly flat over the past four years, going from 8,397 mn. passengers in FY14 to 8,286 mn. passengers in FY18. Passenger traffic, after falling by 1-2% between fiscals 2014 to 2016, witnessed a revival in 2018, driven by non-suburban traffic.
- As per a study conducted by Asian Institute of Transport Development (AITD) titled Environmental and Social Sustainability of Transport - Comparative Study of Rail and Road (2000), rail consumes 75% to 90% less energy for freight traffic; and 5% to 21% less energy for passenger traffic when compared to road. The social cost therefore, in terms of environmental damage or degradation is significantly lower in rail transportation.
- IR is going through a massive revival and improvement program that includes additional lines, massive electrification, going green, technology improvement, outsourcing and efficiency.
- A New Catering Policy 2017 will empower IRCTC and help improve coverage of catering services due to addition of base kitchens. Consequently, IRCTC's catering revenues is expected to grow at 7.5-8.5% CAGR between fiscals 2019 and 2024 to reach ₹ 14.5-15.5 billion in fiscal 2024. IRCTC plans to expand its base kitchen network, with 15-20 greenfield base kitchens to be set up along with conversion of some Jan Ahar outlets on railway stations into base kitchens. IRCTC also plans to add pantry cars to some trains not having them.
- IRCTC has less than 2% of the airline ticketing market share in India so there is big room to grow. The Indian Travel Agent / Booking industry was estimated at ₹1,370-1,390 bn. in FY14. On account of

strong growth in domestic and inbound tourism, the industry grew at 11-12% CAGR to reach ₹2,335-2,355 bn. in FY19. These figures are for airline, hotels and railway bookings.

- The organized packaged drinking water market has been estimated to have grown from ₹ 30-35 bn. (at retail price) in FY14 to ₹80-85 bn. in FY19 at 19.5% CAGR. Going forward, the market is expected to further grow by 16-17% CAGR and reach ₹ 180-185 bn. in FY24.

Financials of IRCTC

- IRCTC’s revenues, EBITDA and PAT over the years are in Fig 3. Revenues, EBITDA & PAT have grown at a CAGR of 10.4%, 10.1% and 9% resp. from FY17-19. The 3 year nos. may look average.
- The PAT growth for FY19 was 23.5% from ₹221 cr. to ₹273 cr. IRCTC wrote off bad debts of ₹46.1 cr. in FY19. Adjusting for this the PAT growth would have been 37% for FY19.
- IRCTC had a RoE of 26.14% and RoCE 38.77% for FY19. This is excellent. The 3 year avg. RoE is 25%.

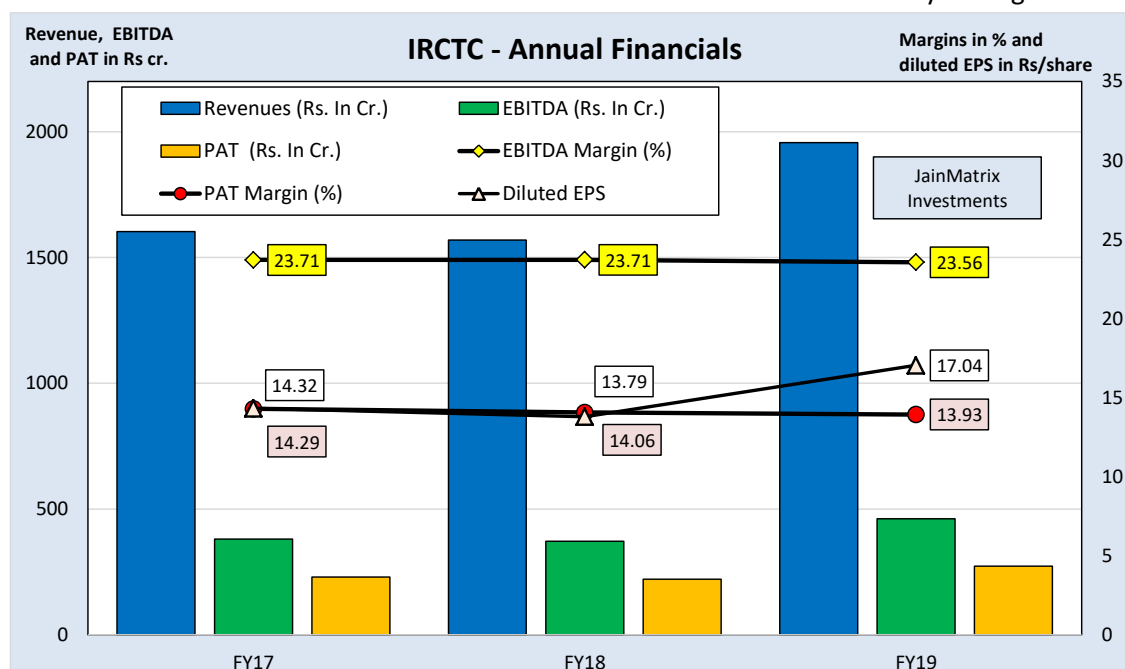
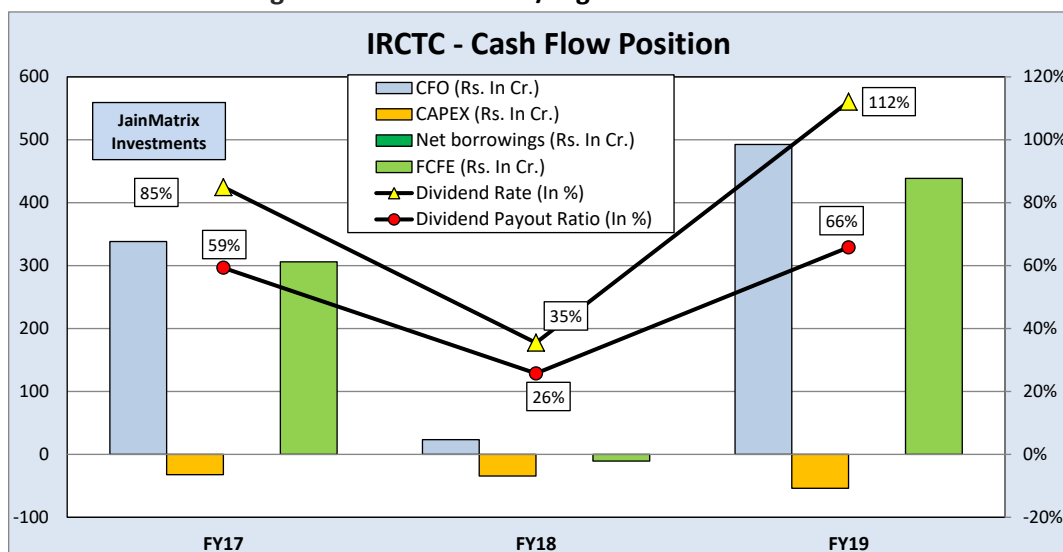


