

MANAGEMENT MEET UPDATE

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GATI LTD

PRICE : Rs.105
TARGET PRICE : Rs.135

RECOMMENDATION : BUY
FY09E PE : 15.7x

Reason for this report: Introduction of FY09 estimates and upward revision of price target to Rs.135. Upgrade from HOLD to BUY with a 29% upside potential.

Introduction of FY09E numbers

We recently met the management of Gati and are positive about the growth prospects of the company. We are introducing our FY09 estimates on higher earnings visibility due to strong growth in the express distribution business of the company and also its foray into the air cargo segment with five freighters. Also, Gati is going to spend Rs.2.5 bn in the next two years to increase the warehouse space to 2 mn sq ft and acquire a ship. This would help to maintain its robust growth in revenues and profitability, going forward.

In FY09E, we expect Gati to report net sales of Rs.9.5 bn, EBIDTA margins of 11.6% and PAT of Rs.622 mn, thereby translating into an EPS of Rs.6.7 and CEPS of Rs.8.7 on a diluted basis.

Following are the key takeaways from the management meeting

Agreement with state-owned Indian to wet lease five freighter aircrafts

In May 2007, Gati entered into an agreement with the state-owned airline Indian to operate freighter aircrafts, which would carry parcels, documents and cargo. The agreement is for the wet lease of five B737-200 freighter aircrafts for five years to run these cargo freighters on various routes covering all metros and other parts of the country.

The agreement is primarily aimed at expanding its business across the country and creating a dominant position in the express cargo segment. The agreement also has the provision of extension after five years for further periods by mutual consent.

Both, Gati and Indian would jointly do branding, advertisement and launch related activities. The freighters aircraft would be painted with logos of both Indian and Gati.

The first freighter aircraft is expected to be inducted by the end of August 2007 or early September 2007. The tentative schedule for the remaining aircraft induction for operation is November, December 2007, January 2008 with the last one being in February 2008. Thus, the company is scheduled to have the entire fleet of five aircraft operational by March 2008.

The above leased aircraft shall have a valid certificate of airworthiness to be issued by the department of civil aviation of India for carrying out transportation with cargo freighters.

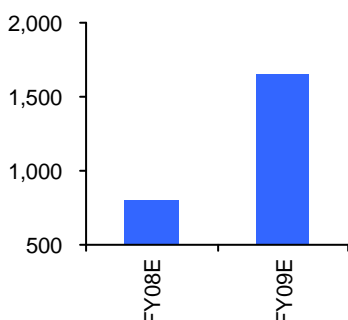
Gati is likely to pay Rs.275,000 to Rs.300,000 per hour per aircraft as lease rentals, which include all aircraft related charges. The company has given a minimum commitment of a total of 17 hours of flying per day for all five-cargo freighters. Each aircraft is likely to operate for three to four hours of flying per day.

We feel the above step is very positive for the overall growth prospect of the company as it can now offer complete end to end logistics services with quick and efficient deliveries. Currently, Gati conducts business of about Rs.400 to Rs.500 mn out of air cargo. With the induction of five cargo aircraft it is likely to touch Rs.2 bn in a full year of operation.

Cons. summary table - Year end June

(Rs mn)	FY07E	FY08E	FY09E
Sales	5,629	7,420	9,501
Growth (%)	22.4	31.8	28.0
EBITDA	510	773	1,103
EBITDA margin (%)	9.1	10.4	11.6
Net profit	255	428	622
Net debt	418	974	1,291
EPS (Rs)	3.0	4.6	6.7
Growth (%)	32.9	68.1	45.4
DPS (Rs)	0.7	0.8	1.8
ROE (%)	8.4	10.1	13.3
ROCE (%)	8.4	12.3	15.2
EV/Sales (x)	1.8	1.5	1.2
EV/EBITDA (x)	20.0	13.9	10.1
P/E (x)	35.5	22.9	15.7
P/BV (x)	3.2	2.3	2.1

Source: Kotak Securities - Private Client Research

Airfreight revenue growth (Rs mn)

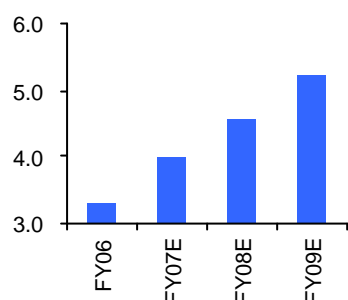
Source: Kotak Securities - Private Client Research

Tie-up with Chinese logistics company

Gati has signed a comprehensive memorandum of understanding (MoU) with China Railway Express International Logistics Company Ltd (CREIL), which is a market leader in China for rail and road cargo and package delivery. CREIL has a presence in 500 cities in all 31 provinces of China. The two companies have agreed to cooperate in the development of freight forwarding, express courier and logistics services in the booming India-China trade.

