"GATI Limited Q2 FY2018 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the Gati Limited, Q2 FY2018 Earnings Conference Call, hosted by SBI Cap Securities Limited. As a reminder all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sandeep Mathew from SBI Cap Securities. Thank you and over to you Sir!

Sandeep Mathew: Very good afternoon everyone. We are very happy to have with us today the management of Gati Limited represented Mr. Bala Aghoramurthy, Deputy Managing Director, Gati Kintetsu Express Limited and Mr. Manoj Gupta, CFO of Gati Limited. I now handover the conference to the management team for opening remarks. Over to you Sir!

Bala Aghoramurthy: Good afternoon friends. This is Bala here. Welcome to Gati's second quarter FY2018 results discussion. I thank you all for joining the call today and for your participation in the call. We shall take you through the quarterly performance of the company and then address any questions that you may have after that. So let me first start with some opening remarks on macroeconomic and relevant other developments related to our sector.

Index of industrial production IIP asset is known as registered a 3.8% in September 2017 versus 4.5% in August. Domestic GDP had grown at 5.7% in Q1 FY2018 a three year low widely attributed to GST transition issues across industry sector. Onset of the festival season towards the end of second quarter helps revive business activity especially in consumer oriented sectors such as apparels, durables, auto sector. E-way bill, which was expected to be rolled out in October, has now been further deferred to April. We explained last time that this e-way bill will help drive compliance further in the logistics industry and it will strengthen the market position of organized logistic player such as Gati.

Moving on to major developments in the growth. Core express distribution business for Q2 FY2018 improved through the course of the quarter after a rather sluggish start in July on account of the GST transition B2B surface closed flat, while the air registered a 15% Q-o-Q growth. Rail business faced significant loss of business opportunity firstly on account of the GST transition in July and thereafter due to lack of trains availability in post August and September because of the monsoon flood, which happened in the eastern part of the country.

E-commerce some sort of expectations in the September start of the festival season as e-tailers thereafter revoke strategy to post correct for the rest of the festival period. Cost control both in operating expenses as well as overheads remained a central focus to the period of business uncertainty related to GST transition. Capacity utilization improved 300 to 400 basis points in the line hall network in Q2 over the corresponding period last year. Customers across industry sector including large corporates and SME still adapting to the change caused in their supply chain post the GST rollout. We expect stabilization in the overall business environment through the course of the financial year. Going forward our future efforts will be directed in the following direction. The GST transition issues being streamlined across industry and across our customer franchise. Core express distribution is expected to ramp up well in H2 over H1. Train availability has improved significantly in Q3 and the temporary setback to the rail business stands overcome now.

New tender has been released by the railways for west-east corridor in this month of November 2017. Gati has introduced the new product managed value added transportation service or MVAT. This has been launched over the last couple of months. This is a significant portfolio augmentation, which will help provide end-to-end logistics service including transportation, warehousing and distribution to relevant customer.

E-commerce continues to see significant pricing pressure falling for sharp choices to be made to maintain profitability. Cost control effort will remain a key priority for us in H2. I now handover to Mr. Manoj Gupta to take you through the numbers and the performance in Q2.

Manoj Gupta: Thank you Bala and good afternoon everyone and thanks for participating in our investor call. I am sure that you have had a look at the numbers, which is on our website and on the various communication media. So basically we have almost a flat revenue with rather slight dip and our all other things are remaining similar all operating cost and stuff like that remaining similar and we have EBITDA margin of about 4% to 5% versus last quarter. Over the corresponding period last year we have a slight dip on the EBITDA margins and this is mainly because of the change in the product mix where our fuel station contribution has increased being lower margin business so therefore there is a slight change. The other major factor is the redemption/payment of FCCB, which has got converted in Q1 and Q2, so that has given us all the interest and foreign exchange restatement has given us some positive impact although we all know that this is one time, but once upon a time this was hitting us each quarter-on-quarter so there is a cumulative return.

On the PBT and PAT because of this one time numbers we are putting up much better number versus the last quarter and similar quarter last year. On half year basis also the results are more or less similar 2% drop in the topline and however because of 2% drop we have a slight dip in EBITDA. Our quality of business is similar 5% to 6% of EBITDA and then in addition I have already spoken about the exceptional or one time income or the statement of FCCB related matters and as a result our PBT and PAT post FCCB conversion is reporting a better number.

