DELHIVERY

Date: February 16, 2023

BSE Limited **Floor 25, P J Towers,** **Dalal Street,** **Mumbai – 400 001** **India**	**National Stock Exchange of India Limited** **Exchange Plaza, C-1, Block G,** **Bandra Kurla Complex,** **Bandra (E), Mumbai – 400 051** **India**
Scrip Code: 543529	**Symbol: DELHIVERY**

Sub: Transcript of Earnings Call pertaining to the Unaudited Financial Results for the quarter ended December 31, 2022

Dear Sir,

This is in continuation to our earlier letter dated February 11, 2023, regarding audio/video recording of the analysts/investors Earnings Conference Call held on February 11, 2023 at 04:00 P.M. (IST) on the performance of the Unaudited Financial Results of the Company for the quarter ended on December 31, 2022.

Please find attached herewith the transcript of the above investor and analyst call.

The same is also available on the website of the Company at https://www.delhivery.com/investor-relations/.

You are requested to take the same on your record.

Thanking you,

Yours faithfully,

For Delhivery Limited

SUNIL KUMAR BANSAL
Digitally signed by SUNIL KUMAR BANSAL
Date: 2023.02.16 18:08:37 +05'30'

Sunil Kumar Bansal
Company Secretary & Compliance Officer
Membership No: F4810

Place: Gurugram

Encl: As above

"Delhivery Limited Q3 FY23 Earnings Conference Call"

February 11, 2023

Management: MR. SAHIL BARUA, MD & CHIEF EXECUTIVE OFFICER

MR. SANDEEP BARASIA, ED & CHIEF BUSINESS OFFICER

MR. AMIT AGARWAL, CHIEF FINANCIAL OFFICER

MR. VARUN BAKSHI, HEAD, INVESTOR RELATIONS

Moderator: MR. VIJIT JAIN, CITI EQUITIES TEAM

Vijit: Ladies and gentlemen, good day and welcome to the Q3FY23 Earnings Conference Call of Delhivery Limited, hosted by Citi Research. I'm Vijit Jain.

So before we start, Delhivery would like to point out that some of the statements made in today's call may be forward-looking in nature and a disclaimer to this effect has been included in the earnings presentation shared with you earlier. Kindly note that this call is meant for investors and analysts only. If there are any representatives from the media, they're requested to drop off this call immediately.

To discuss the results, I'm pleased to welcome Mr. Sahil Barua, the MD and Chief Executive Officer; Mr. Sandeep Barasia, ED and Chief Business Officer; Mr. Amit Agarwal, Chief Financial Officer; and Mr. Varun Bakshi, the Head of Investor Relations.

As a reminder, all participants line will be on the listen-only mode and participants can use the raise-hand feature to ask any questions post the opening remarks. I thank the management team for providing us the opportunity to host this call.

I now invite Mr. Sahil Barua to take us through key highlights for the quarter, post which we'll open up for Q&A. With that, over to you, Sahil.

Sahil: Thank you, Vijit. Good evening everyone and thank you for joining our earnings presentation for quarter 3 and for giving us the time. Welcome to the call. Just a quick check, Apar if I am audible?

Apar: Yes Sahil, you are audible, loud and clear.

Sahil: Great. Thank you all. So, as always, I'll spend about 15 to 20 minutes walking through a summary and highlights of quarter three, and then we'd be very happy to take questions from everyone.

Apar, if you can move two slides forward to the summary of quarter 3, yeah. Before we get into the slides I think some context on quarter 3. Our objectives as a management team really were to achieve two major milestones in quarter 3. The first was to continue on the operational and financial integration of SpotOn, which was a PTL network that we acquired last year, as you would remember. And the second was to maintain and grow market share in our two critical transportation verticals and set us up well for quarter 4 and beyond.

So I'm pleased to announce that in quarter 3 we have been able to achieve both of these objectives; and we have seen continued sequential improvement in the profitability in the transportation business and in the company overall. And we saw growth in e-commerce volumes that have persisted so far into January and February

and similarly in the PTL business growth that has set us up well for quarter 4 and beyond.

