

GATI

INR 121



*Valuation expensive in the backdrop of back-ended profitability* **REDUCE**

Gati's Q3FY08 (June-ending) results were below our expectations in terms of revenues and profitability. Revenues, at INR 1.4 bn, grew 5.8% Y-o-Y and 8.8% Q-o-Q. The company has transferred its fuel division to its subsidiary, which contributed INR 232 mn to revenues in Q3FY07. Adjusted for the same, revenues grew 27% Y-o-Y, owing to strong growth in its coast-to-coast shipping segment, which grew 34% Y-o-Y. However, growth in its express business remained muted Q-o-Q. Net profits, at INR 40.3 mn, declined 12.9% Q-o-Q and 40% Y-o-Y.

EBITDA for the quarter declined 8.3% Y-o-Y on account higher costs in its air freight division. It incurred an additional cost of INR 40 mn towards deploying additional air freighter, which sustained losses for the second consecutive quarter, and INR 10 mn towards its new rail parcel business. It also incurred brand development cost of INR 29.90 mn, which further reduced margins. Net profit declined due to higher interest cost, incurred towards loan raised for purchase of vessels.

Gati started its rail parcel business, which is expected to generate revenues of INR 30 mn/quarter, and is currently delivering parcels from Mumbai to Guwahati. Its express distribution centre in Bangalore, with a capacity of 250,000 sq. ft., is already operational and is expected to achieve full capacity utilization only by FY08-end. Other warehouses at Nagpur, Hyderabad, Mumbai, Delhi, and Chennai are expected to be operational in 9-12 months. The company's recently-acquired subsidiary, Kausar India, is also expected to show lower profits due to high interest and depreciation. Further, its air freight business is expected to break-even only by Q1FY09 and will continue to impact margins due to high cost of deployment.

**\* Profitability likely to be back-ended; valuation expensive in the backdrop**

Gati's foray into warehousing and air freight is expected to boost profitability in the medium term, however, evolution of hub and spoke model for freighters and optimum utilization for warehouses is likely to take a couple of quarters. In the backdrop of increased costs this quarter and likely pressure on margins, we are revising our profit estimates downwards by 18.2% and 17.2% for FY08E and FY09E, respectively. On the revised EPS estimates, the stock trades at 29x and 20.7x FY08E and FY09E, respectively. This, in our view, is expensive till the improvement in visibility for margin occurs. We downgrade the stock from 'BUY' to 'REDUCE'.

**Financials**

Year to June	Q3FY08	Q3FY07	% change	Q2FY08	% change	FY07	FY08E
Revenues (INR mn)	1,464	1,383	5.8	1,345	8.8	5,325	6,600
EBITDA (INR mn)	114	124	(8.3)	101	12.4	486	728
Net profit (INR mn)	32.2	68.0	(52.6)	124.9	(74.2)	239.7	358.4
EPS (INR)	1.3	0.5	193.2	0.7	91.0	2.6	3.8
P/E (x)						48.5	29.0
EV/EBITDA (x)						1.6	1.2
ROAE (%)						21.3	10.7

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Bloomberg : GTIC IN

**Market Data**

52-week range (INR) : 215 / 80  
Share in issue (mn) : 75.8  
M cap (INR bn/USD mn) : 9.8 / 230.1  
Avg. Daily Vol. BSE / NSE ('000) : 194.0

