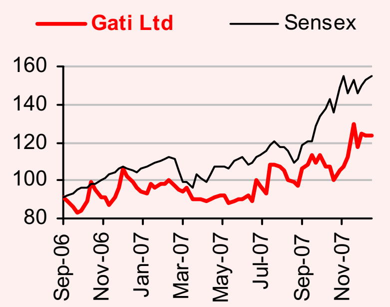
Initiating coverage

Gati (one stop logistic shop)

Reduce | **Current Price: Rs.123** | **Target price: Rs.110**

Key data

Sector	**Logistics**
Market Cap	Rs9.3bn/US$0.2bn
52 Wk H/L (Rs)	148/80
Avg. daily vol. (6 month)	168,670
BSE Code	532345
NSE Code	GATI
Bloomberg	GTIC IN
Reuters	GATI.BO
Sensex	19,261
Nifty	5,777



Shareholding pattern (%)

	30-Jun-07	30-Sep-07
FIIs NRI, Adr/GDR	16.4	18.8
MFs and institutions	1.6	1.5
Promoters	50.0	50.0
Others	32.0	29.7

Absolute returns (%)

	1mth	3mth	12mth
Gati Ltd	(5.3)	9.7	24.2
Sensex	(2.2)	24.2	41.5

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Great business but rich valuations

Gati is a play on India's booming express cargo industry. A buoyant industry and Gati's leadership position in the Indian express market will drive strong earnings growth of 38% CAGR over FY07-10E. However, at 28x 1-year forward earnings, all the positives are in the price. There are many other sectors like mid cap capital goods and infrastructure where the earnings growth is similar, return ratios are higher and valuations lower. Hence, we initiate coverage on Gati with a **Reduce** rating and a target price of Rs110.

Leader in the express cargo industry… Gati is a leader in the fast growing express cargo business with a market share of 10% in the organized express cargo segment. Its leadership is driven by its international presence, strong distribution network, excellent IT facilities and warehousing space. A tie up with Indian Airlines for providing air freight cargo services further adds to its gamut of services, and makes it an integrated logistic player.

…with strong earnings growth of 38% CAGR over FY07-10E. Higher sales growth, improving margins due to the re-engineering of its distribution network, expanding infrastructure capabilities and low gearing will help EPS grow at a CAGR of 38% over FY07-10E despite an equity dilution of ~30% over the same period.

Valuations however are very rich. At the CMP of Rs123, the stock trades at 27.7x its 1-year forward diluted earnings. We have valued Gati at a 2 year forward P/E multiple of 18.5x, a 30% premium to TCI, to arrive at a target price of Rs110. So, much as we like the story and its business model, the current market price fully reflects all the positives. Investors will gain more by investing in other sectors like mid cap capital goods and infrastructure where the earnings growth is similar, return ratios are higher and valuations lower. Hence our **Reduce** rating.

Figure 1: Financials

Year to 30th June	FY06	FY07	FY08E	FY09E	FY10E
Net Revenues (Rs mn)	4,599	5,680	6,961	9,428	11,336
EBITDA (Rs mn)	380	463	734	1,073	1,364
PAT adj (Rs mn)	192	236	386	573	719
EPS adj (Rs)	2.5	2.7	4.2	5.6	7.0
EPS diluted (Rs)	2.5	2.5	3.9	5.2	6.6
EPS growth (%)	21.0	1.2	54.4	34.8	25.6
P/E (x)	49.6	49.0	31.7	23.5	18.7
Div. yield (%)	0.6	0.7	0.7	0.7	0.7
RoE (%)	17.5	10.8	11.0	12.8	14.2
RoCE (%)	12.7	10.1	10.5	11.9	12.9
Price/BV (x)	5.4	3.2	2.5	2.3	2.0
EV/EBITDA (x)	24.3	22.0	16.1	11.8	9.3
EV/Sales (x)	2.0	1.8	1.7	1.3	1.1

Source: Company, Religare Institutional Equity Research

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Leader in the express cargo industry.

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Express cargo industry to double by 2012

The size of the Indian logistics industry is estimated to be ~US$73bn, and accounts for 13% of the India's GDP

The size of the Indian logistics industry is estimated to be $73bn, and accounts for 13% of the India's GDP (Source: CARE). The organized logistics market is projected to witness an 8% CAGR over FY07-11 mainly driven by robust trade growth and improving infrastructure facilities. The express cargo industry is a sub-set of the logistics industry.

The size of the global express service industry is estimated to be ~$149bn in 2005 while the size of the Indian express industry is estimated to be $1.6bn (Rs71bn) in FY06. The Indian express industry has grown at a CAGR of ~33% over the past decade and CARE expects the industry to grow at a CAGR of 20% during the next 5 years and more than double its size by 2012.

The Indian express industry is highly fragmented with over ~2,500 players in the organized, semi organized and unorganized segments. The organized segment constitutes ~65% of industry revenues.

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The opening up of the banking, insurance, retail, aviation and telecom sectors and their penetration to the smaller cities will be the major growth driver of the express industry in India. Implementation of VAT (Value Added Tax), rising international trade and increasing outsourcing will thus drive this industry's growth. Organized integrated logistics solutions providers like Gati, will be key beneficiaries because of their capability to provide superior quality, low cost services backed by a strong network, infrastructure, fully integrated services and IT.

Key challenges to the growth of Indian express industry

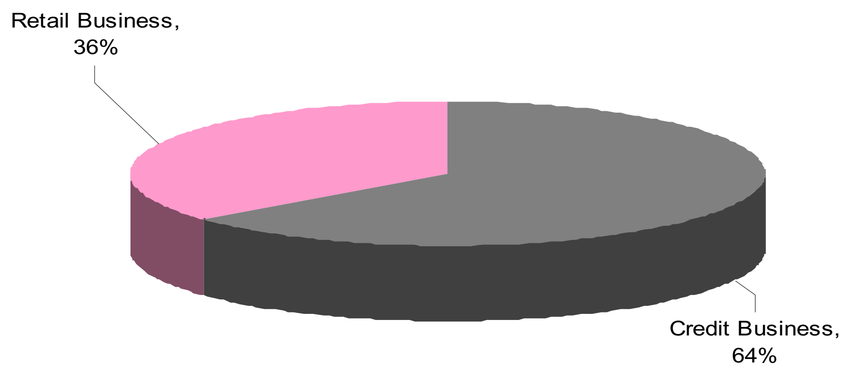
Despite all the above mentioned positives trends and projections, the Indian express industry can suffer huge losses if the proposed changes to the postal regulations like reservation of all document shipments weighing less than 300gms for the Postal Department goes through. Another key challenge that the industry faces is increasing fuel/ freight cost and manpower attrition rates.

Express Distribution and Supply Chain (ED&SC)

Gati offers integrated, multi-modal transportation services to its customers including surface cargo movement, trucking, warehousing, priority (air), ZIPP (courier) and international business.

Gati has ~3,000 credit corporate clients which contribute 64% of revenues and over 41,000 retail customers, with the largest customer contributing less than 2% of the total revenues. Thus it has a well diversified customer base.

Figure 2: Business Breakup (%)



Source: Company, Religare Institutional Equity Research

The ED&SC division is the largest contributor to Gati's total revenues contributing ~70%. The revenue in this division grew at a CAGR of 24% over FY04-07 and we expect them to grow at a CAGR of 23% over FY07-10E.

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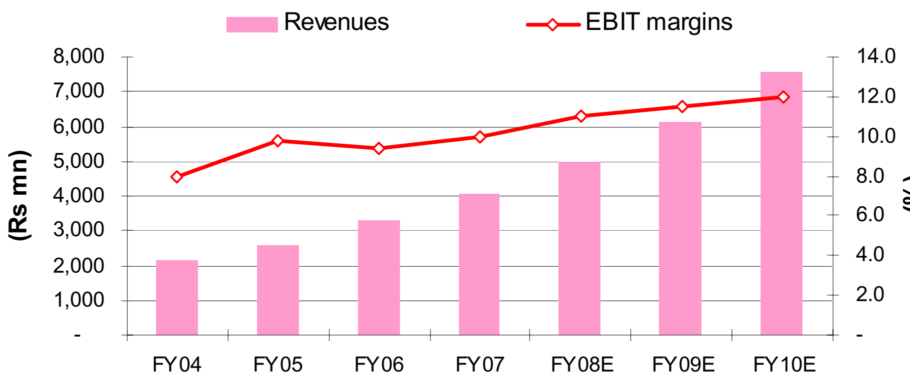
Figure 3: Revenues from the ED&SC segment



Source: Company, Religare Institutional Equity Research

Strong distribution network

Gati provides surface cargo distribution services through its wide distribution network which reaches out to 594 of the 602 districts in India. With a large fleet of over 2000 vehicles, it handles about 28mn packages annually. It commands a leadership position in the Indian express cargo business with 10% market share in the organized express segment.