Moving on to the numbers for quarter 3. We delivered about 1,822 crores of revenue in Q3FY23, which was growth of about 1.5% over quarter 2 when we did close to about 1,780 crores of revenue. Our adjusted EBITDA margin, importantly, continued to improve. If you will remember from our last earnings call, we had incremental gross margins of 50% in quarter 2. The incremental gross margin trend for the business has continued into quarter 3; and operating leverage in the business has remained intact, while service standards have improved. As a consequence, we've seen adjusted EBITDA margins improved from minus 7% in quarter 2 to minus 3.7% in quarter 3.

We delivered about 170 million shipments, which is about 5.6% growth quarter-on-quarter in our e-commerce express delivery business, which is the number that I referred to in quarter 2 as well. We continue to have a leading market share as an independent third-party logistics player in this space. We've seen our overall share of market and share of wallet with customers persist into the New Year as well.

We delivered 258,000 tons of part truckload freight in Q3FY23. We delivered about 3 million tons, since fiscal '19. More importantly, in December, or in October, November, December -- in the month of December we delivered about 98,000 tons of PTL freight. That trajectory has continued into the New Year as well.

We continue to operate one of the largest networks in the country. We operate about 18 million square feet of logistics infrastructure. The integration of Delhivery and SpotOn's facilities continues as per plan, which I'll talk about in the next slide. 26,000 customers continue to depend on Delhivery for multiple services, with over 58% of our revenue coming from customers who use two or more of our services across business lines; and we've expanded reach marginally between quarter 2 and quarter 3. We continue to cover the entire country with 18,510 pincodes under direct coverage of Delhivery.

Moving to the next slide, just a quick snapshot of metrics as usual. As you can see, at the end of financial '22, we were in 18,074 pincodes. That has expanded to 18,510 pincodes as of quarter 3. This is a regular operational expansion that we expect will continue in quarter 4 and beyond. Through our partnerships with FedEx, Aramex and other global players, we continue to allow Indian customers of ours to access the rest of the world. We have about 26,845 active customers who continue to buy services from us across business lines.

On the infrastructure side, as you can see, the integration of SpotOn infrastructure into Delhivery has continued in quarter 3. We had 18.9 million square feet of real estate spread across 96 gateways; 21 automated sort centers; 189 processing

centers; about 3,000 delivery centers; and 237 freight service centers. This has now been consolidated to 17.9 million square feet of real estate in Q3FY23 as per plan, with 92 gateways; 22 automated sort centers; 172 processing centers; 2,750 express delivery centers; and 150 freight service centers. And our team size continues to remain about 52,800 people across the country.

Moving on, key highlights for Q3FY23. I think the first is really that adjusted EBITDA improvements have continued quarter-on-quarter post the SpotOn integration. As you saw on the previous slide, network footprint optimization has continued in quarter 3. We are more or less now completely done with the footprint optimization that began in quarter 1 when we began to operationally integrate Delhivery and SpotOn. There are a few locations that are still awaiting final optimization, which we expect will happen over quarter 4 and the first half of the next financial year.

We also continued to revise pricing across low-margin customers. This is something that we expect will continue into Q4 and will continue into the early part of the next financial year as well, which has had an impact both on yield, as well as on profitability. And we continue to drive capacity utilization across our operations, especially in the mid-mile operation.

On the PTL business, specifically, I think we are entering the crucial March end period with excellent operational and business momentum. As you can see, tonnage continues to remain below the numbers that we were at in Q4FY22. However, as of December and January, we have done 96,000 tons of freight at network service levels, which are above service levels that the network has delivered at any point in the past. Our network service levels, as experienced by customers, continue to be in the 95% range.

More importantly, network quality has improved significantly. This was an issue that we were dealing with immediately post the integration. Short shipments have dropped from 0.2% when the integration began to nearly 0.05% as of January; and network speed has returned to pre-integration levels or better. So the PTL business is set-up extremely well for quarter 4 and beyond.

The supply chain services business pipeline continues to expand. We continue to add new clients that are key verticals that we operate in, which are auto and auto spare parts; healthcare; home furnishing; beauty and personal care; and consumer electronics. And we have also expanded existing contracts in the auto, industrial and consumer segments. This is a business that has stayed somewhat flat sequentially, owing to seasonality in the underlying business, but has grown 33% from the same time last year.

We also completed the acquisition of Algorhythm Technologies in January 2023. Algorhythm has a suite of supply chain software products, which will enhance our SCS offering with inventory management and transport optimization solutions. So that's a quick snapshot of quarter 3.

