TVS Supply Chain Solutions Limited

Q1 FY '24 Earnings Conference Call

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MANAGEMENT: **MR. RAVI VISWANATHAN – MANAGING DIRECTOR – TVS SUPPLY CHAIN SOLUTIONS LIMITED**
MR. RAVI PRAKASH BHAGAVATHULA – GLOBAL CHIEF FINANCIAL OFFICER – TVS SUPPLY CHAIN SOLUTIONS LIMITED
MR. NARAYANAN B – HEAD, INVESTOR RELATIONS – TVS SUPPLY CHAIN SOLUTIONS LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the TVS Supply Chain Solutions Limited Q1 FY24 Earnings Conference Call. 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, please signal an operator by pressing star and then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Narayanan, Head Investor Relations at TVS Supply Chain Solutions. Thank you and over to you, sir.

Narayanan: Thank you. Good evening and welcome to the inaugural earnings call of TVS Supply Chain Solutions. We will discuss our financial results for the quarter ended 30th June 2023. We have with us Mr. Ravi Viswanathan, Managing Director and Mr. Ravi Prakash, Global CFO. Our financial results and investor presentation have been uploaded on the stock exchanges. We will commence the call with opening remarks from our management team, followed by an open forum for questions and answers.

Before we begin, I would like to point out that some of the statements made during today's call may be forward-looking in nature and must be reviewed in conjunction with the risks that the company faces. A disclaimer to this effect has been included in the earnings presentation that has been shared. I now invite Mr. Ravi Viswanathan, Managing Director, to make the opening remarks. Over to you, Ravi.

Ravi Viswanathan: Thank you, Narayanan and good evening to all of you. I would like to welcome you once again to our first earnings call as a publicly listed company. We are absolutely excited and are looking forward to interacting with you. Given that this is the first time we are interacting in this forum, I will start off by spending a few minutes providing an overview of our company and our vision for the business. I will then share with you the highlights of our performance for the quarter and my colleague, Ravi Prakash, the CFO, will then take you through the detailed analysis of our numbers.

We are an end-to-end supply chain solutions provider with capabilities across the value chain. Ours is a global business headquartered in India with presence across four continents. As our name suggests, we provide solutions that help customers manage their supply chains better.

This customer focus has meant that we have grown along with our customers and got to our current scale. In doing so, we have built long-term relationships with our top customers. Another thing that we have focused on over the years is the mix of our business. We have built a business with a revenue that is diversified across multiple sectors. We are an asset-light business and technology is a key element of the value we bring to our customers. We have differentiated capabilities that form an integral part of the solutions we provide to our customers.

We classify our business into two segments, Integrated Supply Chain Solutions or ISCS segment and Network Solutions or the NS segment. In the ISCS segment, our capabilities including sourcing and procurement, in-plan solutions, aftermarket solutions, integrated transportations and aftermarket fulfilment. Customer engagements in this segment are typically driven by multiyear outsourcing contracts under which we deploy solutioning, manpower & transportation and technology.

In the NS segment, as the name suggests, we leverage our operating network of two types: global freight solutions or GFS where we have a global forwarding network which we leverage to provide end-to-end solutioning on air and ocean freight along with warehousing and ground transportation. And Integrated Final Mile or IFM. We used to call it time-critical last mile but we have repositioned as integrated final mile or IFM where we leverage our final mile network to provide time-critical services such as courier, break pick support, spares management amongst other things.

As I mentioned earlier, we lay large emphasis on customer relationships and growing with our customers. On an average, our relationships have lasted upwards of 10 years with most of our key customers. Our business development hence has two elements to it, new customer addition whereby we add new logos to our roster of customers and encirclement where we expand the scope of our existing relationship by either adding newer capabilities to our solution or expanding the relationship to newer geographies.

In summary, what we have built is an Indian multinational with a capability set that is on par with the largest players in our sector. We have a clear vision on the way forward. We want to continue to grow and grow profitably. We want to leverage our capabilities and expertise to double our scale to be one of the top 50 logistics companies worldwide.