Gati's basket of offerings includes:

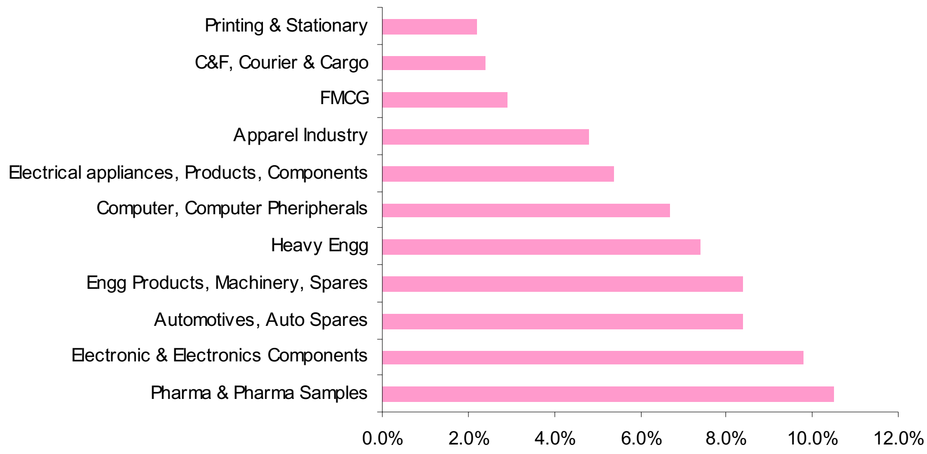
- On - time departure of vehicles irrespective of capacity utilization
- Assured date of delivery
- Door pick - up and door - delivery, absolutely hassle - free
- Weather - proof containerized vehicles for safe movement
- One - time lock for tamper - proof transit
- Online track and trace facility to trace your cargo
- Physical proof of delivery option
- e - billing and e – POD

It has about 1mn sq.ft. of warehousing space which it plans to double by FY09. This is because customers demand warehousing along with the freight services from the same vendor in order to streamline their processes and lower their costs.

Gati provide services across various verticals like pharmaceuticals, auto and auto components, IT, textile & apparel, electronic goods, etc

Gati provide services across various verticals like pharmaceuticals, auto and auto components, IT, textile and apparel, FMCG, electronic goods and other high value cargos. A strong infrastructure and value added services enable the company to cater to the leading companies in each vertical.

Figure 4: Segment wise business analysis



Source: Company, Religare Institutional Equity Research

Figure 5: Some of the valued customers in each vertical

Capital Goods	Bosch, Cummins, Havell's, Hitachi, Indoasian, Paharpur Ind, Schneider, Siemens
Auto & Auto Comp	Ashok Leyland, Eicher, Force, Ford, Hero Honda, Honda, Mahindra, Tata Motors
IT	3M, D-Link, Flextronics, HCL, HP, Ingram Micro, NCR, Wipro, Zenith
Pharma	Cadila, Cipla, Dr. Reddy, Nicholas Piramal, Novartis
FMCG	Amway, LG, Samsung, Sony, Timex, Titan
Textile & Apparel	Adidas, Gini & Jony, Pantaloon, Reebok
Telecom	Nokia

Source: Company, Religare Institutional Equity Research

Integrated logistics service provider

Gati is an integrated logistics player providing complete logistics solutions as a third party logistics (3PL) service provider.

MNCs who have set up a manufacturing base in India are the biggest user of 3PL services. Major domestic companies have also started outsourcing their basic logistics functions to 3PL service providers, on realizing the significant benefits like cost reductions and just-in-time delivery gained by the use of 3PL services. As a result, there is a tremendous potential for the 3PL market in India.

Gati provides customized third party logistics solutions by integrating all the four stages of business – procurement, production, distribution, after sale service and reverse logistics.

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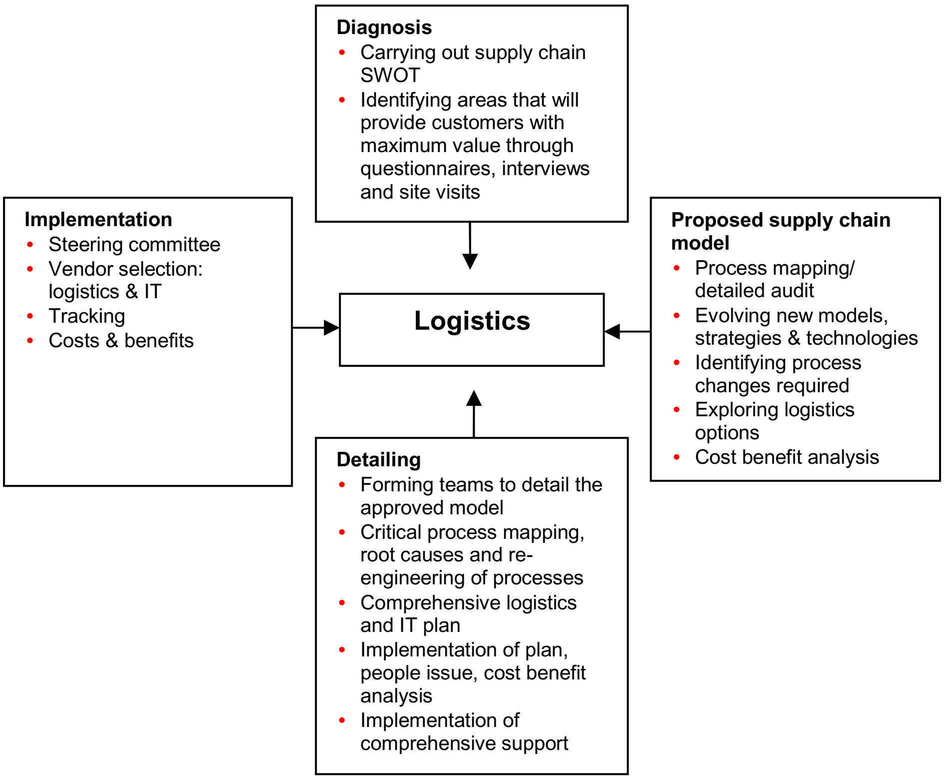
Figure 6: Process Flow



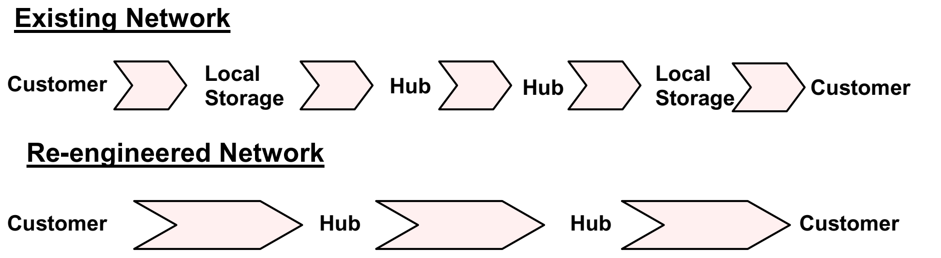
Source: Company, Religare Institutional Equity Research

Re-engineered the distribution network to Hub-and-Spoke concept with excellent IT facilities

Gati has re-engineered its distribution network to the Hub-and-spoke concept wherein it will have 1 Central Distribution Centre (CDC) in Nagpur and 19 Express Distribution Centres across India, which are expected to be operational by end of FY09. This will help the company reduce its operating and manpower costs, reduce multiple handling and damage and optimize space utilization. This will result in an improvement in profitability.

Gati has re-engineered its distribution network to the Hub-and-spoke concept wherein it will have 1 Central Distribution Centre (CDC) in Nagpur and 19 Express Distribution Centres (EDC) across India

Figure 7: Distribution Network



Source: Company, Religare Institutional Equity Research

It has revolutionized the industry with its first state-of-the-art Mechantronic Express Distribution Centre (EDC) at Peenya, Bangalore wherein it offers the latest IT facilities which include cargo tracking solutions, online warehouse management system, inventory management and control system and customer relation management (CRM). It offers a high level of operational efficiency. It has already opened 10 more centre's across the country and 9 more will be opened by FY09. This will enable it to enhance its capabilities and generate more business in express distribution and supply chain business.

IC-Zipp - Joint courier service of Gati and Indian Airlines

Gati and Indian Airlines have strategically tied up to provide retail courier services. IC-Zipp, the brand name used for courier service, caters to the needs of corporates, SME's and institutions which require courier service on a regular basis. It offers customized services along with various value-added services across 119 locations.

Focus on becoming a globally preferred logistic services provider

In order to increase its scope of services and to expand internationally, Gati has set up Gati Holdings Ltd, a wholly owned subsidiary in Mauritius, which has established 5 step-down subsidiaries. This subsidiary offers multimodal connectivity through air and sea for inbound and outbound cargo movement along with other logistic services like pick up, customs clearance, storage facility, etc.