The debt wise we are better off versus March our net debt was 430 Crores in March and however it is better 315 Crores so major change is FCCB conversion and the other major change is effective working capital utilization where we have repaid about 35 to 36 Crores of loans, which is outstanding so as a result we are significantly down on the loan book. So now we are ready to take questions. Let go over the results and we could clarify any questions if you have.

Moderator; Sure Sir! Thank you very much. Ladies and gentlemen we will now begin the question and answer session. We have the first question from the line of Chandra Gopal from JM Financial. Please go ahead.

Chandra Gopal: Thank you for the opportunity Sir! Just wanted that one off income figure if you can give for the quarter?

Manoj Gupta: So for the quarter it is 237 million and for the half year it is 491 million.

Chandra Gopal: Sir just wanted your overview on this express business and basically the transition phase, which is happening from GST and how it is looking now it has been like half of November now, so how it is shaping up for us post GST?

Bala Aghoramurthy: So let me take that Chandra Gopal. Q2 July was a very poor start across industry sector because a customer industry sector themselves had to go through the transition and all logistics players also plays back so July was a really poor start. In August they flipped around significant improvement in August and September was actually quite good I am talking from Gati perspective. In general between surface express, air express and so on going forward from September we do not see any issue on the GST transition front. We only see opportunities, which are slightly more medium term is which is where the warehouses kind of consolidate and you have longer falling of goods and you have better distribution system rather than the legacy distribution system so in the medium term we see a lot of opportunities, the customers after taking three to four months to effect the transition both in their TRP systems, etc., after doing that compliance pay now customers are surely beginning to speak on the supply chain itself so I think things are working well, it has actually stabilized faster than what we thought it can take, stabilized faster.

Chandra Gopal: Sir also there was one qualification in the results can you please elaborate on that what is that regarding?

Manoj Gupta: Which qualification you are talking of?

Chandra Gopal: It was regarding in the other equity some adjustment has been done in June and then again it is reversed so auditor has qualified for

Manoj Gupta: Yes, so this is regarding some investments, which we provided for and Ind-AS wants us to have a look once in the whole year and the board also suggested that rather than doing every quarter let us have a holistic look and view by the yearend and therefore you can read our note along with the accounts where we are saying that we will take a holistic view by the year end. Note No.8.

Chandra Gopal: The investments are pertaining to what Sir?

Manoj Gupta: The investments are pertaining to power business of our group.

Chandra Gopal: Also on this e-commerce how are things shaping up because what I see is you know margins are dipping every quarter so how we should look about it?

Bala Aghoramurthy: Yes, let me try and address that, e-commerce actually the industry seems to be changing every year, no year is like how it was in the past in the previous year. We are seeing a trend where the larger retailers are happy to experiment with their own logistic services so that is one trend that we are seeing, but I am reasonably positive all these are cycles where companies experiment alternate mode and then find the most efficient. So this is one trend that I am seeing. The second is because of this you also have a lot of price competition happening in the market. The pressure on pricing is tremendous so that is a second piece. The third thing there is a change of end consumer dynamic you are seeing less and less of COD. You are seeing a lot more prepaid and so on, so there is definite change happening. In this context companies have to make their choices about which portion of e-commerce to play in. Gati of course has changed track at least once in the last two three years I did explain in the previous call as well and that we started off with a larger rail segments in the Tier-II, Tier-III cities we moved to the smaller rail segments and so on. So we are actively reevaluating what is the best source that is definite pressure on the pricing and volume track.

Chandra Gopal: Currently if I am not wrong we are also doing a last mile delivery as well and the B2B part of it as well right Sir?

Bala Aghoramurthy: And what part of it?

Chandra Gopal: And the B2B part of it like taking from the e-fulfillment centers to the in-between distributors and then to the last mile so there are two legs right?

Bala Aghoramurthy: Yes, so we are actually, first of all our B2B business is all in the express business we do not do count that in the e-commerce at all, so the e-commerce business is more to do with the last mile piece that we group. My comments were in the context of the last mile business that we are currently engaged.

Chandra Gopal: All the best and thank you so much.