Fig 2 – IRCTC Financials / Fig 3 – IRCTC Cash Flow



	FY19	FY18	FY17
At the Effective Income Tax rate	1,575.07	1,272.05	1,254.72
Income tax expense reported in the statement of profit and loss (relating to continuing operations)	1,575.08	1,272.05	1,254.71
Effective Tax Rate	36.60%	36.14%	35.19%

Fig 4 – IRCTC Corporate Income Tax Rate

- IRCTC had an EBITDA margin of 23.5% and PAT margin of 13.9% for FY19. These are high margins and marginal sales growth can drive high profit growth.
- IRCTC has strong operating cash flows and the firm is FCFE positive. See Fig 3.
- IRCTC derives ~75% of its operating profits (EBIT) from its catering and internet ticketing business. Both the business segments have witnessed sharp rise in margins over the years. Tourism business margins have turned from loss making to high single digit margin. Rail Neer and State Teertha business segment margins have marginally declined. Overall the margin trajectory is robust.
- Fig 4 we can see that IRCTC has paid an effective corporate IT rate of 36.6% for FY19. IT rates have been lowered from the current fiscal year to 25%. This will lead to higher earnings growth.
- IRCTC FY20 PAT outlook is robust given (a) Tax Savings of 32% (b) **Convenience fee restoration** by Ministry of Railways which should double segment revenues (c) Low/No expected doubtful bad debts compared to FY19 (d) Organic growth across catering, water, ticketing and travel.

Benchmarking

Particulars	IRCTC	IRCON	RVNL	RITES	Balmer Lawrie
Revenues (Rs. in cr.) (FY19)	1,957	4,798	10,069	2,047	1,775
EBITDA (Rs. in cr.) (FY19)	461	668	804	768	283
Profits (Rs. in cr.) (FY19)	273	450	692	490	161
Market Cap (Rs. in cr.)	5,120	3,520	5,316	6,643	1,897
PE TTM (x)	18.78	8.33	7.68	14.47	10.66
Price to Book Value (x)	4.91	0.89	1.21	2.66	1.46
3 Yr CAGR Sales (%)	10.49	24.40	30.40	23.36	-18.08
3 Yr CAGR Profit (%)	9.09	4.61	16.84	20.32	-3.43
Debt to equity ratio (x)	0.00	0.65	0.69	0.02	0.05
EBITDA Margin (%)	23.56	13.92	7.98	37.52	15.94
Net Profit Margin (%)	13.93	9.38	6.87	23.94	9.07
Return on Equity (%)	26.14	11.35	16.04	19.38	10.74
RoCE (%)	38.77	8.05	10.38	26.80	14.38
Dividend Yield (%)	2.39	5.76	0.35	4.80	6.61
Mkt Cap to sales	2.62	0.73	0.53	3.25	1.07

Fig 5 – Benchmarking

We benchmark IRCTC against peers, See Fig 5.

Note: For IRCTC, only 2 year CAGR sales and PAT growth have been presented, per RHP data.

- PE and PB of IRCTC is the highest in the peer group. However the valuations are attractive given the monopoly status, sector growth, B2C nature, high earnings, high return ratios and debt free status.
- The sales and PAT growth look low. However the reasons for the same have been explained above. From FY20 the growth numbers should accelerate.