Gati operates from offices in Mauritius, Singapore, Hong Kong, China, Dubai and Sri Lanka which offer a range of distribution solutions to and from India. It aims at becoming a leader in Asia Pacific and a globally preferred provider of India centric supply chain services and solution.

Figure 8: Summary of ED&SC division

Divisions	Operations
Express	Surface cargo movement service covering 594 out of 602 districts in India.
	Value added service such as door-to-door pick up/delivery, documentation assistance and assured delivery time
Priority	Alliance with Indian Airlines for providing air cargo movement for time restricted consignments.
SCM	Integrated service with complete solution for all warehousing needs
	Reengineered the distribution network to hub-and-spoke model
ZIPP	Domestic courier service that provides the choice of price and transit time options
Trucking solutions	Container trucking solutions for bulk cargo movement with online cargo tracking

Source: Company, Religare Institutional Equity Research

Coast to Coast business

Gati offers shipping services through a fleet of 3 container vessels with a combined capacity of ~17,000DWT operating on the Chennai-Port Blair-Yangon-Chennai and the Chennai-Port Kelang routes. Gati is the only service provider who provides shipping services to Yangon, thus giving it pricing power and an optimum capacity utilization of ~85%.

Out of the 3 vessels operational, 2 vessels make a roundtrip and 1 vessel operates between Chennai and Port Blair. On an average, Gati makes 3 round trips per month.

Apart from this, the company has placed an order for a new 7,200 DWT container vessel from **Asian Marine Services**, Thailand worth $13mn which is expected to be delivered by April'08. This ship will provide services on the Thailand, Singapore and Colombo routes.

Figure 9: Vessel capacity

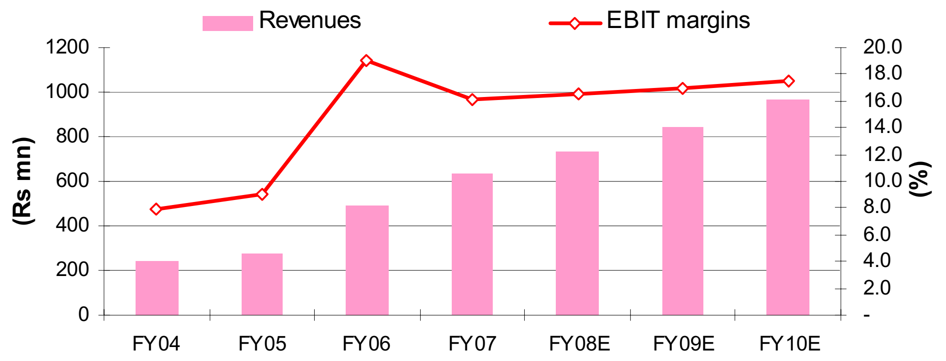
Vessels	DWT	TEUs
Gati 1	4,812	105
Gati - Suvidha	6,084	210
Gati Zipp	6,779	212
New Vessel (under construction)	7,200	442
Total	**24,875**	**969**

Source: Company, Religare Institutional Equity Research

Coast-to-coast contributes ~10% of the total revenues and is expected to grow at a CAGR of 15% over FY07-10E

This division contributes about 10% of the total revenues. The revenues in this division grew at a CAGR of 37.5% over FY04-07 and we expect it to further grow at a CAGR of 15% over FY07-10E.

Figure 10: Revenues from the coast-to-coast division



Source: Company, Religare Institutional Equity Research

Hived off the fuel station division to a wholly owned subsidiary

Gati has 4 fuel stations which are largely for captive use. Gati got these fuel stations as per the scheme of arrangement at the time of its split from TCI.

This division's EBITDA margins are as low as ~1.5% since it is just a trading business. Thus, in order to focus on its core logistics business, the company transferred all the 4 fuel stations located at Bangalore, Hyderabad, Belgaum and Indore to 4 wholly owned subsidiaries.

Strategic acquisitions and tie-ups

Wet-leased 5 freighters to provide integrated air cargo service

Gati has taken five B737-200 freighter aircrafts from Indian Airlines for 5 years on a wet lease, to tap the growing Indian air freight market. Prior to this agreement, Gati had a strategic alliance with Indian Airlines which provided it with assured space on Indian Airlines to provide air cargo services. The Indian air freight market accounts for 4.7% of the global air cargo market. However, it is expected that by 2011, 30% of the air cargo will originate from India. Thus to tap this huge opportunity, it has entered into an agreement with Indian Airlines to wet-lease freighters in order to provide full fledged priority air cargo services.

Gati had entered into a strategic alliance with Indian Airlines to provide air cargo services. We expect this division to achieve revenues of Rs1.5bn by FY10E.

The freighter aircrafts will be utilized by Gati to handle and offer priority air cargo services to its clients across various routes covering all metros and other parts of the country. It will carry parcels, documents and cargo. As per the agreement, the aircrafts have been leased out for 5 years which can be extended on mutual consent. Gati will pay a minimum lease rental on these freighters to Indian Airlines and on the other hand, later will bear all the cost related to the aircrafts. This agreement will enhance Gati's multimodal connectivity and help in creating a dominant position in the express cargo business.

Gati received the delivery of first freighter in the month of Nov'07 and has already started its operations. The balance four are expected to be delivered by the end of FY08. The Management is confident that the business will break even in the first year of its operations.

Strategic tie-up with CREIL, China

Recently, Gati signed a MoU with China Railway Express International Logistic Company (CREIL), a market leader in China for rail and road cargo and package delivery. Gati has a distribution network of 594 out of 602 districts in India, while CREIL has presence in 500 Cities in all 31 provinces of China. This will provide exporters and importers with end-to-end distribution solutions in the Indian and Chinese markets.

Strategic tie up with CREIL, China will provide exporters and importers with end-to-end distribution solutions in the Indian & Chinese markets

As per the agreement, both the companies will cooperate in the development of freight forwarding, express courier and logistics services in the booming India-China trade lane. Both the companies will provide and be responsible for all the necessary infrastructure requirements in their respective countries and will also provide the other with its contacts in his country to promote and to route maximum business possible through this MOU. This agreement will enable the two companies to complement each other's strength which are an extensive network, multimodal capability, mechantronic warehouses and a large base of customers in India and China.

Gati has a large fleet of over 2000 vehicles and CREIL has over 3500 vehicles covering even the remotest corner of China. Gati owns 1mn sq. ft. of warehousing space with a plan to double it in next 3 years, and CREIL has 2mn sq. ft. of warehousing space in China, therefore bringing a perfect synergy between them.

Figure 11: Distribution Network of Gati & CREIL

	CREIL	Gati
Coverage	500 cities in 31 provinces of China	594 out of 602 districts in India
fleet size	3500	2000
Warehousing	2mn sq. ft.	1mn sq. ft.

Source: Company, Religare Institutional Equity Research

Today, China and India are the two key markets that are of major interest to the world trading community. India-China trade which is currently at $17bn is expected to reach $40bn in 2010. Thus, the companies doing business in India and China will now be able to access the networks of two market leaders. This will provide the customers with ideal logistics connectivity for imports, exports and distribution between the two countries.

Value accretive acquisition of Kausar India – organized player in cold chain logistics

Gati acquired a 52.96% stake in Delhi based cold chain logistic firm, Kausar India for Rs143mn. It acquired 1.96mn equity shares for Rs72.84 per share. It will also make an open offer at the same price to acquire an additional 20% stake in the company. The total investment in Kausar India is likely to be ~Rs200mn for 72.96% stake.

Kausar India, one of the organized players in the cold logistics, provides refrigerated transportation of perishable goods and frozen foods. With a strong presence in the cold chain segment in northern India, Kausar specializes in the transportation of meat, pedigree products, dairy products and pharmaceuticals. It has a strong customer base with clients like Hindustan Unilever (HUL), Nestle, Dabur and Amul among others. At present, Gati does not have any presence in the movement of perishable cargo and this acquisition will mark Gati's entry into the cold chain space.

Acquisition of Kausar India helps Gati to foray into organized cold chain logistics business

Kausar handled 120,000 tons through 95 refrigerated vehicles and did revenues of Rs187mn, EBITDA of Rs36.2mn and EBITDA margins of 19.4% in FY07.

Figure 12: Kausar India's revenue trend

Source: Company, Religare Institutional Equity Research

Strong earnings growth of 38% CAGR over FY07-10E.