Moderator: Thank you. We will take the next question from the line of Ankit Panchmatia from ICICI Securities. Please go ahead.

Ankit Panchmatia: Thanks for taking my question. Sir just wanted the breakup of the standalone revenue so what would be the commerce revenues and CASA specific revenues?

Bala Aghoramurthy: The e-commerce revenue in Q2 stands at 37.5 Crores and the CASA revenue stands at 8.6 Crores.

Ankit Panchmatia: So if I see the e-commerce revenues have declined from 47 Crores so almost 20% decline Y-o-Y basis so majorly attributed to our changing mix into the parcel size or the overall weakness in the market?

Bala Aghoramurthy: So it got two three components to it. First of all there was an anticipation of a good September because the festival season started in September. In the start of the festival season, the e-tailers themselves were not happy about their performance. There was a core correction thereafter happened in the second phase, which actually falls into October. Dussehra started in end of September and then Diwali near end of October so the start of the festival season was not good for the e-commerce industry by itself. Having said that I want to acknowledge there are one or two other peoples also which affected us. The first if you recall our COD volumes, etc., used to be really in the high range in the festival season for example we used to do almost 70% COD as a contribution. The more recent trend is closer to about 40% to 45% of COD contribution so that is one effect. The second effect s the pricing pressure that are operating in the market and of course we are having to pick and choose to little more carefully now than ever in the past. So there are three effects, one is to do with the industry itself, which is the start of the festival season that I explained. The second is the COD end consumer preference change. The third is the pressure on logistics pricing.

Ankit Panchmatia; But Sir would not our investments in the BrownTape were channelized to work up this e-commerce of transportation revenues so when we would be able to see that this segment would now be on its uptrend because it has been almost three quarters you are seeing it is sliding down so just wanted our investment on BrownTape and basically how it will help us to support our e-com or total logistics revenue?

Bala Aghoramurthy: The BrownTape concept was linked to a Gati fulfillment service that is not the last mile distribution as we are describing. We said we will disrupt the fulfillment services market where today it is controlled by the e-tailers with the combination of Gati's logistics and BrownTape's Information Services we will be able to move center of such eco-system that effort is still on it is a longer battle than shorter one. So that is the part.

Ankit Panchmatia: I know that I am not asking for any guidance, but when we can see that we will start playing on because at the end of it Sir my understanding goes is with e-fulfillment revenues picking up our B2C would also get some feeder from the fulfillment center so is my thinking right?

Bala Aghoramurthy: So I want to remain ourselves even last time we explained almost all of the e-fulfillment service business that we use to record within our GKE business that was moved out almost one year back so e-fulfillment that we were doing for the larger e-tailers that stopped almost more than a year back. What we are now talking about is the GFS, which is targeted directly at the vendor that is a medium to longer term play; it is not something, which happens in the short term. Having said that the bigger focus right now is on the e-commerce first mile, last mile distribution service that we are focused on that is the big work that has happened.

Ankit Panchmatia; Our update on Kausar because it has been a long time we have raised some fund and what is the update on the same how are they getting spend up and what is the update on our first warehouse coming live because the revenues again from Kausar I have not been able to increase so just your rationale on this?

Bala Aghoramurthy: Right so Kausar of course is a cold chain subsidiary in general Q2 and to some extent Q3 are actually off-season for Kausar when the monsoon hit the cold chain kind of get disturbed so what you see is a combination of that seasonality of the quarter for example the previous quarter it was 11 Crores, right now I told you it is 8.6 Crores, so you see a bit of seasonality of the quarter playing in. Having said that we are of course continuing to focus on the network building. We have one own site, which was the big site that we invested in the 5000 plus pallet spaces. In addition we are now have added near about a dozen other sites, which is not owned by us, but they are least size with varying pallet spaces typically about 200 are going up to 1000 so we have created the network and we are actively in conversation with customers we have added almost eight, nine new customers to the course of this quarter, so there is progress happening, but it is a combination of seasonality and of course further ramping up that is required.

Ankit Panchmatia: Is not the overcapacity of the palletization may cause one of our competitor as well is operating at 50% capacity utilization so just wanted to have your view that how is the pallet utilization or what is the pallet requirement and how are we targeting the same, do we have kind of plans for the same?