**Share Holding Pattern (%)**

Promoters : 49.8  
MFs, FIs & Banks : 1.5  
FII's : 7.3  
Others : 41.4

**Key highlights**

- ◆ Standalone revenue, at INR 1.4 bn, grew 5.8% Y-o-Y, adjusted for the hived-off fuel division, it grew 27% Y-o-Y and 8.8% Q-o-Q. Net profits, at INR 40.3 mn, declined 40.7% Y-o-Y.
- ◆ Revenues from the XPS division grew 26% Y-o-Y, but remained flat Q-o-Q. The margins in the division declined 400bps Q-o-Q to 6.5%. Margins were impacted due to consecutive loss of INR 50 mn in its air freight business. Revenues for the shipping division grew 34% Y-o-Y on account of an additional vessel becoming operational, taking its fleet size to four vessels, all operating at 100% capacity utilization this quarter.
- ◆ EBITDA for the quarter stood at INR 114 mn, growing 12.4% Q-o-Q, but declining 8% Y-o-Y. Decline in EBITDA was on account of additional costs incurred for its express division. Gati has started a rail express business, delivering parcels from Mumbai to Guwahati, for which it incurred a cost of INR 10 mn. Further, the company has added an air freighter and incurred an additional cost of INR 40 mn. As a result, margins in the express division have declined from 10.5% in Q2FY08 to 6.5% this quarter. The company has also incurred a cost of INR 29.9 mn towards brand development, which has further reduced its EBITDA.
- ◆ Net profit, for the quarter was INR 40.3 mn compared with INR 46.3 mn in the previous quarter and INR 68 mn last year, declining 12.9% Q-o-Q and 40.7% Y-o-Y. Decline in profits is on account of higher interest cost, which has increased 212% Y-o-Y and 123% Q-o-Q. Further, the company has also made an exceptional loss of INR 8 mn in the quarter.

Financial snapshot									(INR mn)
Year to June	Q308	Q307	% change	Q208	% change	FY06	FY07	FY08E	FY09E
Net sales	1,464	1,383	5.8	1,345	8.8	4,561	5,325	6,600	8,387
Total expenditure	1,350	1,259	7.2	1,244	8.5	4,174	4,839	5,872	7,357
Direct cost	-	228	(100.0)	-		802	740	4,320	5,464
Employee expenses	163	153	7.1	176	(6.9)	490	579	828	1,035
Other expenditure	1,186	879	35.0	1,068	11.0	2,882	3,520	724	858
EBITDA	114	124	(8.3)	101	12.4	387	486	728	1,029
Other Income	3	8	(67.1)	10	(72.9)	16	38	16	16
Depreciation	33	27	18.6	31	5.2	87	111	168	246
EBIT	84	105	(19.8)	80	5.0	317	413	576	799
Interest	36	12	212.2	16	123.0	42	58	86	113
PBT	48	93	(48.3)	64	(24.7)	275	355	490	686
Provision for taxation - Current	8	25	(68.8)	18	(55.4)	74	89	132	185
Extra-ordinary Items	8	-		(79)	(110.3)	-	27	-	-
Adjusted PAT	32	68	(52.6)	125	(74.2)	201	240	358	502
Tax rate (%)	16	27		28		29	26	28	28
<b>% of sales</b>									
R.M. (% of sales)	-	16.5		-		17.6	13.9	65.5	65.1
Emp exp (% of sales)	11.2	11.0		13.1		10.7	10.9	12.6	12.3
Other exp (% of sales)	81.0	63.5		79.4		63.2	66.1	11.0	10.2
OPM (%)	7.8	9.0		7.5		8.5	9.1	11.0	12.3
NPM (%)	2.2	4.9		9.3		4.4	4.5	5.4	6.0

## Company Description

Incorporated in 1995, Gati has evolved as a leader in the fast-growing express cargo distribution business. It provides services across the entire value chain, from traditional point-to-point transportation to end-to-end integrated logistics and supply chain management. It operates in three different business segments viz., logistics, coast-to-coast, and fuel stations. Logistics is the company's mainstay, contributing 71% to revenues.

## Investment Theme

The express industry in India is expected to grow 20-25% in the next few years, driven by robust economic growth, increased acceptability of outsourcing, and change in regulatory policies. Gati, being one of the leading players in the Indian organised express industry, is poised to take advantage of these trends. Currently, the company has ~1 mn sq. ft. of warehousing space, which is likely to double by June 2008. It currently operates four self-owned container vessels with capacities of 4811 MT, 6084 MT, and 6779 MT.

## Key Risks

Key risks to our investment theme include: (a) intense competition from MNCs, which could lead to lower margins and (b) any impediments to the planned expansion.