Now coming to the highlights of performance for quarter 1 FY24, we had a very strong growth in the ISCS segment with revenues growing 20.1% year-on-year and 5.1% sequentially. We grew in the ISCS segment across all the three geographies namely India, UK, Europe and North America.

In the NS segment, global ocean and air freight markets continue to be subdued in line with our expectation. Freight volumes however hasn't picked up as much as we had expected. India freight volumes were impacted by weak exports from India which is down almost 15% year-on-year in quarter 1 as a country. Our diversified revenue profile in the final mile business continues to be steady in the face of macro weakness in developed markets. Our NS segment revenue declined 9% sequentially and 35.1% compared to previous year.

As a company overall, we are very encouraged with a consistent growth in ISCS which ensured the impact of the freight rates were softened. This showcases the strength in our model where our business portfolio balances very well.

Overall, consolidated revenue declined 1.6% sequentially and 12.4% year-on-year. We have had a strong EBITDA performance this quarter. Our Adjusted EBITDA margins improved 140 basis points over Q1 of last year and 40 basis points sequentially. On a lower revenue in Q1 FY24, we posted an Adjusted EBITDA of INR179.4 crores which is a 3.3% growth sequentially and 7.3% growth year-on-year. Our profit before taxes was a negative INR47.9 crores and post-tax profit was a negative INR65.3 crores. It is important to see these in the context of a couple of specific factors which my colleague Ravi Prakash will provide more details on.

So, with this background, I will hand it over to Ravi Prakash, Global CFO, who will take you through a detailed analysis of the numbers.

Ravi Prakash: Thank you Ravi Viswanathan. Good evening everyone and thank you for joining our inaugural earnings call. I will take you to the highlights of the financials for Q1 FY '24. Revenue from operations for the quarter was INR2,342.4 crores with business development revenues contributing approximately INR255 crores. This helped offset the headwinds on global freight and the business development revenues were in line with what we had been expecting.

As Ravi Viswanathan highlighted earlier in the call, the overall revenue number was driven by a strong growth in the ISCS segment where Q1 revenue grew 20.1% year-on-year. This was offset by a decline in the network segment where revenues declined 35.1% year-on-year. The prime driver for this was that average ocean freight rates in Q1 in our lanes were down almost 55% compared to the same period last year, which was probably the peak of the cold related freight rate that had gone up and air freights were down about 47%. But we have been able to manage the margin impact of that well and I will walk you through that later on.

The segmental revenue performance is consistent across all geographies. In India, the ISCS business grew 14.3% year-on-year and that is very encouraging to us. In the rest of the world, ISCS business grew 25.5% year-on-year on a back of very strong performance in both our European and North American businesses and these details have been provided in the earnings presentation.

The Network Segment declined 62.7% in India and 28.2% year-on-year in the rest of the world, contributing to the overall decline in the Network Segment revenue. The detailed breakdown by geography as well as segments within geography, including an overall volume price impact has been provided in the uploaded presentation. And you can see that overall revenue has been driven more by volume.

Going from revenue from operations into other income, other income of INR18.2 crores was primarily due to interest income and forex gains. Therefore, total income for the quarter was INR2,360.6 crores, a decline of 12.3% year-on-year.

On margins, the key driver was a shift in business mix between the Supply Chain and the Network Segment. The higher margin Supply Chain segment share has expanded to 56.3% in Q1 FY '24 from 41 for the same period last year.

On page 21 of the investor presentation, we have provided the segmental results for the ISCS and NS segment and that will give you a sense of how this is impacting the overall mix. The ISCS business has been able to expand its Adjusted EBITDA margins by 190 basis points year-on-year by leveraging overheads while holding gross margins steady. This quarter, it did also benefit from a very high margin consulting contract.