Bala Aghoramurthy: So let me explain this. I think we spoke about this twice over in the last six months. The pallet utilization across the industry peaks in the summer quarter. At that time you almost feel a shortage of the space in cold chain itself and as the monsoon hits the entire thing come crashing down to almost I am saying about 30% to 40% down that happens year after year. India is still to organize the cold chain in a manner where it is utilized in a consistent manner through the year. Fortunately there are only one, two or three organized players. It is a matter of time before the organized play happens much better. We have confidence in the sector although we realized it is going to be a short term battle for a year or two years and that is the reason why we change the track. If you remember about two years back we had said we want to build six or eight warehouses of our own and about a year back after operating for some time we change the track to saying there is no point in having more capex into the industry right now, hence we changed our strategy into saying we will go more for least warehouses, of course quality controlled and monitored by us, so least warehouses rather than investing more capex, so beyond the north center that we built almost everything else is a least warehouse in the existing space.

Ankit Panchmatia: Just an update. The amount, which we have received, is completely invested or we are yet going slowly on spending that amount?

Manoj Gupta: So we already responded if you reanalyze what Bala said so we are having cost benefit analysis and seeing the return on capital employed and with the change in the scenario we are possibly also looking for a change in the investment strategy; however, the customer service with the same locations and all that is built in either through lease or through our own. So our effort is to reduce the borrowing and to enhance our returns through the better study.

Ankit Panchmatia: Just a book-keeping question. The debt has reduced from 432 to 315 so the interest cost is yet at around a run rate of 10, 10.1 Crores so may be next quarter because the conversion would have happened may be in August so the debt or the interest amount would be lower in the subsequent quarter?

Manoj Gupta: It would be slightly lower because if you note the two third have been converted, one third has been redeemed, so redemption did happen through additional borrowing, so the additional borrowing comes at a rate of about 9% to 10% whereas our FCCB was about 4% to 5%, so you will see that it will offset, but overall interest will slightly come down.

Ankit Panchmatia: That is all from my side. Thank you.

Moderator: Thank you. Next question is from the line of Sandeep Mathews from SBICAP Securities. Please go ahead.

Sandeep Mathews: Just on FCCB so all the adjustments related to FCCBs has been completed and done as of end of this quarter would that understanding is correct Sir?

Manoj Gupta: 100% correct.

Sandeep Mathews: So the conversion which have had to happen is completed and the repayments, which have to be done have been done so correspondingly our net debt change is reflective of that so the current net debt as of September is reflective of the entire transaction correct?

Manoj Gupta: Yes, you are right.

Sandeep Mathews: You briefly mentioned in one of the remarks that your working capital loans saw a decline could you kind of provide some more colour on the same Sir, what exactly has been driving this improvement are you seeing any change in your working capital cycle per se and how much do we have to further improve from current basis?

Manoj Gupta: So we have been having a drive on collection and across the business we have collected better as a result our working capital have dropped, also we have been enhancing, we have been getting better credit from our vendor, so is a combined effect our working capital has dropped and this trend would continue and we will continue to work towards that.

Sandeep Mathews: Just on segment profitability Sir so if I were to look at your reported numbers on a y-o-y basis despite a fall in let us say revenue we have actually almost doubled our segment profit. Now is this largely because of the one off is it getting accounted over here or other factors, which is driving any sustainable improvement because from what I understand if I remember correctly fuel prices are at least on a y-o-y basis up, so can you just explain how this margin improvement has happened Sir?

Manoj Gupta: So it is on one off you are right it is mainly one off the other margins are as I stated earlier are similar versus last quarter and similar quarter last year.

Bala Aghoramurthy: Also if I may add I spoke about capacity utilization by near 300 to 400 basis points over last year the same quarter so while the diesel price you are absolutely right has gone up we have been able to contain the effect of that to less extent.

Sandeep Mathews: What are your initial thoughts on how the sector is shaping up post GST Sir so are you seeing incrementally any shift happening in businesses or our business is coming to your customers rather coming to you and talking more about better improvement in business growth prospect, how do you see things panning out over the next let say six to twelve months?