## Financial Statements

<b>Income statement</b>					<b>(INR mn)</b>
<b>Year to June</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07</b>	<b>FY08E</b>	<b>FY09E</b>
Income from operations	3,592	4,561	5,680	6,600	8,387
Direct costs	2,525	3,200	4,056	4,320	5,464
Employee costs	397	490	607	828	1,035
Other expenses	415	484	583	724	858
Total operating expenses	3,337	4,174	5,246	5,872	7,357
EBITDA	255	387	434	728	1,029
Depreciation and amortisation	73	87	112	168	246
EBIT	182	301	322	560	783
Interest expense	47	42	59	86	113
Other income	21	16	42	16	16
Profit before tax	156	275	305	490	686
Provision for tax	52	74	90	132	185
Core Profit	104	201	214	358	502
Extraordinary items	-	-	-	-	-
Prior Period Adjustments					
Profit after tax	104	201	214	358	502
Minority Interest					
Profit after minority interest	104	201	214	358	502
Equity shares outstanding (mn)	8	71	72	72	72
EPS (INR) basic	12.40	2.83	2.96	4.95	6.93
Diluted shares (mn)	41.80	93.59	93.59	93.59	93.59
EPS (INR) fully diluted	2.48	2.14	2.29	3.83	5.36
DPS	3.00	0.70	0.66	1.24	1.42
Dividend payout (%)	24.2	24.7	27.0	30.1	24.7

### Common size metrics- as % of net revenues

<b>Year to June</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07</b>	<b>FY08E</b>	<b>FY09E</b>
Operating expenses	92.9	91.5	92.4	89.0	87.7
Depreciation	2.0	1.9	2.0	2.5	2.9
Interest expenditure	1.3	0.9	1.0	1.3	1.4
EBITDA margins	7.1	8.5	7.6	11.0	12.3
Net profit margins	2.9	4.4	3.8	5.4	6.0

### Growth metrics (%)

<b>Year to June</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07</b>	<b>FY08E</b>	<b>FY09E</b>
Revenues	17.3	27.0	24.5	16.2	27.1
EBITDA	35.5	51.7	12.0	67.8	41.4
Net profit	72.7	93.6	6.8	67.3	39.9
EPS	72.7	-	13.5	6.8	39.9

<b>Balance sheet</b>					(INR mn)
<b>As on 30th June</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07</b>	<b>FY08E</b>	<b>FY09E</b>
Equity capital	84	142	145	187	187
Reserves & surplus	492	1,444	1,602	4,058	4,436
Shareholders funds	576	1,585	1,747	4,245	4,623
Secured loans	428	417	679	679	1,679
Unsecured loans	210	302	1,223	1,223	1,223
Borrowings	639	719	1,902	1,902	2,902
Net deferred tax	55	58	61	133	235
<b>Sources of funds</b>	<b>1,270</b>	<b>2,363</b>	<b>3,709</b>	<b>6,280</b>	<b>7,760</b>
Gross block	943	1,391	2,013	3,373	5,373
Depreciation	292	373	471	640	886
Net block	652	1,019	1,542	2,734	4,488
Capital work in progress	125	416	719	719	719
Total fixed assets	777	1,435	2,261	3,453	5,207
Investments	42	179	205	205	205
Inventories	11	20	22	26	33
Sundry debtors	420	556	759	882	1,121
Cash and equivalents	74	134	482	1,908	1,468
Loans and advances	149	290	328	344	378
Other current assets					
Total current assets	654	1,000	1,591	3,159	3,000
Sundry creditors and others	149	177	244	352	444
Provisions	53	73	124	185	209
Total CL & provisions	203	251	368	537	653
Net current assets	451	749	1,223	2,622	2,347
Others	0	0	0	0	0
<b>Uses of funds</b>	<b>1,270</b>	<b>2,363</b>	<b>3,689</b>	<b>6,280</b>	<b>7,760</b>
Book value per share (BV) (INR)	69	22	24	59	64