In the Network Segment, absolute Rupee margins have been impacted due to the decline in the revenue of the freight business. But the year-on-year drop in gross margin has been lower than the drop in rates in the freight segment reflecting our procurement and operational efficiencies. Profit margins have also been impacted by cost pressures in the final mile, what we used to call the time critical final mile business, IFM business. We expect the IFM business to start delivering improvements by Q3 FY ‘24. On an overall basis, the portfolio mix has worked well with the ISCS improvements helping grow EBITDA margins 140 basis points year-on-year.

I will now go ahead and explain a few of the major expense line items and how they have evolved. Freight clearing, forwarding and handling charges for the quarter was INR567.4 crores. It was down 48.4% year-on-year. And you would relate this reducing ocean rates as procurement efficiencies drove this change. You can relate this percentage change to my earlier comments about our ability to drive operational procurement efficiencies. And the rates have actually fallen much higher than what the revenue has fallen.

Employee benefit expenses for the quarter was INR575.1 crores versus INR542.5 crores in the prior year. Most of this increase is driven by incremental people being deployed in new contracts in the Supply Chain segment and so is absorbed within the gross margins of the ISCS segment.

Adjusted EBITDA for the quarter was INR179.4 crores versus INR167.2 crores in Q1 FY '23. This represents a 7.3% growth year-on-year. Our Adjusted EBITDA margins have thus improved 140 basis points compared to Q1 of last year. Post the EBITDA line, I would like to call out two factors. Firstly, our borrowing costs have increased on the back of rising interest rates and has impacted Q1 FY ‘24 numbers by INR19.2 crores in comparison to the same period last year. This was due to the increase of average interest rates which have gone up upwards of 350 basis points compared to Q1 of last year.

In Q2, we will be deploying the IPO funds to repay INR525 crores for the borrowing as we had indicated in our Prospectus. We will reduce our borrowings further out of surplus funds in capital raised prior to the IPO. As a result, our borrowing cost is expected to come down by approximately INR15 crores on a net basis on a run rate basis -- or per quarter on a run rate basis.

Secondly, after interest cost, the other item we should look at the PBT level is we had to take a one-time P&L charge of INR23.2 crores due to the impact of conversion of compulsorily convertible preference shares that we had issued to investors from whom we had raised capital before the IPO. As per Ind AS, these instruments were classified as financial liabilities on the balance sheet. They were having variable returns because they were structured to convert into equity at a discount to the discovered price at the IPO. And any discount which is attributed towards, which is in excess to what is attributed towards illiquidity as per accounting standards needs to be charged to the P&L

It is important to note that this was a non-cash expense and does not in any way involve cash outflow. Due to these two items, profit before tax for the quarter was negative 47.9 compared to a loss of 19.5 in the previous quarter and a profit of INR8.1 crores in Q1 FY ‘23. Tax expense for the quarter was INR17.3 crores. The tax expense has been provided based on an effective tax rate for the quarter and as the year progresses, we will get a much better visibility of how the full year tax rate will evolve. And therefore, after considering this, the profit after tax was INR65.3 crores compared to a loss of INR12.3 crores in the previous quarter. This is a quick summary of the financials for Q1 FY ‘24. I will now hand it back to Mr. Ravi Viswanathan.

Ravi Viswanathan: Thank you, Ravi Prakash. Before we open the floor for Q&A, I would like to provide you with our outlook of the current business environment, we operate in and the demand drivers we are seeing. We see outsourcing of supply chain requirements continue to grow across the markets we operate in thus driving growth in the ISCS segment. In India, growth is being driven by domestic consumption and the auto and industrial output expanding.

In the UK and Europe, inflation pressures have shown signs of easing off and in North America, again, inflation has eased off and auto sales have grown double-digit year-on-year despite high interest rates and fuel costs. We are strong in Europe, UK and the US and our business in these markets have shown resilience in the current macro environment and this continues to be the case. We are seeing robust demand in sectors such as utilities, defence, energy, auto and farm equipment. In summary, we expect the market factors to be favourable to us for the rest of the year for the ISCS segment.