Bala Aghoramurthy: So the nature of conversations with customer. The quality of conservations with customers is definitely changing for the better. In the past it was almost like okay, so we see you Gati as express distribution people who will carry from point A to point B. We have been able to both because of our effort and of course GST has added to that we have been able to move the conversation into saying can we be your logistics partner in end-to-end including transportation, warehousing and express distribution, so I think to that extent it gives us great confidence that good times are to come. Having said that I think it will be premature to say it is going to happen in two months, three months and so on. I think it will play itself out. We are very confident of the medium term, long term. It will play to the benefit of organized players like us.

Sandeep Mathews: You mentioned about capacity utilization improving about 400 BPS is there an absolute number Sir where we are currently and where we intend to be let us say a year from now?

Bala Aghoramurthy: So capacity utilization I think there was a question last time as well just to give you a sense I do not want to speak exact number. To give you a sense on an actual weight basis we will be in the 70's, on a volume basis we will be in healthy 80's yes, that is the nature of the business because if you are moving light weight volume metric shipment it occupies more volume less weight if you are moving heavy weight dense thing it occupies less volume more weight yes, that is the range of it. It has improved to our satisfaction by the 400 basis points that I am talking about.

Sandeep Mathew: That was very helpful. Thank you.

Moderator: Thank you. Our next question is from the line of Sahil Jain from ICICI Securities. Please go ahead.

Sahil Jain: Thanks for taking my question. Just wanted to ask a revenue and EBITDA for Gait-KWE?

Manoj Gupta: Revenue has been 271 Crores and EBITDA is 17 Crores or 18 Crores let us say 6.5%.

Sahil Jain: Thank you so much.

Moderator: Thank you. We have a next question from the line of Chandra Gopal from JM Financial. Please go ahead.

Chandra Gopal: Thank you for the opportunity again Sir! Just wanted to understand the surface business we are seeing a flat growth who has been seen, but our competitor is showing a double digit growth consistently for last four, five quarters if I remember correctly, so just wanted to understand where we are missing on this leg and is it the loss of market share or we are operating in a different space to the competitor?

Bala Aghoramurthy: So I do not know which competitor you are talking about.

Chandra Gopal: PCI Express I was talking about.

Bala Aghoramurthy: Glad you mentioned the company's name incidentally TCI express has a much smaller base okay so if you look at the relative size of businesses we are in a very different plane. Having said that this quarter the July was not a great month as we started. We did improve very well through the course of the quarter. In the September month we actually had our all time high business in surface, which we have never seen in the past, so I am quite confident on the surface business as itself. Also last year if you remember we invested in quite some capacity and capability building as well. I think there is lot of confidence in customers about our capability. We meet literally 100s of customers every week across the country. In general I am sensing a very positive report about our surface capability.

Chandra Gopal: Sir also on cold chain you highlighted that India is very much behind in a full year capacity utilization normalizing just wanted to know how we are different from the other developed countries and how much time it can take in your view how do you see this industry shaping up say next five to seven years?

Bala Aghoramurthy: I think that is a very big question I think government should answer that. Having said that I will still make an effort. I think there is a lot of government intervention that is required

Chandra Gopal. The historical cold chain business was done at the agricultural land paying the agricultural power prices, etc., so the economic was not real economic, it was make believe economic. I think the government has started realizing so they are incentivizing, but I think what is being done is not sufficient. In fact one of the points that our chairman made last year in the AGM speech was that the government needs to be doing a lot more in the cold chain for companies like us to add value. The last point I want to say on this our cold chain is not very farmer friendly it is not like the farm produce the perishable, these kinds of things are not necessarily taken through cold chain for longer storage in India. If you look at the wastage that happened I do not have a way of confirming this, but what I was reading the wastage that happens is close to about 40%, how can a country afford 40% wastage in a sector like farming? The only answer to that cold storage, but the cold storage industry is in a very nascent stage, so I think it is a combination of government effort organized industry effort and so on it will take time to work well. I think we are at least a decade away from a cold chain for the country.

Chandra Gopal: Right Sir! Thank you so much.

Moderator: Thank you. As there are no further questions from the participants I now hand the floor back to the management for closing comments. Over to you Sir!

Bala Aghoramurthy: Thank you everybody. It was a very enriching set of questions we look forward to connecting with you again a quarter from now. Thank you all.

Moderator: Thank you very much. Ladies and gentlemen on behalf of SBICAP Securities Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.