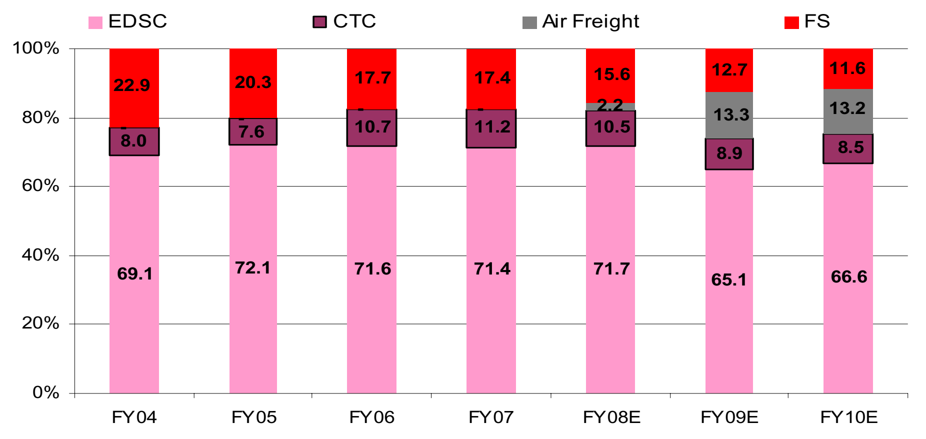
Higher sales growth, improving margins due to the re-engineering of its distribution network, expanding infrastructure capabilities and low gearing will help EPS grow at a CAGR of 38% over FY07-10E despite an equity dilution of ~30% over the same period.

Changing revenue mix

The Express distribution and supply chain division is the largest contributor towards Gati's revenues, accounting for 71% of FY07 revenues. The coast-to-coast division contributed 11% while the fuel division accounted for 17% for FY07 revenues. The share of the shipping division improved substantially from 8% in FY04 to 11.2% in FY07 led by the improvement in its capacity utilization and the addition of new routes. Previously, Gati operated at 60% capacity utilization as it provided shipping services only on 1 route i.e. Chennai-Port Blair. However, the addition of new route i.e. Chennai-Port Blair-Yangon-Chennai, led to the optimal utilization of the vessels, thus taking the utilization rate to 85%.

Going ahead, the share of each segment will decline with the kick off of the air freight division. By FY10E, the air freight division is expected to contribute 15% towards the total revenues.

Figure 13: Segment wise revenue breakup



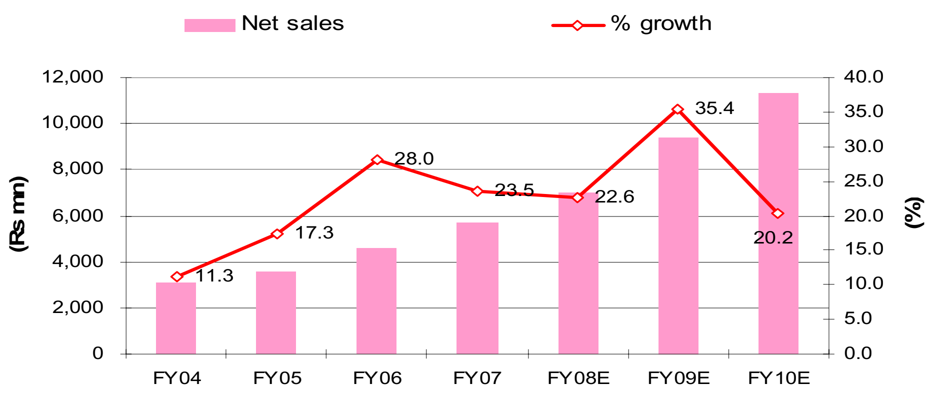
Source: Company, Religare Institutional Equity Research

Sales expected to grow at a CAGR of 26% over FY07-10E

Gati recorded a robust growth of 23% CAGR over FY04-07 led by sales growth of 24% CAGR in the express division and 37.5% CAGR in the coast-to-coast division.

Figure 14: Tend in revenues

We expect sales to grow at a CAGR of 26% over FY07-10E



Source: Company, Religare Institutional Equity Research

We expect revenues to grow at a CAGR of 26% over FY07-10E led by a buoyant express distribution market and the addition of new air freight division. We expect the express cargo and supply chain divisions to grow at a CAGR of 23% over FY07-10E mainly driven by investment in warehousing and up-gradation of IT facilities in order to improve the operational efficiency. Increasing awareness of 3PL benefits and demand for regional warehousing due to the gradual phasing out of CST will lead to a strong growth in the supply chain segment. The full impact of the air freight division will be visible from FY09 onwards. We expect Rs1.5bn revenues from this division by FY10E.

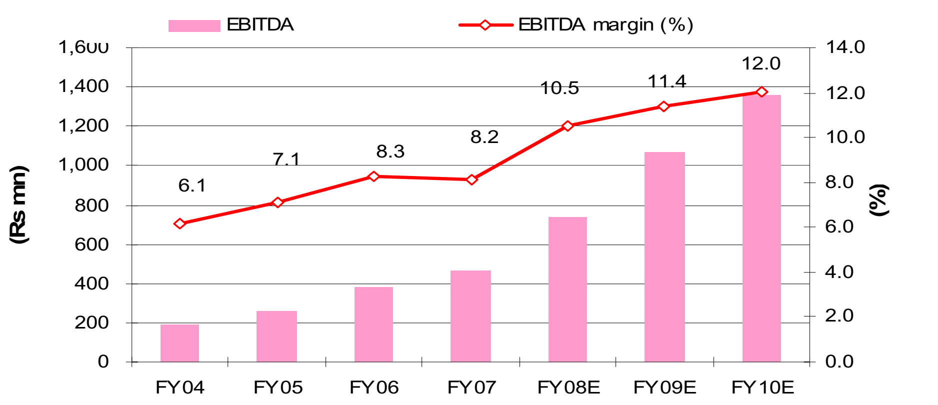
EBITDA margins to expand by 380bps to 12% over a period of FY07-10E

EBITDA margins continuously improved from 6.1% in FY04 to 8.2% in FY07 and 11.7% (standalone) in Q1FY08. The operating profit grew at a CAGR of 35% over FY04-07, outperforming sales growth. This was mainly led by

- Continuous investment in the network expansion
- Implementation of IT support system led to operational efficiency
- Addition of Yangon route in the shipping division led to pricing power, optimal capacity utilization and margin expansion

Figure 15: Trend in EBITDA margin

We expect EBITDA to grow at a CAGR of 43% over FY07-10E vis-à-vis sales CAGR of 26%



Source: Company, Religare Institutional Equity Research

We expect EBITDA to grow at a CAGR of 43.3% vis-à-vis sales CAGR of 26% and expect margins to expand by 380bps to 12% in FY10E led by

- Better utilization of infrastructure facilities due to investments in warehousing and IT facilities
- reduction in the complexity of the distribution network due to re-engineering of the network to hub-and-spoke model
- addition of new air freight division which will have an EBITDA margin of ~12-12.5%

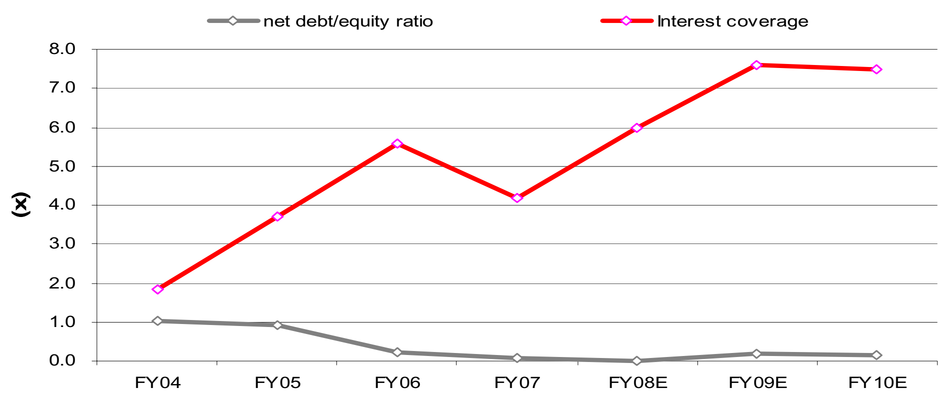
Low gearing resulted in improving interest coverage

Gati has raised ~Rs3.3bn in the past 18 months through the issue of rights shares, preferential equity, warrants and convertible bonds, which has resulted in the net debt/equity ratio declining from 1.0x in FY04 to 0.1x in FY07.

Higher sales growth, improving margins and lower gearing has resulted in an improvement of its interest coverage from 1.8x in FY04 to 4.2x in FY07.