CREIL has large fleet of more than 3500 vehicles with 2 mn sq ft warehousing space in China. With this tie-up, the company would provide exporters and importers end-to-end distribution solutions in the Indian and Chinese markets. We feel this is a step in the right direction and would lead to higher revenues and profitability for the company, going forward.

EDC revenue growth (Rs bn)



Source: Company, Kotak Securities - Private Client Research

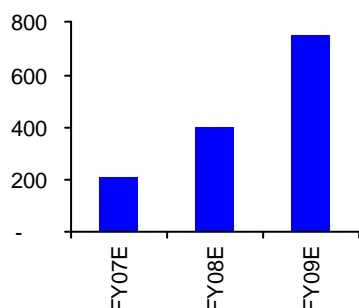
Robust growth in express distribution and supply chain management

In FY07, Gati added eight express distribution centers (EDC) and Gati Distribution warehouse (GDW), thereby taking the total to 23. The company is likely to add 12 to 15 EDC and GDW in the next two years, thereby taking the total number to about 35 to 38 by June 2009. Currently, Gati has 1.2 mn sq ft of warehouse space, which is expected to be expanded to 2 mn sq ft by June 2009.

Currently, Gati has 23 EDCs and GDWs spread across the country - at Mumbai, Pune, Ludhiana, Gurgaon, Jaipur, Indore, Bhopal, Kolkata, Guwahati, Coimbatore and Bangalore among others. These are doing good business and are expected to further contribute significantly to the revenues of the company, going forward. Three more EDCs are slated to go on stream in FY08E at Hyderabad, Panvel and Ahmedabad. All of these are at advanced stages of completion. We believe the full potential of the new EDCs will be realized from the second half of FY08E onwards.

We feel the express distribution and supply chain business of Gati is set to grow aggressively in the years to come, which will lead to higher revenues and profitability for the company, going forward.

International business revenue (Rs mn)



Source: Kotak Securities - Private Client Research

International businesses to grow substantially

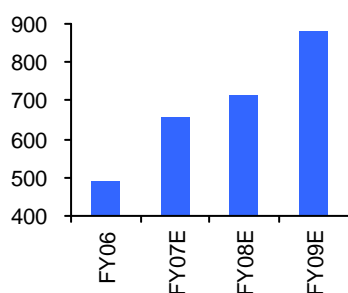
Gati has offices in China, Hong Kong, Sri Lanka, Singapore, Mauritius, Dubai and Thailand. India-centric distribution is happening through these wholly-owned subsidiaries and business is gradually picking up in these offices. The international business is typically high margin business for Gati and the company is looking to expand its presence in the Indian centric distribution business. It is likely to generate business of approximately Rs.200 mn in FY07E. We expect this to go up to Rs.400 mn in FY08E and further to Rs.750 mn in FY09E.

Strong growth in coast-to-coast i.e. shipping business

Gati currently has three ships: Gati 1 with 105 TEUs capacity, Gati Suvidha with 210 TEUs capacity and Gati Zipp with 212 TEUs capacity. All of them are deployed on the Chennai-Port-Blair-Yangon-Chennai route, which is operating at optimum capacity since the addition of Yangon to its route. The company enjoys pricing power, as it is the only company providing shipping services on the Yangon route.

Gati has also placed an order for a ship from the Bangkok shipyard with a capacity of up to 442 TEUs, which is scheduled for delivery in April 2008. Thus, we expect the shipping revenues to go up from Rs.491 mn in FY06 to Rs.710 mn in FY08E and further rise to Rs.880 mn in FY09E.

Shipping revenue growth (Rs mn)



Source: Company, Kotak Securities - Private Client Research

Capex plans & its funding

In order to stay ahead of the competition, Gati is laying a strong focus on further strengthening an extensive network of express distribution centers by expanding the warehousing space from 1.2 mn sq ft currently to 2 mn sq ft by June 2009.