- The EBITDA and PAT margins are in the high range amongst this group. RoE and RoCE are the highest. This is a positive. Dividend yield is average but high considering it is a state owned unit.

Positives for IRCTC and the IPO

- Railways are much more environmentally friendly, consuming less fuel compared to road and air.
- The GoI has planned a massive investment in IR to improve operations, and it has high potential to grow usage and volumes. IRCTC is dealing with essential and cutting edge initiatives, which can grow very rapidly. IRCTC enjoys a monopoly position in several niches with the IR – online ticketing, catering and branded water - which lower risks and ensure business stability and profits.
- The restoration of Convenience Fee from Sept 2019 will allow IRCTC to sharply improve revenues from internet ticketing in FY20 itself. These had fallen in FY18 and FY19 post demon.
- The Catering Policy 2017 envisages a bigger role for IRCTC and takeover of many catering activities.
- The B2C nature of Business with large number of transactions is more stable and allows IRCTC to build a brand with consumers. IRCTC also has a vast amount of data on customers through online portal which can be used more effectively to upsell and cross sell other services.
- With the IPO and listing, IRCTC is well organized and employees better incentivized to take advantage of the emerging opportunities in the defined and new sectors.
- High cash and bank balances and debt free status are clear positives.
- Valuation at PE 19 times is attractive given monopoly nature of its businesses and growth prospects.

Risks and Negatives for IRCTC and the IPO

- If GoI were to allow competition in future in business areas of IRCTC, it will quickly affect valuations.
- IRCTC might be unable to implement the directives of Catering Policy 2017 in a timely manner, which may result in penalties. Totally 159 observations were made by commercial inspectors during 2013-2016 relating to issues of hygiene, tariff, cooking, kitchen, food and service in IR.
- Security, hacking and phishing are key concerns as IRCTC relies on tech to operate its ticketing and tourism business. Currently all servers, IT and storage systems are at a single location.
- IRCTC has a JV, Royale Indian Rail Tours Ltd. (RIRTL) with Cox & Kings India which is under litigation. They have not been able to consolidate the financials of RIRTL since FY11.
- IRCTC's business can be negatively affected if they are unable to maintain quality standards. Any adverse claims, media speculation or bad publicity could quickly affect their reputation and image.
- Ticket booking scams/frauds - many have been discovered on the IRCTC platform over the last few years. The fraud typically pertains to booking Tatkal (last minute travel) tickets. Action is usually taken quickly by authorities. In the high revenue area, good vigilance is needed to detect frauds.
- Change in haulage by Ministry of Railways on the trains IRCTC operates could adversely affect business. Under haulage concept, IR takes fixed charges for hauling the rake of the train from one destination to another; charges are calculated and informed by IR to IRCTC.
- While IRCTC has been asked to unbundle catering services by creating a distinction between food preparation and food distribution, the timelines are not clearly defined and are currently under discussions. Any failure on part of IRCTC to adhere to the mandate may result in penalties.
- While IRCTC has several monopolies, it however does not have pricing controls over the services due to price regulation by IR; they do not hedge risks of market fluctuations in commodities market.

- IRCTC uses PET bottles and other plastic items for their packaged drinking water, which is subject to various regulatory requirements and increasing public scrutiny.
- There are whispers of overcharging in paid mobile catering and lack of transparency / bills.
- In the past IRCTC was affected when Lalu Prasad Yadav (former Railway Minister) was accused of misusing his official position in 2004 and conniving with officials of IRCTC to grant sub-lease rights of 2 IRCTC owned hotels in Puri and Ranchi to a private party. Such scams can tarnish IRCTC's image.
- The GoI has pressured PSUs for dividends and is targeting massive revenue from disinvestment. In general this is an overhang and causes PSUs to lose valuation premiums.

Overall Opinion and Recommendation

- The Indian Railways is undergoing a dramatic transformation to improve service levels, better technology, outsource and grow faster. Subsidiaries like IRCTC are executing on the new initiatives.
- The Railway industrial complex is getting unbundled. 2 out of the 3 recently listed railway PSU IPO's have performed well. [RVNL](#) and RITES gained while IRCON lost value since listing.
- IRCTC has performed well in the last 20 years, using its lean structure, good technology and well-managed financials to record growth and profits. Return ratios and operating cash flows are robust.
- There is ample scope for growth in almost all business segments. IRCTC enjoys several monopoly niches. Profits are expected to improve in FY20 given earnings tailwinds including restoration of **Convenience Fees**, lower corporate tax and lower bad debt provisions YoY. Margins are flat or improving. This makes IRCTC attractive for investors. It is poised for a good listing and future gains.
- The key risks are 1) In the packaged drinking water business, a ban on single use plastic 2) removal of exclusivity for its business divisions 3) reduction in price of services, higher haulage or a removal of Convenience charge for tickets portal 4) Any adverse news flow on catering services 5) GoI may list RailTel and IRFC soon, both are PSU railway firms which can impact valuations.
- At a P/E of ~19 times, the valuation are attractive.
- Opinion: Investors can **SUBSCRIBE** to this IPO with a 2 year perspective.

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