Higher EBITDA and lower debt component will lead to further improvement in interest coverage ratio

Figure 16: Low gearing and improving interest coverage ratio



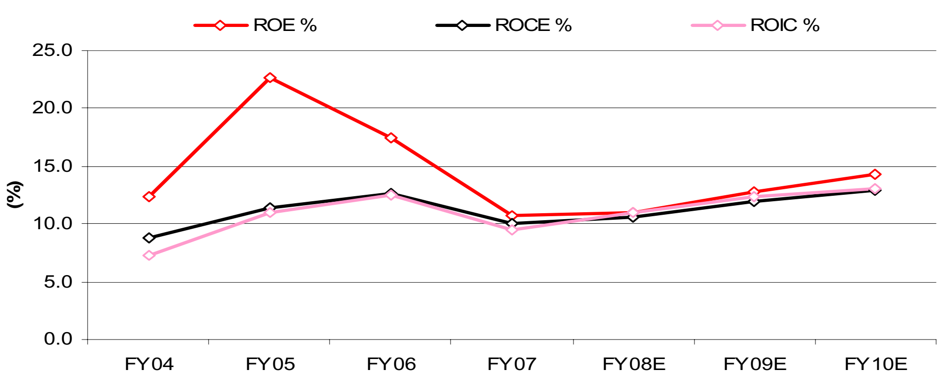
Source: Company, Religare Institutional Equity Research

We expect the interest coverage to improve further because of higher EBITDA and lower debt component.

Improving return ratios

Gati's return ratios fell in FY06 and FY07 due to rights issue and preferential issue of equity shares in FY06 and conversion of warrants in FY07.

Figure 17: Return ratios



Source: Company, Religare Institutional Equity Research

However, we expect the return ratios to improve going forward despite the exercise of warrants and conversion of FCCB's due in the near future. The strong growth expected in net profit due to the buoyant express industry and Gati's investment in each division for expansion will lead to improvement in the return ratios.

Capex of Rs4.5bn over FY06-10E

In order to expand its various business divisions and provide customers with more integrated and efficient services, Gati has earmarked a capex of Rs4.5bn over FY07-10E. Out of this total outlay, investment of Rs1.7bn has already been done till date.

Gati will invest Rs4.5bn over FY06-10E to expand its warehousing space, acquire a new vessel and update IT facilities

Gati is building a hub-and-spoke model in order to streamline its distribution network and reduce costs by improving efficiency. 11 Express Distribution Centres (EDC's) have already been built. 9 more EDC's will be added in order to have pan India presence by FY09 end. Thus, Gati will further strengthen its network by expanding its warehousing network from 1mn sq. ft. currently to 2mn sq. ft. within 2 years. Once completed, such extensive distribution network will help the company to grow robustly in its supply chain solutions division.

In order to tap a new route in the shipping division, Gati has placed an order for a new vessel worth $13mn from **Asian Marine Services,** Thailand, the delivery of which is expected by end of FY08. Balance will be spent on augmenting IT facilities in order to make the entire distribution network IT-enabled.

Figure 18: Capex of Rs4.5bn

CAPEX Plan (Rs mn)	Planned outlay between FY06 to FY10	Spending in FY 06 & 07	Balance
Warehousing & Construction	2,250	584	1,666
- Land/Building/P&M			
IT	1,000	80	920
- Computers/SW/HW			
Ships & Containers	1,000	253	747
Motor Trucks & Cars	150	76	74
Others	100	69	31
- Office furniture/Equipments etcs			
Total	**4,500**	**1,062**	**3,438**

Source: Company, Religare Institutional Equity Research

Equity dilution of ~30% over FY07-10E

Gati raised Rs3.3bn to fund the capex of Rs4.5bn which will result in equity dilution of ~30% over FY07-10E

In order to fund the above capex of Rs4.5bn, Gati raised Rs3.3bn through a rights issue, an FCCB issue, preferential allotment of equity shares and issue of convertible warrants. Preferential allotment of equity shares has been made to The Infrastructure Fund of India LLC (TIFOI) and convertible warrants have been issued to TIFOI and promoters. This will result in equity dilution of ~30% over FY07-10E and the promoter holding will reduce to ~38%.

Figure 19: Details of equity dilution

Long term equity raised for capex purpose	No of shares (mn)	Rate (Rs/share)	Amount (Rs mn)
Rights issue	20.9	10.8	226
TIFOI			
Preferential allotment of equity shares	7.9	84.6	665
Convertible warrants	1.6	84.6	133
Convertible warrants	1.1	90.0	95
Promoters			
Convertible warrants	2.5	84.6	212
Convertible warrants	11.5	90.0	1,035
Lehman Brothers			
FCCB	7.2	125.0	894
Total	**52.5**		**3,258**

Source: Company, Religare Institutional Equity Research

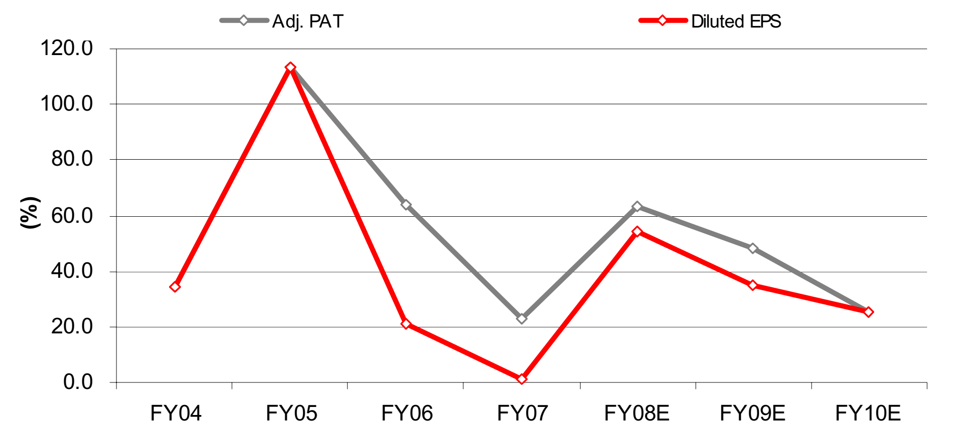
Gati plans to fund the balance capex with debt of Rs750mn and internal accrual of Rs500mn. As all the warrants are convertible in FY08, we expect the company to raise debt only in FY09 and FY10.

Earnings to grow at CAGR of 38% over FY07-10E

The earnings growth did not keep pace with the net profit growth in the past due to the rights issue and preferential allotment of equity shares made to TIFOI in FY06. While the PAT grew at a CAGR of 62.5% over FY04-07, diluted EPS grew at a 37.8% CAGR.

Earnings to grow at a CAGR of 38% over FY07-10E despite higher equity dilution of ~30%

Figure 20: Slower earnings growth



Source: Company, Religare Institutional Equity Research

Going ahead, with the warrants and the FCCB conversion due, we expect the earnings to grow at CAGR of 37.8% vis-à-vis PAT CAGR of 45%.

Valuation and Recommendation

At the CMP of Rs123, the stock trades at 27.7x its 1-year forward diluted earnings. So, much as we like the story and its business model, we believe that the current market price fully reflects all the positives of the company. Investors will gain more by investing in other sectors like mid cap capital goods and infrastructure where the earnings growth is similar, return ratios are higher and valuations lower. For comparison we are giving below valuation matrix of both the sector's stocks which are under Religare Coverage Universe.

Figure 21: Valuation Matrix for Capital Goods Stocks (We will have Adj. PAT growth of 37% over a period of FY07-10E)

Capital Goods	Price	Mkt Cap	EPS (Rs)			P/E (x)			EPS Growth (%)			RoE (%)			RoCE (%)		
	(Rs)	(Rs bn)	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E
Indo Tech	671	71	36.5	44.0	56.4	18.4	15.2	11.9	47.2	20.5	28.2	34.0	32.0	31.7	29.9	27.6	27.7
Voltamp	1,630	16	70.7	88.9	120.4	23.1	18.3	13.5	82.7	25.7	35.4	53.0	45.0	42.7	33.6	28.7	27.3
Bharat Bijlee *	3,230	18	141.0	189.0	219.7	20.1	15.0	12.9	43.9	34.0	16.2	56.0	52.0	43.0	71.3	64.7	60.4
EMCO *	1,358	16	65.0	89.5	110.3	17.9	13.0	10.6	19.5	37.7	23.2	22.0	21.0	19.9	15.4	14.7	14.7

Source: Religare Institutional Equity Research
* P/E adjusted for core business

Figure 22: Valuation Matrix for Infrastructure Stocks (We will have Adj. PAT growth of 49% over a period of FY07-10E)

Construction	Price	Mkt Cap	EPS (Rs)			P/E (x)			EPS Growth (%)			RoE (%)			RoCE (%)		
	(Rs)	(Rs bn)	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E
IVRCL *	478	62	14.3	19.4	26.5	22.0	16.2	11.9	16.7	35.8	36.7	12.6	15.1	17.7	11.8	13.8	15.8
Nagarjuna Const. *	317	66	8.7	11.8	15.9	29.6	21.9	16.2	33.4	35.3	35.0	14.4	14.7	17.0	10.3	11.1	12.4
Gammon India *	572	50	13.0	18.5	25.3	24.8	17.4	12.7	14.0	42.3	36.8	9.4	12.1	14.5	8.7	10.6	12.2
Punj Lloyd *	511	133	11.7	17.7	24.0	41.0	27.1	20.1	113.5	51.1	35.2	17.8	18.0	20.4	5.8	6.7	6.8