Gati has also placed an order for ships from the Bangkok shipyard with a capacity of up to 400 TEUs. The total acquisition cost is Rs.550 mn out and the company has already made the down payment for the acquisition of the ship. The ship is scheduled for delivery in April 2008.

FCCB - December 06

FCCB	\$20 mn
Exchange Rate	44.67
Rs. mn	893.4
Shares mn	7.15
FV	2
Premium	123
Total per share	125

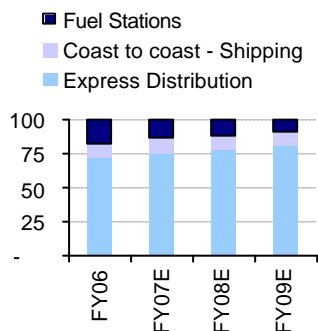
Source: Company

The management indicated that they have plans to spend about Rs.2.5 bn in the next two years for the purposes. Gati has already raised Rs.893.4 mn out of FCCBs in December 2006 and earlier warrants were issued to promoter and the Infrastructure Fund of India. We felt that this, together with internal accruals would be sufficient to meet the capex plans for the company. Hence, we do not expect any further equity dilution to fund the capex.

Equity Dilution

	(Rs mn)
Equity after rights issue	125.4
1.57 mn sh. Issued to IFOI @ 423 FV 10	15.7
0.310 mn warrant. Issued to IFOI @ 423 FV 10	3.1
0.5 mn warrant issued to promoters @ 423 FV 10	5.0
10.5 mn warrant issued to promoters @ 90 FV 2	21.0
1.05 mn warrant to IFOI @ 90 FV 2	2.1
FCCB 7.15 mn share @125 FV 2	14.3
Total Equity	186.6
Mn sh. Fv 2	93.3

Source: Company

Revenue breakup (%)

Source: Company, Kotak Securities - Private Client Research

Earnings estimates

We maintain our earnings estimates for FY07E and expect Gati to report net sales of Rs.5.6 bn, EBIDTA margin of 9.1% and PAT of Rs.255 mn, thereby translating into an EPS of Rs.3.0 and CEPS of Rs.4.3.

Change in estimates (Rs mn)

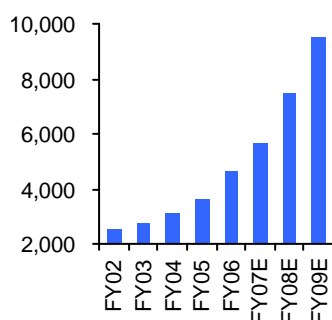
	Old		Revised		
	FY07E	FY08E	FY07E	FY08E	FY09E
Revenues	5,629	7252	5,629	7,420	9,501
EBIDTA	510	767	510	773	1,103
Profit	255	447	255	428	622
Equity	167	167	172	187	187
EPS (Rs)	3.1	5.3	3.0	4.6	6.7
CEPS (Rs)	4.4	7.1	4.3	6.2	8.7

Source: Company, Kotak Securities - Private Client Research

In FY08E, we expect Gati to report net sales of Rs.7.4 bn, that is, sales growth of 31.8%, EBIDTA margins of 10.4% and PAT of Rs.428 mn, that is, YoY growth of 68%, thereby translating into an EPS of Rs.4.6 and CEPS of Rs.6.2 on diluted basis.

With the acquisition five freighters we expect express distribution to contribute to 80% of the total revenues by 2009E that was 72% in FY06.

In FY09E, we expect Gati to report net sales of Rs.9.5 bn, that is, sales growth of 28%, EBIDTA margins of 11.6% and PAT of Rs.622 mn, that is, YoY growth of 45%, thereby translating into an EPS of Rs.6.7 and CEPS of Rs.8.7 on diluted basis.

