

GATI

INR 92

Steering ahead

BUY



Gati's Q3FY07 (June ending) results were in line with our expectations on the revenue and profitability fronts. Revenue, at INR 1.3 bn, was up 18.4% Y-o-Y, while net profits, at INR 68 mn, grew by 31.3% Y-o-Y and 60% Q-o-Q. Higher profitability on a Q-o-Q basis is on account of one-time expense of INR 26.5 mn which Gati incurred on brand building and renovation and maintenance of its trucking fleet in the last quarter. Adjusted for this, the company's net profit was flat on a Q-o-Q basis.

Performance of both XPS (express distribution) and coast-to-coast divisions continues to be robust with the former registering growth of 16.7% Y-o-Y at INR 992 mn and revenues for the latter at INR 161 mn grew by 30.7% Y-o-Y and 12.3% Q-o-Q. Growth in the XPS division was fuelled by addition of new contracts and new trucks, whereas growth in the coast-to-coast division was driven by achieving near 100% capacity utilization. Segmental margins improved by 330bps for the former and declined by 420bps for the latter.

Gati has outlined INR 4.5 bn capex over FY06-09E in high margin businesses such as warehousing and coast-to-coast. The capex is expected to provide 45% PAT CAGR over FY06-09E. We expect Gati to register revenues of INR 6.6 bn and INR 8.4 bn in FY08E and FY09E and net profit of INR 446 mn and INR 626 mn during the same period. The stock trades at a P/E of 20.2x and 14.4x our FY08E and FY09E earnings, respectively. With the express industry expected to grow at 20-25% in the coming years and warehousing and shipping divisions to be Gati's next growth drivers, we maintain our 'BUY' recommendation.

Result highlights

- Revenue, at INR 1.3 bn, was up 18.4% Y-o-Y but flattish Q-o-Q, while net profits, at INR 68 mn, registered a 31.3% Y-o-Y growth.
- XPS and shipping divisions registered revenue growth of 16.7% and 30.9% Y-o-Y, respectively. Higher growth in XPS division is on account of addition of new contracts and trucks to its exiting fleet. Shipping division's growth was robust on account of company achieving near 100% capacity utilization for its vessels deployed.
- Gati added 45 new trucks to its existing fleet of 2,000, majority of which are hired.
- Segmental margins for XPS division improved by 330bps Y-o-Y due to better capacity utilization. Shipping division's segmental margins declined by 420bps Y-o-Y as Gati is currently operating three vessels from five operational in Q3FY07. Higher overhead costs of five vessels resulted in declining margins.

Financials

Year to June	Q3FY07	Q3FY06	% change	Q2FY07	% change	FY07E	FY08E
Revenues (INR mn)	1,383	1,169	18.4	1,390	(0.4)	5,045	6,600
EBITDA (INR mn)	124	102	21.7	126	(1.3)	553	824
Net profit (INR mn)	68	52	31.3	43	59.6	268	446
EPS (INR)	0.7	0.5	31.3	0.4	59.6	2.7	4.5
PE (x)						33.7	20.2
EV/EBITDA (x)						17.4	8.2
ROAE (%)						14.4	13.5

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Market Data

52-week range (INR) : 120 / 63
Share in issue (mn) : 86.0
M cap (INR bn/USD mn) : 7.9 / 193.0
Avg. Daily Vol. BSE ('000) : 143.2

Share Holding Pattern (%)

Promoters : 50.0
MFs, FIs & Banks : 0.2
FIs : 5.6
Others : 44.1

- EBITDA stood at INR 124 mn and EBITDA margin was at 9.0%, compared to 9.1% in the previous quarter and 8.7% in Q3FY06.
- Net margin stood at 4.9%, an improvement of 50bps Y-o-Y and 180bps Q-o-Q. In the previous quarter, margins were low due to one-time expenses of INR 25 mn that Gati had incurred on brand building and overhauling of its trucking fleet.

* Aggressive capex plan to drive future growth

Gati has outlined an aggressive capex plan of INR 4.5 bn for expansion into warehousing, coast-to-coast, and trucking fleet. Gati currently is in the process of setting up warehousing facilities at Bangalore, Mumbai, Ludhiana, Gurgaon, Lucknow, Kolkata, Jaipur, Indore, and Pune. It plans to bring into operation 1 mn sq ft of warehousing space in FY08E. In the coast-to-coast division, Gati is currently running three ships with a cumulative capacity of 17,674 DWT. It has already signed an agreement to purchase another 7,000 DWT vessel, delivery of which is due in March 2008. Such capacity expansion in high margin businesses like warehousing and shipping is expected to drive robust growth and improve margins going forward.