Moving into the specific numbers. Revenue from services in quarter 3 stood at 1,822 crores, compared to 1,796 crores in quarter 2. Sequentially from the last year, this is lower by about 170 crores, driven largely by the PTL business. Express continues to be our major business, form 66% of revenues; PTL is today 15% of revenues; and our newer businesses, which our supply chain services, truckload services and cross border form the remainder, which is about 20%.

On express parcel, between quarter 2 financial '23 and quarter 3, we've seen growth quarter-on-quarter of about 7%. We closed the quarter at about 1,200 crores of revenue in Q3FY23. We delivered close to 170 million shipments in Q3FY23. This is despite the fact that the high season in e-commerce this year was earlier than in the previous year. This year the high season was in quarter 2. So we've seen a 6% growth sequentially.

On the PTL side, revenues have declined from quarter 3 of last year and from quarter 2 of this year. We closed quarter 3 at 277 crores of revenue versus 293 crores in the previous quarter. Freight tonnage has been at 258,000 tons for quarter 3 versus 286,000 tons for quarter 2. However, December, as I had mentioned, was 96,000 tons of freight. January has continued in the same vein and we see similar momentum in February as well.

This is a quick snapshot of week-wise volumes in the part truckload business. The way to read this chart is, at the bottom is the period of every month from November to February. The red bars are November, the black bars are December, the gray bars are January, and the yellow bar is February so far. As you can see, we've seen a consistent increase in PTL volumes in every comparable week from the last -- for the last 3.5 months; and February is trending well above November, December and January.

This is being driven primarily by massive improvements in service quality across the network, which is a natural consequence of the operational integration being complete between Delhivery and SpotOn. So an increase in network speed, an increase in service precision, and an improvement in service quality, as evidenced by the reduction in network shortages. So we've seen January, as an example, trend at about 10% to 15% higher than November in general. And so far, we see February trending at 15% to 20% higher than January.

For the other businesses, the truckload business has grown to 102 crores of revenue in Q3FY23 versus 103 crores in Q2FY23. This was driven by underlying

seasonality in the truckload business. The business has grown 33% over the last year. The supply chain services business has grown to 178 crores in Q3FY23, more or less flat versus quarter 2; but 33% again higher than the same period last year. This has been driven both by expansion of existing accounts, as well as new accounts, as I had mentioned earlier.

The cross border services businesses declined year-on-year and sequentially from 96 crores of revenue to 66 crores of revenue. However, this has been driven by a compression of yields in both the air freight and the ocean freight markets globally. Volumes in the ocean freight business have grown significantly over this financial year. And there has been a shift away from air freight volumes toward ocean freight volumes in the same period.

On the adjusted EBITDA front, I think this is where the most positive news for the quarter is. Revenues have grown, as I mentioned, from 1,796 crores in Q2FY23 to 1,824 crores in quarter 3. Service EBITDA in the same period, however, has grown from 86 crores to 139 crores. So service EBITDA margins have improved from 4.8% in Q2FY23 to 7.6% in Q3FY23, which is a reflection of the underlying operating leverage in the business. Our incremental gross margins in the transportation business especially continue to be high.

Corporate overheads, as we discussed last time, we continue to exercise control over central costs. Corporate overheads have remained more or less constant between quarter 1 and quarter 3. As a percentage of revenue, they've dropped from 12% to 11.3% as of quarter 3. We foresee corporate costs remaining broadly constant going forward as well.

What this has led to is a massive improvement in adjusted EBITDA. As of Q1FY23 when we began the integration, adjusted EBITDA stood at negative 12.5%. As of Q3FY23, owing to improvements in gross margin in the transportation business, as well as operating leverage on the fixed costs, we've seen adjusted EBITDA improved to a -67 crores or -3.7% as of quarter 3.

Moving to the next slide. The key driver of adjusted EBITDA continues to be massive incremental gross margins in the transportation business. Our Q2FY23 adjusted EBITDA stood at -125 crores. Our incremental revenues in the transportation business in quarter 3 stood at 59 crores. The incremental gross profit that we've seen in transportation is 58 crores.