Source: Religare Institutional Equity Research
* P/E adjusted for core business

Figure 23: Peer group comparison reveals it is trading at a substantial premium to other logistic stocks

Logistic	Price		Mkt Cap	EPS (Rs)			P/E (x)			EPS Growth (%)			RoE (%)			RoCE (%)		
	(Rs)		(Rs bn)	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E
Concor	1789	Reduce	116	121.6	137.0	152.5	14.7	13.1	11.7	13.5	12.7	11.3	27.0	25.1	23.3	31.9	29.9	27.9
GDL	146	Acc	17	7.0	9.6	12.8	20.7	15.1	11.4	4.1	37.0	32.7	12.8	16.2	19.3	12.9	15.4	18.4
TCI	136	Hold	10	4.9	6.5	9.2	27.5	20.8	14.8	-2.4	32.0	40.4	15.3	15.5	17.8	13.3	14.1	17.5
Gati	123	Reduce	9	3.9	5.2	6.6	31.7	23.5	18.7	54.4	34.8	25.6	11.0	12.8	14.2	10.5	11.9	12.9

Source: Religare Institutional Equity Research

We have assigned Gati a 2 year forward P/E multiple of 18.5x which is at 30% premium to TCI. This premium is because of its presence in higher margin segments and faster earnings growth. This, gives us a target price of Rs110 and hence our Reduce rating.

Figure 24: Segment wise comparison with TCI

	Gati		TCI	
Business Segments	**Contribution to revenues (%)**	**EBIT margins (%)**	**Contribution to revenues (%)**	**EBIT margins (%)**
Express cargo	64%	10%	24%	6.5%
Supply chain	7%	11%	10%	7%
Coast-to-coast	11%	16%	5%	21%

Source: Company, Religare Institutional Equity Research

Figure 25: Financial comparison

	Gati	TCI
Revenue growth (%)		
FY04-07	22.90	19.8
FY07-10E	25.9	22.6
EBITDA growth (%)		
FY04-07	35.1	36.3
FY07-10E	42.2	33.3
Adj PAT growth (%)		
FY04-07	62.5	56
FY07-10E	42	32.7
Diluted earnings growth (%)		
FY04-07	37.8	49.2
FY07-10E	34.9	21.9

Source: Religare Institutional Equity Research

Risks to the express cargo industry

High Fuel Prices – Any increase in the fuel price will affect the logistics industry as the companies might not be able to pass on the hike to its clients completely. Gati has however, well-defined diesel/ATF price index to pass any fuel price increase to its customers.

Unorganized Sector – Express service industry is highly fragmented with many unorganized players having strong regional presence. Thus, the company faces a stiff competition from these unorganized players and might face margin pressure. However, the company's infrastructure, network and technology give it an edge over unorganized sector.

Indian Postal Amendment Act, which bars the courier companies carrying less than 150gm packet, if implemented, will have serious adverse impact on the courier industry. However, Gati derives only 1% of its revenue from courier operations.

Global economic slowdown - A global economic slowdown may impact the international trade which in turn might lead to slowdown in the express industry.

Risks to our Call

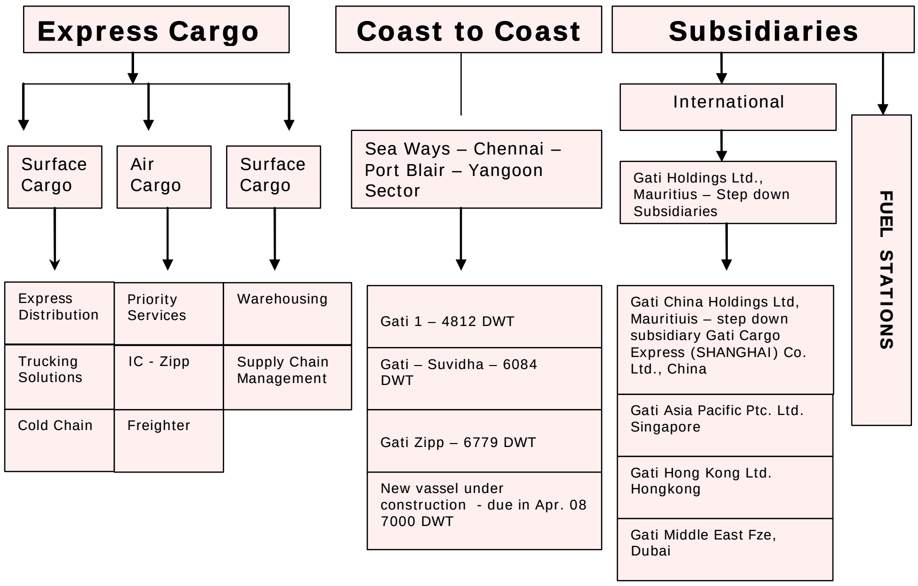
- **Re-rating of logistics sector** – The whole sector can get re-rated in case growth in revenues and profitability is higher than estimated
- Earnings growth higher than our expectation can re-rate Gati.

Annexure 1

Company Background

Gati, established in 1989, as a division of Transport Corporation of India, was later split into a separate entity, Gati Corporation Ltd in 1998. Gati is a leading express cargo distribution company offering multimodal connectivity (surface, air, rail and sea) and end to end logistic solutions. It offers door to door service along with cargo tracking facility and warehousing solution across 594 out of 604 districts in India. The company has a global presence through its wholly owned subsidiary in Mauritius, Gati Holdings Ltd, which further has five step down subsidiaries.

Figure 26: Gati SBU's



Source: Religare Institutional Equity Research

The company's business can be classified into three divisions namely, Express Distribution & Supply Chain division (ED&SC), Coast-to-Coast division (shipping) and fuel division. The fuel division has been hived off to a separate wholly owned subsidiary from the current fiscal year.

Annexure 2

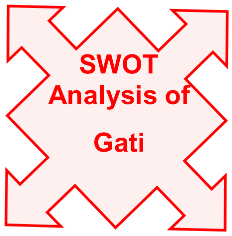
SWOT analysis of Gati

Strengths

- Leader in the Indian express cargo market
- Excellent IT infrastructure
- International presence
- Tie-up with Indian Airlines

Opportunities

- Implementation of VAT
- Rising international trade
- Increasing logistic outsourcing
- Opening of organized retail sector



Weaknesses

- Higher equity dilution as the business is inherently capital intensive

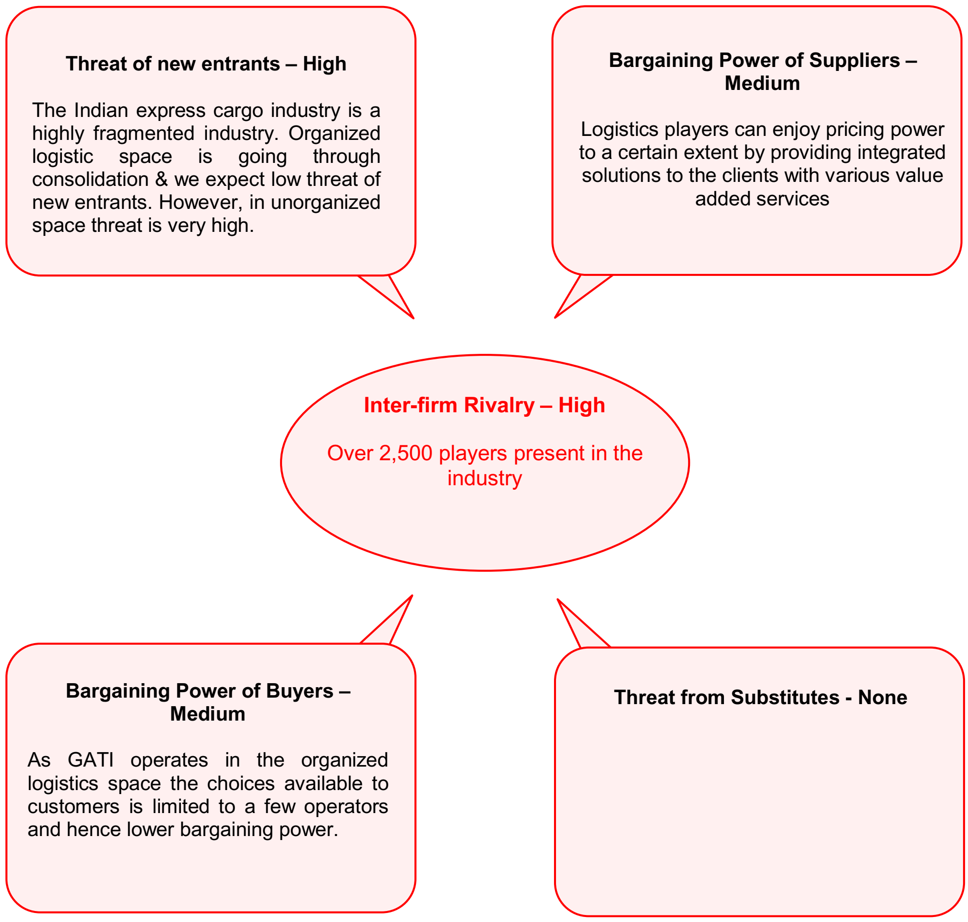
Threats

- High competition due to presence of unorganized sector
- Inadequate infrastructure in the country
- Rising fuel/freight cost
- Manpower retention
- Proposed changes to the postal regulations if passed through