Table 1: Breakup of capex plan

Particulars	FY07E	FY08E	FY09E	FY10E	Total
Warehousing	1.2	1.3	0.3	0.3	3.1
Shipping division	0.1	0.5	0.2	0.2	0.9
IT	0.1	0.1	0.1	0.1	0.3
Fleet	0.1	0.1	0.1	0.1	0.3
Total	1.5	1.9	0.6	0.6	4.5

Source: Company, Edelweiss research

* Financials and valuations

We expect Gati to post revenues of INR 8.3 bn in FY09E, a 22.5% CAGR, from INR 4.5 bn in FY06. This will be driven primarily by a 30.5% CAGR in the freight division. EBITDA is expected to grow at a CAGR of 44.6% to reach INR 1.17 bn in FY09E. We expect Gati to register a CAGR of 46% in net profit to reach INR 626 mn in FY09E. The stock trades at 20.2x and 14.4x our FY08 and FY09 EPS estimate of INR 4.5 and INR 6.4, respectively. With robust outlook for the express and supply chain industry and Gati rightly-positioned to capitalize on the growth opportunity, we maintain our **'BUY'** recommendation.

Financial snapshot								(INR mn)
Year to June	Q3FY07	Q3FY06	% change	Q2FY07	% change	FY06	FY07E	FY08E
Net sales	1,383	1,169	18.4	1,390	(0.4)	4,561	5,045	6,600
Total expenditure	1,259	1,047	20.2	1,264	(0.4)	4,174	4,491	5,776
- Cost of goods sold	228	194	17.5	254	(10.0)	802	-	-
- Employee	153	122	24.8	134	14.0	490	637	828
- Other	879	731	20.2	876	0.2	2,882	3,854	4,948
EBITDA	124	102	21.7	126	(1.3)	387	553	824
Other income	8	4	97.5	5	54.9	16	6	28
Depreciation	27	22	22.9	27	0.0	87	134	168
EBIT	105	84	25.1	104	1.2	317	425	683
Interest (net)	12	11	0.9	18	(37.5)	42	58	72
PBT	93	72	28.9	85	9.5	275	367	611
Taxes	25	21	22.8	16	57.1	74	99	164
Adjusted PAT	68	52	31.3	43	59.6	201	268	446
Tax rate (%)	27.1	28.5		18.9		26.9	26.9	26.9
% of sales								
- Cost of goods sold	16.5	16.6		18.2		17.6	-	-
- Employee	11.0	10.1		9.6		10.7	12.6	12.6
- Other	63.5	64.6		63.1		63.2	76.4	75.0
Operating profit	9.0	8.7		9.1		8.5	11.0	12.5
Net profit	4.9	4.4		3.1		4.4	5.3	6.8

Company Description

Incorporated in 1995, Gati has evolved as a leader in the fast-growing express cargo distribution business. It provides services through 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 business, contributing 71% to revenues.

Investment Theme

The express industry in India is expected to grow by 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 well-poised to take advantage of the trends. Currently, Gati has 1 mn sq. ft. of warehousing space, which is likely to double by June 2008. Gati also offers coastal shipping services between Chennai, Port Blair, and Yangon. It currently operates three self-owned container vessels with 4811 MT, 6084 MT, and 6779 MT. It has also chartered one ship on the Chennai-Srilanka route and is in the process of purchasing another ship worth USD 13.4 mn scheduled to be delivered in March 2008.

Key Risks

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

Financial Statements

Income statement					(INR mn)
Year to June	FY05	FY06	FY07E	FY08E	FY09E
Income from operations	3,592	4,561	5,045	6,600	8,387
Direct costs	2,525	3,200	3,259	4,224	5,321
Employee costs	397	490	637	828	1,035
Other expenses	415	484	595	724	858
Total operating expenses	3,337	4,174	4,491	5,776	7,215
EBITDA	255	387	553	824	1,172
Depreciation and amortisation	73	87	134	168	246
EBIT	182	301	419	656	926
Interest expenses	47	42	58	72	113
Other income	21	16	6	28	44
Profit before tax	156	275	367	611	857
Provision for tax	52	74	99	164	231
Reported profit	104	201	268	446	626
Adjusted net profit	104	201	268	446	626
Shares outstanding	98	98	98	98	98
Dividend per share	0.3	0.5	0.7	1.1	1.6
Dividend payout (%)	24.2	24.7	24.7	24.7	24.7