Of this 58 crores, approximately half of it comes from improvements in the gross margin or operating leverage. In addition, we had three specific programs that began in quarter 3 once the operational integration with SpotOn was complete. One of which was revising pricing and rationalizing business with less profitable customers. I had alluded to this on our previous earnings call. The second is

improving capacity utilization, deploying more of our tractor-trailers across high-density routes across the country. And the third is ongoing cost optimization measures, including improvement in weight capture. All of which have had an influence both on yield, as well as on profitability.

The network footprint has continued to be optimized as well. We've seen a decrease in transport fixed cost by 3 crores. Net result of this is an improvement in adjusted EBITDA from -125 crores to -67 crores for quarter 3.

This is a quick snapshot of how various costs have trended as a percentage of revenue. The two bars that are highlighted are Q1FY23 and Q3FY23. As you can see, total freight, handling and servicing costs between quarter 1 and quarter 3, while revenues have increased, our costs have actually reduced on an absolute basis, from 1,453 crores in quarter 1 to 1,409 crores in quarter 3. Therefore, total freight, handling and servicing cost as a percentage of revenue has declined by nearly 6%, from 83.2% in quarter 1 to 77.4% in quarter 3.

We've seen an improvement across all key cost elements. Line haul, which is our trucking expense, has reduced from 37% in quarter one, to 33.4% in quarter 3. We've seen manpower expenses also reduce with improvements in productivity and higher loads. Manpower expenses have dropped from 13.8% to 11.7%. In addition, most of the fixed costs of the business have also scaled as volumes have grown between quarter 1 and quarter 3. So overall, the profitability trend has been positive in quarter 2 and in quarter 3. And going forward, we expect this trend to continue.

So a quick snapshot of adjusted EBITDA. As of quarter 1, as I have mentioned, we were at -12.5%. As volumes have grown across the integrated network in quarter 2 and quarter 3, we've seen sequential improvements in adjusted EBITDA, from -12.5% in quarter 1, to -7% in quarter 2, to negative 3.7% in quarter 3. So nearly a 50% improvement in adjusted EBITDA quarter-on-quarter. As operating leverage in the business continues with higher volumes, we expect this trend to continue.

A quick bridge on adjusted EBITDA. I've walked through this before, so I'll do this quite quickly. In quarter 3, total revenue from customers stood at 1,824 crores, total expenses stood at 2,126 crores. There are three categories of expenses that are added back. The first is, 5 crores of finance cost on borrowings. The second is lease adjustments due to AS 116, where we expense the leases versus capitalizing them, which has a net impact of 5 crores. And an add-back of non-cash recurring costs, which include depreciation and amortization, which stood at 157 crores for quarter 3; and ESOP expenses which have declined from 95 crores in quarter 3 last year, to 67 crores this year. The net impact of this is that adjusted EBITDA has improved to -67 crores, compared to -125 crores in quarter 2.

A similar graph on the cash PAT side. Overall cash PAT has turned green again. We were at 5% and 6.6% cash PAT last year at about the same time. In quarter 1, cash PAT had dropped to -10.4%. Again, the same story of operating leverage plays out. We've seen cash PAT improve from -10.4% to -1.7% in the previous quarter, which has now improved to positive 1.8% as of Q3FY23.

The cash PAT bridge follows the same logic as the adjusted EBITDA bridge. Profit after tax for the company improved from quarter 2 to quarter 3 from -254 crores to -196 crores. Adding back non-cash recording costs principally gives us the adjusted cash PAT of 34 crores for this quarter.

With that, I'd like to end the call. Again, I'll just quickly summarize. Quarter 3, from a management team standpoint, has been a positive quarter in terms of improvement in profitability, consolidating market share on the e-commerce side and stabilizing the part truckload business. We've seen improvement as a logistics business -- service quality, reach, speed are the three major metrics that we look at. We have seen improvements across all of these. We are well-positioned in quarter 4. The momentum from the end of quarter 3 has continued. And we're confident about quarter 4 and the financial year ahead.

With that, I'll pause. Thank you for listening to me. And we're happy to take questions.

Vijit: Thank you, Sahil. Operator, can we have the first question from Sachin Salgaonkar? Thank you.

Sachin: Hey, Vijit! Hi, guys, this is Sachin here. I have three questions. Firstly, Sahil, just wanted to understand the 6% Q-o-Q shipment growth in 3Q. It looks like even adjusted for Shopee, this appears to be slower than historical trend. So just wanted to understand any specific drivers which impacted this quarter.

