Last updated: May 29, 2020

Rating Methods by Sector

Warehousing

1. Business base

Warehouse companies primarily combine a warehousing business with logistics, including associated operations such as transportation along with real estate rental using the redeveloped sites previously used for warehouses. Because of the characteristics of risks and cash flow which vary between the logistics business and the real estate rental business, ratings take into account the rating methods for land transportation and real estate.

(1) Characteristics of the industry

(i) Market overview

The warehousing business is susceptible to the volume of domestic logistics. Since logistics volume is closely linked with domestic economy, earnings of the warehousing business are easy to fluctuate depending on economic trends. From a long-term perspective, logistics volume has almost reached the ceiling due to the maturity of the domestic economy and shifting of logistics overseas, but controlled areas for public warehouses have been increasing. This is reflecting changes and diversification in logistics needs. As customers are seeking warehouses that help improve their logistics efficiency, warehouses are becoming larger and logistics centers are expanding into inland and suburban areas from seaports. Meanwhile, demand for outsourcing of logistics functions in order to reduce logistics costs is also growing. JCR believes that the warehousing business could achieve moderate market growth by catering to customer needs, despite the influence of economic fluctuations.

In addition to warehousing, warehouse companies operate land transportation, port transportation, air cargo transportation, customs clearance agency, and other businesses. While all these businesses are influenced by economic trends as with the warehousing business, medium- and long-term market trends vary one by one. Land transportation would be affected by shrinking population and shifting of domestic manufacturing bases overseas. Port transportation seems to continue facing a harsh business environment due to a decline of Japanese ports’ international status. Air cargo transportation, meanwhile, is expected to see an increasing demand for international cargo but is susceptible to international relations.

The real estate rental business, which is influenced by the office building market, has become a stable source of income based on relatively stable rents received over the long term.

(ii) Competitive situation

With the exception of special operations such as refrigerated warehouses, barriers to entry in the warehousing market are low, and the industry is characterized by a large number of small and midsize players. The drive by customers to reduce their logistics expenses has rapidly gathered momentum and inventory has been reduced in the late 1990s, causing a decline in the capacity utilization ratio of warehouses. This has resulted in increasing downward pressure on storage fees and intensifying competition over cargo among companies in the same industry. In the late 1990s, the earnings of large warehouse companies experienced a significant decline. These companies have streamlined their existing logistics centers and have built new warehouses or rebuilt existing ones. In addition to storage, they have restored profitability by aggressively adopting distribution processing activities such as packaging and increasing the handling of freight with higher added value to better serve customer needs. Although the situation that small and midsize warehouse companies face is more difficult than that of larger companies, their stable customers help sustain the business and to this point there has been no increase in industry reorganization. By acquiring companies with strength in land, overseas, and air cargo transportation rather than other warehouse companies, large warehouse companies are attempting to obtain operational soft infrastructure and expertise, increasing their collective strength as logistics companies.

The real estate rental business redevelops sites previously used for warehouses located close to seaports and riversides that in the past played key roles in logistics. These properties are often less popular as office locations than the properties of general real estate companies. Therefore, downward pressure on rents tends to be higher when the economy slows down.

(iii) Cost structure (profit structure)

Warehouse fees are divided primarily into storage fees and stevedoring charges. Although each has established a fee structure, market prices are lower than that. The stock-type business—largely storage of warehouse freight with low labor costs—used to contribute substantially to earnings. However, changing customer needs and rising demand for reduced logistics costs have resulted in lower storage fees, which have led to an increased reliance on flow-type operations such as warehousing as well as shipping and distribution processing. These activities, however, entail higher labor costs, making it difficult to control overall costs. Losses are likely to result, particularly at the start of the business, although they are generally recouped over time. Warehouses with extensive distribution processing and other activities must be examined in terms of their individual earnings.

Warehouse companies respond to shortages of storage space due to increased freight by renting nearby storage space. Meanwhile, a space that has become vacant due to decreased freight is, in many cases, rented out for a fee to owners of goods who are entrusted to handle their goods themselves. While having the benefit of responding flexibly to changes in logistics volumes, the former entails large rent payments and profitability is not high. In some cases, therefore, the details of transactions must be reexamined, and construction of a new warehouse must be considered. Renting out a space, on the other hand, generates earnings effects similar to that of real estate rental. Especially when the entire warehouse building is rented out, it must be analyzed as a business similar to real estate rental, as the cost structure differs from that of the general warehousing business.

Compared with warehousing, the real estate rental business enjoys high profitability and earnings stability despite the heavy burden of depreciation. Yet, since reduced rent and increased vacancies directly affect earnings, efforts to prevent the capacity utilization ratio of properties from falling and to avoid a reduction in rental rates are necessary in maintaining the rental income.