Common size metrics- as % of net revenues

Year to June	FY05	FY06	FY07E	FY08E	FY09E
Operating expenses	92.9	91.5	89.0	87.5	86.0
Depreciation	2.0	1.9	2.7	2.5	2.9
Interest expenditure	1.3	0.9	1.2	1.1	1.4
EBITDA margins	7.1	8.5	11.0	12.5	14.0
Net profit margins	2.9	4.4	5.3	6.8	7.5

Growth metrics (%)

Year to June	FY05	FY06	FY07E	FY08E	FY09E
Revenues	17.3	27.0	10.6	30.8	27.1
EBITDA	35.5	51.7	42.9	48.9	42.2
PBT	76.5	76.2	33.6	66.6	40.2
Net profit	72.7	93.6	33.6	66.6	40.2
EPS	72.7	93.6	33.6	66.6	40.2

Cash flow statement					(INR mn)
Year to June	FY05	FY06	FY07E	FY08E	FY09E
Net profit	145	201	268	446	626
Add: Depreciation	73	87	134	168	246
Add: Deferred tax	4	3	35	90	127
Gross cash flow	222	290	437	705	999
Less: Dividends	25	50	66	110	155
Less: Changes in W. C.	25	238	(48)	77	107
Operating cash flow	172	2	419	518	737
Less: Change in investments	25	137	-	-	-
Less: Capex	136	585	1,150	1,360	2,000
Free cash flow	11	(721)	(731)	(842)	(1,263)

Balance sheet					(INR mn)
As on 30th June	FY05	FY06	FY07E	FY08E	FY09E
Equity capital	84	142	150	187	187
Reserves & surplus	492	1,444	1,982	4,209	4,680
Shareholders funds	576	1,585	2,132	4,396	4,867
Secured loans	428	417	817	817	1,817
Unsecured loans	210	302	302	302	302
Borrowings	639	719	1,119	1,119	2,119
Sources of funds	1,215	2,305	3,251	5,515	6,987
Gross block	943	1,391	2,541	3,901	5,901
Depreciation	292	373	507	675	921
Net block	652	1,019	2,035	3,227	4,981
Capital work in progress	125	416	416	416	416
Total fixed assets	777	1,435	2,451	3,643	5,397
Investments	42	179	179	179	179
Inventories	11	20	23	29	37
Sundry debtors	420	556	559	732	930
Cash and equivalents	74	134	147	1,233	970
Loans and advances	149	290	319	335	368
Other current assets					
Total current assets	654	1,000	1,048	2,329	2,306
Sundry creditors and others	149	177	240	304	382
Provisions	53	73	94	148	203
Total CL & provisions	203	251	334	452	585
Net current assets	451	749	714	1,877	1,721
Net Deferred tax	(55)	(58)	(93)	(183)	(310)
Uses of funds	1,215	2,305	3,251	5,515	6,987
Book value per share (BV) (INR)	6	16	22	45	50

Ratios

Year to June	FY05	FY06	FY07E	FY08E	FY09E
ROE (%)	28.0	18.6	14.4	13.7	13.5
ROCE (%)	18.2	18.0	15.3	15.6	15.5
Current ratio	3.2	4.0	3.1	5.1	3.9
Debtors (Days)	43	44	40	40	40
Fixed assets t/o (x)	5.0	4.1	2.6	2.2	1.9
Debt/Equity	1.1	0.5	0.5	0.3	0.4

Valuations parameters

Year to June	FY05	FY06	FY07E	FY08E	FY09E
EPS (INR)	1.1	2.0	2.7	4.5	6.4
<i>Y-o-Y growth (%)</i>	<i>72.7</i>	<i>93.6</i>	<i>33.6</i>	<i>66.6</i>	<i>40.2</i>
CEPS (INR)	21.1	20.3	26.8	32.8	46.6
PE (x)	87.2	45.0	33.7	20.2	14.4
Price/BV(x)	15.7	5.7	4.2	2.1	1.9
EV/Sales (x)	2.7	2.1	1.9	1.5	1.1
EV/EBITDA (x)	37.6	24.8	17.4	11.7	8.2

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INDIA RESEARCH

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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