Sahil: Sure, Sachin, do you want to go through all three questions? I can note all three.

Sachin: No. Why don't you answer this, then I'll ask the next one?

Sahil: Yeah, sure. I think this year was a little atypical between quarter 2 and quarter 3, because the sale impact came in, in quarter two this year; whereas last year, the sale impact came in, in quarter 3. From our standpoint, as we look at the market, we've done 170 million shipments odd in quarter 3. Our momentum going into quarter 4 continues to be similar to what we saw in quarter 3, in terms of shipment volumes. In the sense that our share of wallet with customers has grown in this period. That is broadly a summary of volumes from quarter 3.

Sachin: Got it. And just to extend that further. Any thoughts on outlook for shipments for 2023? And I'm asking that because we are seeing the impact from funding winter where the e-commerce, social commerce, D2C companies are not as aggressive and everyone is focusing on their cost control.

Sahil: Absolutely, Sachin. I think we've spoken about this before. Our view has always been that while individual players in the e-commerce marketplace may go through ups and downs based on their respective funding situations, the broad arc of e-commerce continues to remain positive. It is a growing category. We continue to see new categories coming into the market. We continue to see new buyers coming into the market and that's not just in e-commerce alone. You'll see this across all consumer Internet businesses.

I think the reality is that the last year was slower than people expected, partly because a lot of growth had been pulled forward during the COVID period; but I don't think that fundamentally alters the path for e-commerce in the country.

The other thing worth remembering also is, if you look at the new participants in the e-commerce marketplace, I think you will find that they are not necessarily affected by funding situations in the private markets. The new entrants in the e-commerce space, as an example, include the likes of Reliance, Unilever, for instance, Dabur, for instance, which are also entering with direct-to-consumer brands.

And so, our view on e-commerce continues to remain positive. I think, in any given quarter, there will always be volatility based on how individual players and their ability to raise capital, but for e-commerce as a category, we remain unconcerned.

Sachin: Yeah. So, 2022, as you rightly indicated, was a bit slower than expected. What your sense of 2023? Should we see a 25 - 30% shipment growth? Or do we see a downside risk out there? Generally, as an industry, I'm asking.

Sahil: So it's a tough question to answer. Last time when we spoke about this on the earnings call, I had signaled that we would see about a 5% to 8% growth in shipment volumes in quarter 3. It turned out that we were at about 6%, more or less on track, But as I look forward, our sense is that, at the conservative end, e-commerce volumes should be expected to grow in sort of the 15% to 20% range. That said, I think if some of the inflationary pressures ease, and depending on how individual players react, you could see growth rates which are higher than that as well.

Sachin: Got it. And if there is a slowdown there should be an impact on your operational leverage on the negative side or directionally the kind of results what you shared in the 3Q those kind of results from an operational leverage will continue?

Sahil: They will absolutely continue. From our standpoint, what's important to note is that the further improvements in operating leverage in our business, because we are an integrated network, will actually come from growth in PTL volumes. And so as a management team, as we look at the business towards the end of quarter 3 and how quarter 4 has begun I think what is satisfactory is the growth in PTL volumes.

As the PTL volumes continue to grow, our overall unit economics will get significantly better. And the fundamental reason is because our mid-mile utilizations of the hubs and the trucks will improve drastically as volumes go up. So we're not as dependent on what happens to e-commerce volumes necessarily. And from a margin perspective, it doesn't make any difference.

For us also, I should point out that any volatility in an underlying market which places pressure on our competitors is ultimately good for us. We have always maintained that our objective is to commoditize the space. We are the lowest-cost player. We have the highest-gross margins in this space and the ability to absorb pressures in the market. And if it is necessary, we will exercise whatever steps we have to maintain or grow market share.

Sachin: Thanks, Sahil. Last question from me, your thoughts on competition on both PTL and express. Is it increasing, decreasing or status quo?

Sahil: I think on the PTL space, the good thing in India, not just for Delhivery, but for all players, listed or unlisted, is the fact that it's a highly fragmented and unorganized market. The top 10 players in PTL, the organized players in PTL in India today, will form less than 20% of the market. And so there is significant headroom for growth without any of us trying to claw each other's eyes out. As long as we continue to deliver high-quality service across a wide network and at costs that customers are used to seeing, there's almost, in some senses, no limit to the headroom for growth, not just for Delhivery, but for other PTL players as well.