(2) Important factors in market position and competitiveness

(i) Market position

Warehouses are divided into private warehouses (those of manufacturers that store their own freight) and public warehouses (those operated by warehouse companies), with private warehouses accounting for the majority. Although public warehouses owned by warehouse companies are part of logistics function, their positions in the logistics market are low. Moreover, a large number of companies operate public warehouses, and even large warehouse companies have only a marginal share in the logistics market on the basis of controlled area. Accordingly, moves of even warehouse companies with a high industry position have only limited influence over the logistics market and other companies.

(ii) Customer base

The warehousing business of storing important raw materials and products of customers tends to last a long time once customer trust has been gained. JCR examines the major customers and the conditions of transactions with them, growth potential of the major customers, and profitability of storage freight. Particularly when major customers comprise a large part of sales, the credit rating of such customers must also be taken into consideration.

(iii) Ability to respond to customer needs

Although relations with customers tend to be for the long term, cases in which competitive bidding is regularly requested are also increasing. The ability to meet customer needs is essential also to avoid simple price competition. JCR examines companies' ability to respond to customer demand for facilities, distribution processing, and other activities. In particular, a business in which the warehouse company takes charge not only of storage, but the entire logistics of the customer, tends to last longer, and is assessed as a stable income source.

The ability to handle different types of freight must also be analyzed to respond to new demands for outsourcing. JCR surveys the details of facilities, the ability to attract freight, and the operational expertise needed to handle high value-added freight such as the storage of pharmaceuticals and documents.

(iv) Location

Warehouses are located close to seaports, where there is concentration of import and export freight, and, among others, near highway interchanges that play important roles in inland transportation. There is often concentration of warehouses of multiple companies in these areas. Given changing needs for logistics centers, however, it is important to examine whether companies have many of their warehouses in locations with long-term potential.

Location is also an important factor in assessing the medium- to long-term earnings of real estate rental properties created through the redevelopment of former warehouse sites. Although the locations are often less favorable than those of the properties of large real estate companies, the properties are often relatively large as the former sites of warehouses. Taking advantage of this feature, data centers and office buildings that can be used in part as logistics facilities have been constructed. Warehouse companies also try to enter into the rental agreements in longer term in an attempt to prevent vacancies and reduced rental rates.

Many warehouse companies plan to permanently use their land rather than selling it, and JCR needs to check for any scope for the redevelopment of their sites. Land with the potential for future redevelopment is analyzed in terms of the development schedule, amount invested, and profit plan.

(v) Overseas business development

Warehouse companies are somewhat lagging behind other logistics companies in terms of overseas expansion. Amid the continuing trend of shifting of the production bases of domestic manufacturers overseas, however, warehouse companies also need to gain ability to handle overseas logistics. By strengthening the ability, companies would maintain their domestic customers who are expanding their business overseas and acquire new customers. Still, it seems to take time for them to enjoy full-scale contribution of overseas business. JCR looks at establishment of overseas subsidiaries and warehouses, synergies of business acquisitions or capital alliances with overseas companies, enhancement of relationships with domestic customers, whether such activities are facilitating acquisition of new customers, and other factors.

2. Financial base

(1) Earnings strength

The segments of warehouse companies are divided chiefly into real estate rental business and logistics business. Because of the varying profit characteristics between the real estate rental and logistics businesses, JCR predicts the level of profit stability of the company based on the profit contribution made by each segment. The logistics business can be divided into warehousing, land transportation, port transportation, and other operations, each of which has different profit characteristics. Analyzing the earnings power of each operation and its weighting within the logistics business to verify the stability of logistics business profits is a prerequisite for segment profit analysis.

Key financial indicators:

- Operating income
- Profit contribution by segment

(2) Cash flow

Both the logistics and real estate rental businesses are based on a business model of recovering investment funds through long-term stable cash flow. The repayment ratio is calculated from the amount of interest-bearing debt, EBITDA, and other indicators, which is monitored for changes. However, because the logistics and real estate rental businesses have different profitability and payback periods, changes in yields must also be learned from factors such as EBITDA and the asset size of each business.

If a new investment is made, the estimated yield is confirmed based on EBITDA, asset size, and other factors for each property to ensure the scheduled progress of investment recovery. The effect of the property on overall EBITDA and asset size is also analyzed.

Key financial indicators:

- Cash flow from operating activities
- Free cash flow
- EBITDA
- Ratio of interest-bearing debt to EBITDA

(3) Safety

Both warehousing and real estate rental properties require a large initial investment. Interest-bearing debt rises rapidly when making this investment, and this may reduce the performance of financial ratios. With a business model of long-term recovery, progress in recouping the investment is confirmed while estimating the future financial structure based on financial policies. The level of improvement is also considered in the rating.

Warehouse companies have unrealized profits gain on owned real estate and JCR confirms the situations.

Key financial indicators:

- Interest-bearing debt
- Shareholders' equity
- Debt equity ratio
- Equity ratio

Japan Credit Rating Agency, Ltd.
Jiji Press Building, 5-15-8 Ginza, Chuo-ku, Tokyo 104-0061, Japan
Tel. +81 3 3544 7013, Fax. +81 3 3544 7026