Source: Religare Institutional Equity Research

Annexure 3

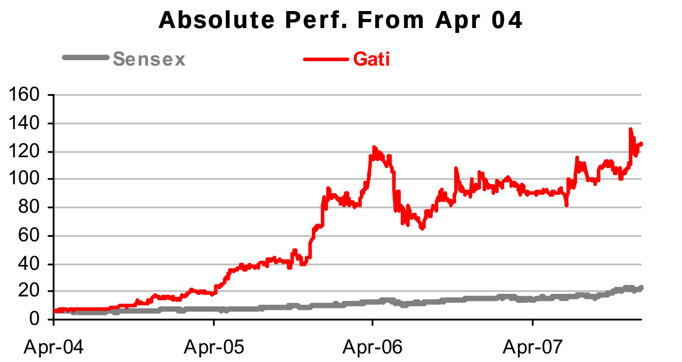
Five Forces Analysis – Indian Express Industry

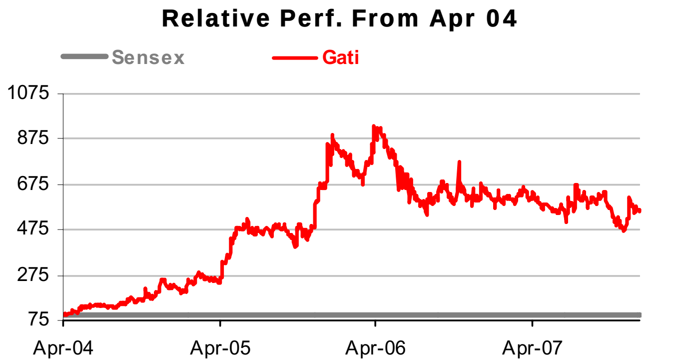


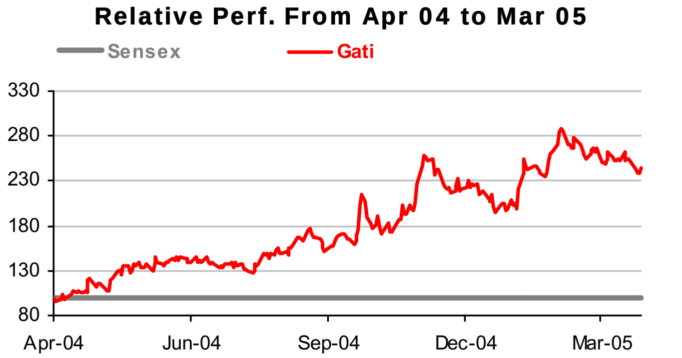
Source: Religare Institutional Equity Research

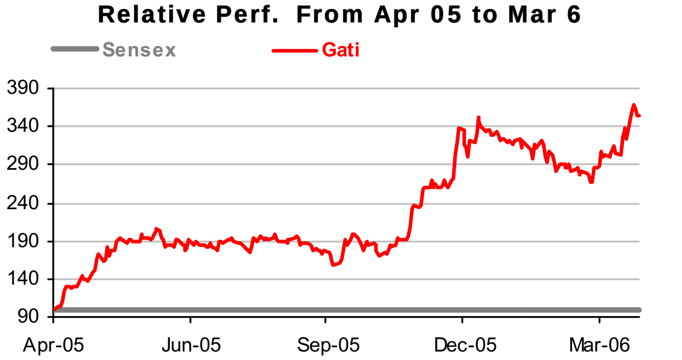
Stock performance

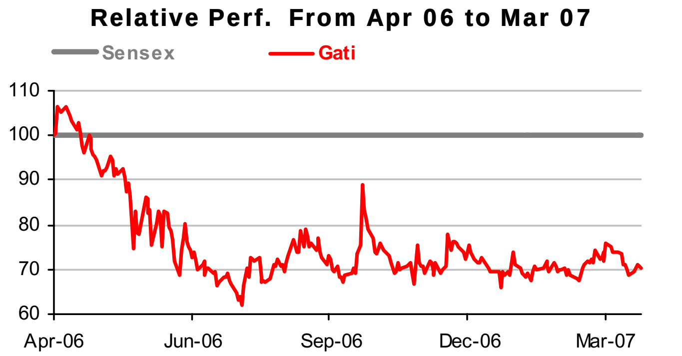
Gati

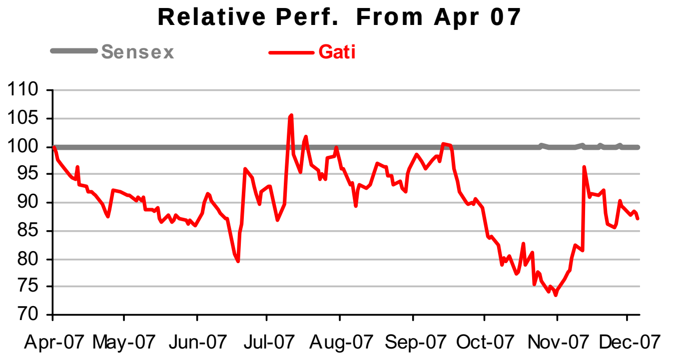










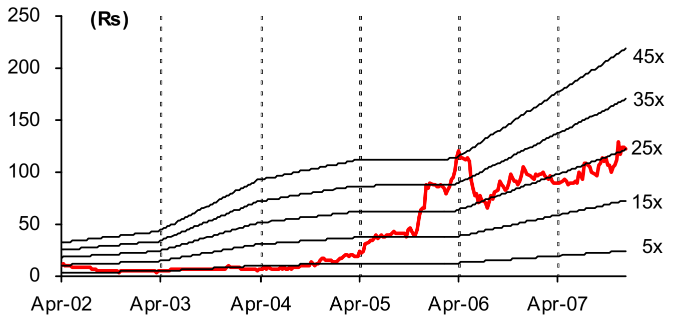


Source: Bloomberg, Religare Institutional Equity Research

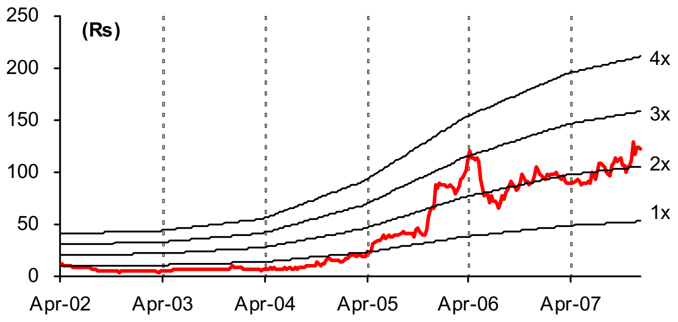
12 month forward rolling band charts

Gati

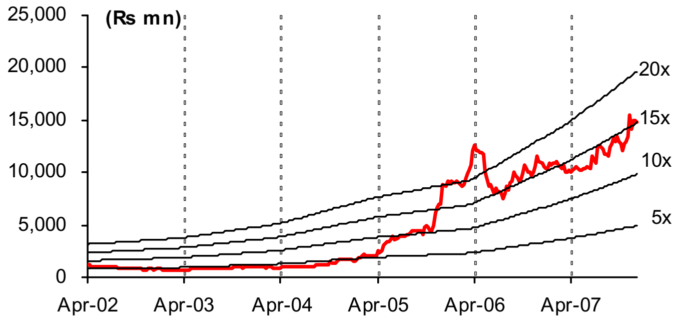
P/E Band



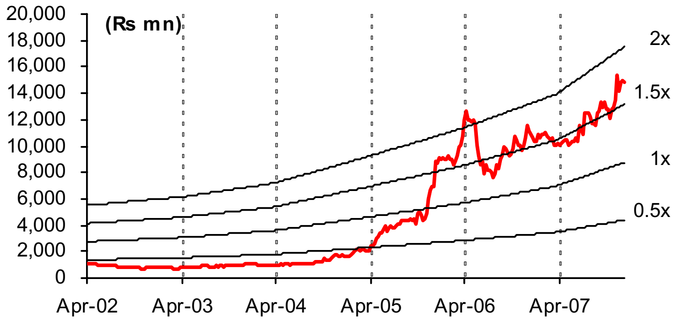
P/BV Band



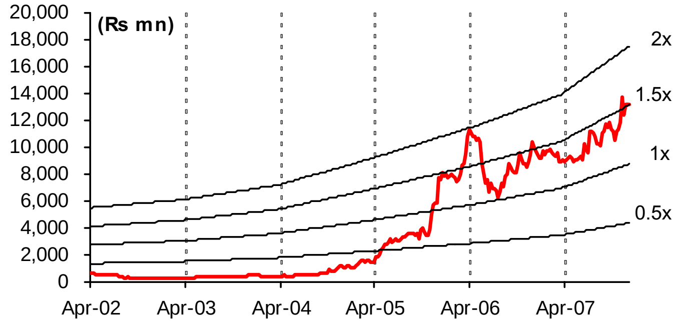
EV/EBITDA Band



EV/Sales Band



Mkt cap/Sales Band



Gati consolidated financials

Income statement

(Rs mn)