Net sales (Rs bn)

Source: Company, Kotak Securities - Private Client Research

Valuation & recommendation

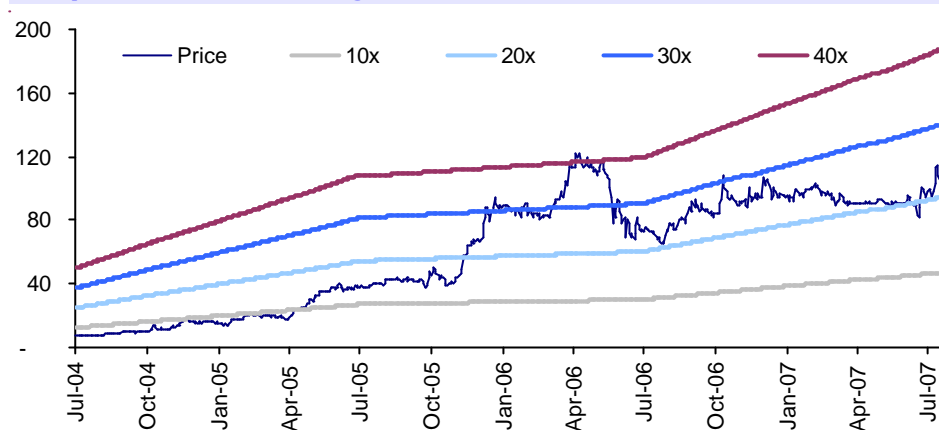
At Rs.105, the stock trades at 2.3x FY08E and 2.1x FY09E to book value.

It discounts FY08E and FY09E earnings at 22.9x and 15.7x, respectively.

It discounts FY08E and FY09E cash earnings at 17.0x and 12.1x, respectively.

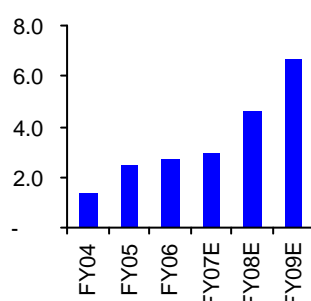
We have also done our one-year forward rolling band analysis for Gati, which revealed that over the last one year the stock has traded within 20 to 30x one-year forward estimates. Based on our FY09E EPS of Rs.6.7 and target price of Rs.135 the stock would trade at 20.1x.

One year forward PE rolling band



Source: Company, Kotak Securities - Private Client Research

EPS (Rs)



Source: Company, Kotak Securities - Private Client Research

Based on the introduction of FY09 numbers and using DCF method of valuation we get a target price of Rs.135 with 12.2% WACC and 4% terminal growth rate.

We continue to remain positive on the growth prospects of the company as it has a strong reach of 594 out of 602 districts in India with strong infrastructure support like more than 1 mn sq ft of warehouse space, pan-India express distribution centers, web-based tracking, growing international business through wholly-owned subsidiaries, three ships and now five leased freighter aircrafts. We believe Gati is ideally placed to take advantage of the logistics boom that is going to unfold over the next few years in the country.

We are upgrading the stock from **HOLD** to **BUY** with a target price of Rs.135 with 29% upside potential.

Key risks

- Any delay in expanding the warehouse space or acquiring ships would lead to revision in earnings estimates.
- The company faces competition from the organized as well as unorganized sector on the aspects of pricing and certain local advantages.
- The movement of materials by air, surface and ships could be affected by weather conditions or natural calamities. This can harm the business operations of the company.

Peer Valuation

	Revenues (Rs mn)				Net Profits (Rs mn)				EPS (Rs)				P/E (x)			
	FY06	FY07	FY08E	FY09E	FY06	FY07	FY08E	FY09E	FY06	FY07	FY08E	FY09E	FY06	FY07	FY08E	FY09E
GDL	1,386	1,610	2,364	3,312	722	774	948	1,236	7.8	8.4	10.3	13.4	23.8	22.1	18.1	13.9
CONCOR	24,332	30,460	38,349	45,348	5,258	6,906	8,233	9,705	80.9	106.3	126.7	149.3	27.5	20.9	17.6	14.9
GATI *	4,599	5,629	7,420	9,501	192	255	428	622	2.7	3.0	4.6	6.7	38.9	35.0	22.8	15.7
Allcargo**	12,281	19,752	22,468	-	713	1,145	1,435	-	35.2	56.5	70.8	-	29.3	18.2	14.5	-

	Current price (Rs)	Target price (Rs)	Upside potential (%)	Market cap (Rs bn)	Diluted no of shares (mn)	Target P/E (x)
GDL	186	211	13.4	17.1	92.2	15.7
CONCOR	2,226	3,000	34.8	144.7	65.0	20.1
GATI *	105	135	28.6	9.8	93.3	20.1
Allcargo**	1,030	1,346	30.7	20.9	20.3	19.0

* June end; ** December end; Source: Companies, Kotak Securities - Private Client Research

NOTE: Analyst holding: Concor - 50 Shares