Added to that, our business development momentum continues to be good with new engagements in all three geographies including the large transformative engagement with Centrica, one of the leading utilities in the UK, which went live in quarter one FY '24. We have a strong pipeline of new opportunities in the Integrated Supply Chain Solution segment. We expect a year-on-year growth in the mid-teens in the ISCS segment for the full year FY '24.

In the Network Solution segment, we expect the final mile business to remain steady. On global freight, while we are not expecting any uptrend in freight rates, we are expecting volumes to improve. Our continued focus on business development is delivering a strong pipeline. In the previous financial year, freight rates were high in the first half and then declined significantly in H2. In that context, our year-on-year comparison of revenues for freight should improve significantly in the second half because of the base getting normalised.

On margins for the Network Solutions segment, margins should improve H2 onwards as some of our price increases come through and freight volumes pick up. We are also taking specific cost reduction initiatives in order to improve the efficiencies of our business. We expect Adjusted EBITDA margins to improve year-on-year compared to full year FY '23. Putting it together, we expect full year Adjusted EBITDA margins to be higher than the previous year by 80 bps to 100 bps. Our revenue estimates might be subdued.

Our profit has been impacted by the exceptional impact on CCPS conversion, but reduction in borrowing cost and impact of cost reduction initiatives will be obvious positive impacts. We are extremely confident of the business and our exit run rates will reflect our focus on profitable growth, which has been our mantra. With that, I would like to open the floor for questions.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Achal Lohade from JM Financial. Please go ahead.

Achal Lohade: Good evening team. Thank you for the opportunity. My first question is on the Integrated Supply Chain business. You mentioned that the growth was strong at 20% for the first quarter, but I guess for the full year you talked about mid-teens kind of growth. Can you help us understand, how do you see the growth in the coming quarters for the Integrated Supply Chain business and within that, if you could split between India and the rest of the world? With that, also if you could elaborate a bit with respect to any leadership related changes you have seen or undertaken over the last couple of years, which should help or influence this growth?

Ravi Viswanathan: Okay. Thank you, Achal. This is Ravi Viswanathan here. Let me answer that question. Firstly, the ISCS segment grew across all the three geographies that I mentioned with revenues coming close to 20% and EBITDA growing by 190 basis points. India grew by 14.3% in the ISCS segment. So clearly, India continues to be a very strong driver of growth. Europe and North America together made the rest. When I say we will grow in teens, we are looking at very high teens, maybe closer to the 20% and we will hold to that. With respect to your second question, which is with respect to the leadership change, one of the changes that we initiated was about two years ago when we brought in Richard Vieites in the North America region and North America has seen stellar growth over the last 18 months and we continue to have a very, very strong growth momentum in North America.

Achal Lohade: Thank you. With respect to the Network Solution piece, you indicated that, I think Ravi Sir indicated about the margin part of it. If you could elaborate a bit with respect to the freight rates, how it has influenced in terms of the gross profit and the percentage margin and how do we see it given the low base or rather corrected base of last year in the second half, how do we see it as a growth, from a growth and a margin perspective?

Ravi Prakash: Achal if we do a trend line Q1 FY23 was the highest rate per container that we had ever in our history. Versus that, the current rate has dropped by almost 55%. But against that, our gross margin has dropped only about approximately 16.5% to 17%. That is what I meant when I called out the fact that we managed procurement efficiencies and operational discipline very well.

The business also has been very disciplined with respect to its cost and that is why when I called out the increase in employee cost, all that was purely in the Supply Chain Segment, that too driven by contract, incremental contracts. In the network segment, actually costs have stayed flat and we are taking measures to make sure that they are leveraged further as we go into the second half.

Therefore, in the second half, the comparatives versus last year should look a lot better because rates dropped sharply in September-October of last year and versus that in the second half, it should look a lot better.

Achal Lohade: Understood. With respect to specifically India geography, if you could give a combined, you know, in terms of the Supply Chain plus Network Solution in terms of how the growth has been and how do we see this vis-a-vis, in terms of the market share and the outlook?