Y/E, 30th June	FY06	FY07	FY08E	FY09E	FY10E
Net sales	**4,599**	**5,680**	**6,961**	**9,428**	**11,336**
EBITDA	**380**	**463**	**734**	**1,073**	**1,364**
EBITDA margin (%)	8.3	8.2	10.5	11.4	12.0
Depreciation	87	112	153	204	264
EBIT	**294**	**351**	**581**	**869**	**1,100**
Other income	25	67	44	31	33
Interest Exp/(Inc)	53	84	97	114	147
PBT	**266**	**334**	**528**	**785**	**986**
PBT margin (%)	5.8	5.8	7.5	8.3	8.7
Extra ord exp	-	29.7	-	-	-
Taxes	74	90	143	212	266
Minority interest	-	-	-	-	-
PAT(Reported)	**192**	**214**	**386**	**573**	**719**
Less: Extra ordinary income / Others	0	(22)	0	0	0
Adj PAT	**192**	**236**	**386**	**573**	**719**
Adj PAT margin (%)	4.2	4.1	5.5	6.1	6.3

Quarterly – Standalone financials

(Rs mn)

Y/E, 30th June	Q1FY07	Q2FY07	Q3FY07	Q4FY07	Q1FY08
Net sales	1,332	1,390	1,383	1,220	1,171
Changes (%)	33.0	20.8	18.4	(1.7)	(12.1)
EBITDA	112	99	124	123	137
Changes (%)	26.4	(4.1)	21.7	32.8	22.3
Margin (%)	8.4	7.2	9.0	10.1	11.7
PAT	**56**	**43**	**68**	**73**	**65**
PAT adj	56	43	68	73	65
Changes (%)	28.6	(25.7)	31.5	52.2	16.4
Margin (%)	4.2	3.1	4.9	5.9	5.6
EPS adj (Rs)	0.8	0.6	0.9	1.0	0.9
EPS dil (Rs)	0.7	0.5	0.9	0.9	0.8

Ratios

Y/E, 30th June	FY06	FY07	FY08E	FY09E	FY10E
Growth					
Net sales (%)	28.0	23.5	22.6	35.4	20.2
EBITDA (%)	49.0	21.9	58.3	46.2	27.1
PAT adjusted (%)	63.7	22.8	63.5	48.5	25.6
EPS adjusted (%)	21.0	9.5	53.7	33.8	25.6
EPS diluted (%)	21.0	1.2	54.4	34.8	25.6
EPS Consl and diluted (%)	21.0	1.2	54.4	34.8	25.6
Valuations					
P/E (x)	49.6	49.0	31.7	23.5	18.7
P/BV (x)	5.4	3.2	2.5	2.3	2.0
EV/EBITDA (x)	24.3	22.0	16.1	11.8	9.3
EV/Sales (x)	2.0	1.8	1.7	1.3	1.1
Profitability					
EBITDA margin (%)	8.3	8.2	10.5	11.4	12.0
Adj PAT margin (%)	4.2	4.1	5.5	6.1	6.3
RoE (%)	17.5	10.8	11.0	12.8	14.2
RoCE (%)	12.7	10.1	10.5	11.9	12.9
RoIC (%)	12.5	9.5	11.0	12.3	13.0
B/S ratios					
Inventory days	1.6	1.4	1.4	1.4	1.4
Creditor days	4.0	5.9	6.0	6.0	6.0
Debtor days	44.1	48.8	45.0	45.0	45.0
Working Capital days	48.4	47.6	40.6	42.5	43.4
Net debt/equity	0.4	0.3	0.2	0.3	0.2

* ROIC is calculated on post tax basis.

Balance sheet

(Rs mn)

Y/E, 30th June	FY06	FY07	FY08E	FY09E	FY10E
Liabilities					
Equity share capital	142	145	174	174	174
Total Res. & Surplus	1,478	1,731	3,173	3,664	4,303
Total Shareholders' fund	**1,620**	**1,876**	**3,347**	**3,838**	**4,476**
Convertible Debt	-	893	893	893	893
Others Debt	685	879	679	1,229	1,329
Total Loans	**685**	**1,772**	**1,572**	**2,122**	**2,222**
Deferred tax liability (net)	**58**	**61**	**61**	**61**	**61**
Total liabilities	**2,363**	**3,709**	**4,980**	**6,021**	**6,759**
Assets					
Net fixed assets & others	1,019	1,542	2,909	3,804	4,840
Capital WIP & others	416	731	612	712	112
Total non-current assets	**1,435**	**2,273**	**3,520**	**4,516**	**4,952**
Total investments - non current	**163**	**189**	**189**	**189**	**189**
Current assets					
Inventories	20	22	27	36	43
Sundry debtors	556	759	858	1,162	1,398
Cash & cash equivalents	150	499	488	210	262
Cash	*134*	*482*	*471*	*194*	*245*
Liquid investments	*17*	*16*	*16*	*16*	*16*
Other current assets	290	328	348	471	567
Total current assets	**1,016**	**1,607**	**1,721**	**1,880**	**2,269**
Total current liabilities	**183**	**244**	**314**	**424**	**508**
Total provisions	**73**	**124**	**144**	**148**	**151**
Net current assets	**760**	**1,239**	**1,263**	**1,308**	**1,610**
Misc. expenditure	**6**	**8**	**8**	**8**	**8**
Total assets	**2,363**	**3,709**	**4,980**	**6,021**	**6,759**

Cash flow

Y/E, 30th June	FY06	FY07	FY08E	FY09E	FY10E
Cash from operations					
PBT	266	334	528	785	986
Tax paid	(81)	(100)	(136)	(208)	(263)
Dep & amortization	87	112	153	204	264
Working capital changes	(251)	(69)	(55)	(327)	(253)
Others	44	56	97	114	147
Net cash from operations	**65**	**334**	**588**	**568**	**880**
Cash from investments					
Capital expenditure	(749)	(938)	(1,400)	(1,200)	(700)
Sale/purchase of inv & others	(129)	1	0	0	0
Net cash from investments	**(877)**	**(938)**	**(1,400)**	**(1,200)**	**(700)**
Cash from financing					
Issue of shares & share premium	870	(55)	1,166	0	0
Dividend paid	(29)	(57)	(68)	(81)	(81)
Debt change	81	1,182	(200)	550	100
Others	(50)	(89)	(97)	(114)	(147)
Net cash from financing	**872**	**982**	**801**	**354**	**(128)**
Net change in cash	**60**	**378**	**(11)**	**(278)**	**52**

Per share data

Y/E, 30th June	FY06	FY07	FY08E	FY09E	FY10E
EPS adjusted	2.5	2.7	4.2	5.6	7.0
EPS diluted - wtd	2.5	2.5	3.9	5.2	6.6
EPS Consl and diluted	2.5	2.5	3.9	5.2	6.6
CEPS	3.6	3.7	5.4	7.1	9.0
Book value	22.9	38.3	48.8	54.4	61.7
Dividend	0.7	0.8	0.8	0.8	0.8
O/s shs.-actual (mn)	70.9	72.4	87.0	87.0	87.0
O/s shs.-wtd avg (mn)	77.4	86.8	92.3	102.4	102.4
O/s shs diluted & wtd (mn)	77.4	93.9	99.5	109.6	109.6

Technical View

Gati Ltd. Close Price Rs.123

The weekly candlestick chart of Gati Ltd shows that's its oscillating within an "upward sloping channel" pattern (depicted by the trendlines in blue). The weekly averages are positively phased (implying that the trend is up) and there is strong support around Rs.110. Looking at the overall picture one can accumulate this stock in declines as it has the potential to test its recent high of Rs.148 in the medium term. In the event of this high being taken out on high volumes it could even hit Rs.171 in the long term. At this moment one can wait to accumulate in declines.

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Rating definition

Buy	: > 15% returns relative to Sensex	**Accumulate**	: +5 to +15% returns relative to Sensex
Sell	: > (-)15% returns relative to Sensex	**Reduce**	: (-) 5 to (-) 15% returns relative to Sensex
Hold	: Upto + / (-) 5% returns relative to Sensex		

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