**Cash flow statement**

<b>Year to June</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07</b>	<b>FY08E</b>	<b>FY09E</b>
Net profit	104	201	214	358	502
Add: Depreciation	73	87	112	168	246
Add: Deferred tax	4	3	2	73	102
Add: Others	(8)	(187)	(84)	(108)	(124)
Gross cash flow	172	103	245	491	725
Less: Changes In Working Capital	25	238	125	(26)	165
Operating Cash Flow	148	(135)	119	517	561
Less: Capex	136	585	648	1,360	2,000
<b>Free cash flow</b>	<b>11</b>	<b>(721)</b>	<b>(529)</b>	<b>(843)</b>	<b>(1,439)</b>

**Ratios**

Year to June	FY05	FY06	FY07	FY08E	FY09E
ROAE (%)	20	19	13	12	11
ROACE (%)	16	18	11	12	11
Inventory (days)	1	2	2	2	2
Debtors (days)	42	39	42	45	44
Debt/Equity (x)	1	0	1	0	1
Interest cover (x)	4	7	5	7	7
Payable (days)	22	19	19	25	27
Cash Conversion Cycle	21	22	25	22	19
Current Ratio	3	4	4	6	5
Debt/EBITDA	3	2	4	3	3
Adjusted Debt/Equity	0	0	1	0	0

**Valuation parameters**

Year to June	FY05	FY06	FY07	FY08E	FY09E
EPS (INR)	2.5	2.1	2.3	3.8	5.4
<i>Y-o-Y growth (%)</i>	73	(14)	7	67	40
CEPS (INR)	22	4	5	8	12
P/E (x)	45	52	48	29	21
Price/BV(x)	2	5	5	2	2
EV/Sales (x)	0	2	2	1	1
EV/EBITDA (x)	6	21	21	11	9
Basic EPS (INR)	12	3	3	5	7
Basic P/E (x)	9	39	37	22	16
Current market price	111	111	111	111	111
Market capitalisation	928	7,867	8,035	8,035	8,035
EV	1,451	8,273	9,249	7,824	9,263

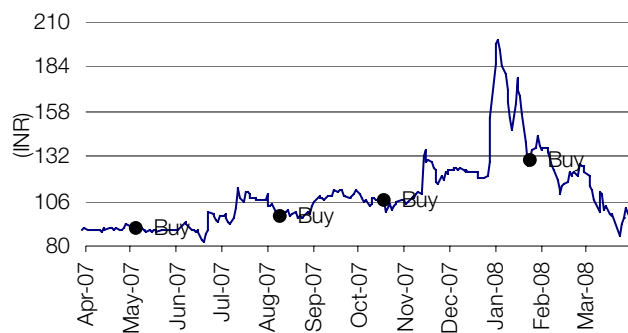
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**Coverage group(s) of stocks by primary analyst(s): Logistics:**

Allcargo, Concor, Dredging Corp Of India, Gateway Distriparks, Gati, SICAL and Transport Corporation of India

**Gati**



**Recent Research**

Date	Company	Title	Price (INR)	Recos
07-Feb-08	<b>Allcargo Global</b>	Integrating the value chain; <i>Result Update</i>	720	Buy
04-Feb-08	<b>Sical Logistics</b>	Smooth sailing; <i>Result Update</i>	223	Buy
1-Feb-08	<b>Gateway Distriparks</b>	Robust volume growth; <i>Result Update</i> ;	110	Buy
31-Jan-08	<b>Container Corp.</b>	Robust outlook; attractive valuations; <i>Result Update</i>	1,720	Buy

**Distribution of Ratings / Market Cap**

**Edelweiss Research Coverage Universe**

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	104	57	10	1	192

\* 15 stocks under review / 5 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	85	76	31

**Rating Interpretation**

Rating	Expected to
<b>Buy</b>	appreciate more than 20% over a 12-month period
<b>Accumulate</b>	appreciate up to 20% over a 12-month period
<b>Reduce</b>	depreciate up to 10% over a 12-month period
<b>Sell</b>	depreciate more than 10% over a 12-month period

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