Ravi Prakash: So, India, I think it is important to actually the reason we broke out the Supply Chain and the Network and with the presentation also, because the Supply Chain business growth, I think it is important to be benchmarked versus probably peers, listed peers, to see we have grown 14% and we see that revenue momentum continuing.

In terms of the Network Segment in India, that has actually declined a fair bit in terms of rates. We are expecting that in the second half it will stabilize and therefore, India overall revenue at

INR680 crores versus the same period last year was about 17% down. But the driver has been a 14% growth in ISCS revenue.

Achal Lohade: Understood.

Ravi Viswanathan: So, Achal if I may just add, on the ISCS, if you benchmark ourselves with our India peers, you will see that our ISCS numbers compare extremely well with the listed peers that we have called out. And even on the Network Solutions, if you look at the one listed peer that we have benchmarked, we compare very favourably because globally and in India the Network Solutions business, which is predominantly driven by the global freight rate, has been on the downward trend, as all of us know.

Achal Lohade: Understood. Understood. I think I will stop here for the question. I will come back in the queue for any follow-up. Thank you and wish you all the best.

Moderator: Thank you. The next question is from the line of Sumit Kishore from Axis Capital. Please go ahead.

Sumit Kishore: Good evening and thanks for the opportunity. My first question is…

Moderator: Sorry to interrupt, but the line for you is not very clear. I request you to please move to an area where you are getting good network.

Sumit Kishore: Am I audible now?

Moderator: No, not really, sir. It is still breaking up in between.

Sumit Kishore: Hello.

Ravi Prakash: Yes, now it is clear.

Sumit Kishore: Thanks for the opportunity. Good evening. My first question is, could you help disaggregate the revenue and EBITDA margin performance of GFS and IFM and basically speak about the year-on-year performance separately for these two components of network services?

Ravi Prakash: So, in fact, the GFS business, EBITDA margins have improved, Sumit, compared to the same period last year, because what I had said was that the gross margin percentage has improved by almost about 7% to 8% points versus the same period last year. And so, and the costs have been actually held flat.

So, the EBITDA margins, if I were to break it down between GFS and IFM, GFS actually EBITDA margins have improved compared to the same period last year. The IFM business, we talked about it, it is having -- we said that it will take a little bit of time to work through the cost pressures that are there in the business.

And we have taken measures which we expect to start showing benefit in the second half of the year. Revenue has been pretty steady in the IFM business as well.

Sumit Kishore: Okay sir. On a full year basis, my understanding was that GFS will overall see a margin decline and it is actually IFM which is going to see margin improvements of a low base that you had in FY '23. I mean, so, what has happened in first quarter is I mean, not on the expected lines but I think that trend will sort of establish itself as we go into second half. Is my understanding right?

Ravi Prakash: On a full year basis, your understanding is right, Sumit. Well, we do expect IFM margins to improve off a low base, but we had also expected them to start from H2 onwards. So, the Q1 performance of IFM is actually on expected lines. GFS has been a bit of a pleasant surprise, pleasant but helpful surprise in Q1, where I think the team has, what you call, managed their costs very well. But on a full year basis, your expectation is pretty fair.

Sumit Kishore: Right. So, even though you expect some operating leverage benefits in second half, I think in GFS that is going to be tough because unless you have very strong volume growth to offset the decline in pricing, which is already in and unless you are assuming that prices will recover in second half, you know, how do you expect to sort of see the top line for GFS in second half of the fiscal?

Ravi Prakash: So, Sumit, we are not expecting prices to change much from what we have seen in the first quarter. We always expected that prices would -- we are now around pre-COVID levels, and we expect prices to stay around that number for the rest of the year.

We expect volumes to recover on back of two things. There are a few business development deals which we are expecting to kick in, that is one, and we are seeing some early signs maybe of slight volume improvement.

The third element is very strong cost management to deliver the operating leverage. So, I had already said that if I take employee cost, GFS actually has remained flat versus prior year same quarter and we are pushing that even more to take measures to help us deliver the operating leverage in the second half.

Ravi Viswanathan: And Sumit, if I can add, if you look at GFS, we are continuing to win deals. We have retained our entire customer base. It is a volume uptake which is a global phenomenon, and it is an industry-wide phenomenon, and we expect that to change and when it changes, we are well placed for us to -- get a hockey stick going for NS, for the Network Solutions segment.

Sumit Kishore: Sure. Got it and wish you all the best. Thank you.

Moderator: Thank you. The next question is from the line of Achal Lohade from JM Financial. Please go ahead.

Achal Lohade: Thank you for the follow-up opportunity. If you could elaborate, sorry, I was bit lost there in terms of the CCPS, what exactly is the impact, how it is classified, how is there any further impact which is expected in the rest of the year?

And also, if you could elaborate on the debt reduction, where we are as of March and June '23? And how do you see by March '24 in terms of gross and net debt, please?

Ravi Prakash: So, thanks Achal. On CCPS Achal, we had issued a total of INR556 crores worth of CCPS out that, INR417 came before even the IPO, and about the balance of them came after we had got the DRHP approval.

The way the accounting works for CCPS is because the number of shares to which the CCPS converts was based on a 15% discount to the discovered price in the IPO. And the way the accounting works is because it is a variable number of shares that come out of a CCPS, the instrument is classified as a financial liability.

A financial liability, therefore, needs to be fair-valued. What the auditors have determined is a certain portion of the discount to the IPO price they have attributed to illiquidity, but the balance accounting standards require that it be taken to the P&L. It is a non-cash charge, and it is a one-time impact. You will not see that Q2 onwards and that is how the CCPS works.

From a debt perspective, we had indicated in the prospectus that INR525 crores worth of funds would be utilized for debt reduction 392 of that in India, which will happen in Q2 and another 132 to our subsidiary in UK, LI UK, which will also happen in Q2.

In addition, to this 525 approximately a similar amount has been available to us from pre-IPO fundraising as well as the CCPS. All that will also be utilized for debt reduction. Therefore, if I take the June 30th gross debt, which is at about INR1,788 crores that will come down by roughly about INR1,090 crores and we should end the year at a gross debt of about INR685 to INR700 crores approximately. Net debt should be about 100 to 150 no more than that and as a result of that, the interest savings should be about INR15 crores a quarter.

Achal Lohade: Right. Okay. Understood. And how do we look at the capex plans here for FY ‘24, ‘25, ‘26?

Ravi Prakash: We would like to keep it at under 1% of revenue around INR100 crores, INR100 to INR110 crores.

Achal Lohade: Understood. And if you could just clarify on this -- if I look at the segmental breakup in our results if you could just highlight in terms of the segment assets, unallocated segment assets what does it comprise of? So, if I look at June 30th, there is unallocable corporate assets of INR4,345 crores and a corporate liability of INR3,064 crores. If you could highlight, what does it pertain to, what all heads under which it is sitting?

Ravi Prakash: The acquisition-related assets, acquisition-related assets Achal.

Achal Lohade: Is that goodwill we should understand, sir?

Ravi Prakash: Yes. It’s actually investments, which on a consol basis will translate into goodwill.

Moderator: Thank you. As there are no further questions, I would now like to hand the conference over to the management for closing comments. Over to you, sir.

Ravi Viswanathan: Thank you. And I want to thank all of you for joining in the call. In summary, I would like to say that we've had a stellar growth in the ISCS segment across all the three geographies, significant customer wins of almost INR255 crores of new business development, which is in line with what we speak about 11% of our quarter one numbers, and our EBITDA margins and Adjusted EBITDA has expanded admirably.

Thank you and we appreciate you logging into the call. Good night.

Moderator: Thank you. On behalf of TVS Supply Chain Solutions Limited, that concludes this conference. Thank you all for joining us. You may now disconnect your lines.