And so, our job remains pretty simple, which is essentially to continue to deliver service quality, to continue to deliver precision, and to continue to add new customers. So competitive intensity on the PTL side is not even a factor.

Coming to the e-commerce space, I think obviously, when volumes go up and down, individual players, again, like I had mentioned, see different levels of strain on their businesses. For us, we realized long back and when we set up the business, it was part of our strategy, that an integrated network is the only way to go. The lowest-cost player in a space generally is not the one that faces the pressure in the market.

And so from our standpoint, even if e-commerce were to stay absolutely flat next year, or de-grow should it, which is very unlikely, for us, strategically nothing will change. Our financials will not change, our strategy in no way will change. If anything, I think it will increase competitive intensity in our favor, which seems to be what we have seen in January and February as well. Our numbers suggest that we have gained share in this quarter.

Sachin: Got it.

Operator: Thank you. The next question will be from Hitesh Goel. Hitesh, please go ahead.

Vijit: Just a housekeeping thing, please keep your questions limited to two per person. Thank you.

Hitesh: Sure. Thank you. I have only one question. On the PTL side, just wanted to understand the unit economics. So I understand that the volume growth or mid-mile utilization will go up and that could reduce your costs -- unit cost per Kg. But when I see your yield versus competitors, that is quite low, right? So that is also an important element to improve profitability. So can you give us some sense and how should we look at the PTL yields? Can that go up further from here? Or you want to become the lowest-cost operator in the PTL itself, that will give you profitability? How should we think about that?

Sahil: Good question, Hitesh. I think there are two separate questions for me to unpack here really. The first is what is the strategy and the second is, really, what are the economics. On the strategy, again, in PTL, exactly as we did in express. Delhivery exists to be the lowest-cost and most efficient player in any market that we are in. And so, that will be our strategy in PTL as well.

Now, unlike the express or the e-commerce space, whether we will continue to pass efficiency gains in our PTL business back to customers or not, is a decision that we will take based on how various market participants operate. So our pricing strategy may be different in PTL compared to express; but strategically, the cost objective of the business will remain the same.

Now, why we believe we have that ability is very simple. We run the biggest trucks. We run the largest hubs, we run the most efficient hubs. And that’s a significant portion of the cost in PTL.

In terms of yields — so that answers the question on what our strategy will be. In terms of the yield, it’s misleading to look at yield across different PTL players, because the yield depends on the distances that you are traveling, the yield depends on where the business is coming from. There are PTL players, as an example, where

a significant portion of their business comes from retail customers. Retail customers typically may pay rates which are anywhere from 14 to 20 rupees per kilogram.

Equivalently, if you have Delhivery as an example, we do a significant portion of our business from large enterprises, where rates are not 14 to 20 rupees per kilo; but the difference is that you're typically carrying more predictable and larger loads. So yield by itself cannot really be compared across different PTL players.

In terms of how the unit economics work, the PTL business is actually a fairly simple business. There are fundamentally two large costs. The first is pickup and delivery costs, which typically will range for most players between about 15% to 20% of yield; and there is line haul, which is the trucking cost, which will typically be anywhere from 35% to 40% depending on the specifics of the load that they carry. Outside of which, there are the costs of handling the load, which is the manpower costs, which will again typically be in the range of about 5% to 7% for most players.

Effectively, our view is that this creates a gross margin opportunity between 25 and 30% in the PTL business. And then depending on the underlying infrastructure strategy, could yield EBITDA margins in the range of anywhere from 14% at the lower end to 20% at the upper end.

Hitesh: Okay. Just a follow-up there, can you give me the mix of your small enterprises and large enterprises ?

Sahil: Hitesh, I'm sorry, I didn't catch that fully. You said a list of small enterprises?

Hitesh: The revenue mix between the large enterprises and SMEs that you pointed out.

Sahil: We don't declare that, Hitesh publicly, number one. And the second thing is that this is a mix which changes practically every month, because we continue to be in a customer acquisition mode and different segments of customers have different sales cycles. And so, really, any quarter is not going to be an indication of what our mix will be two quarters hence. So this is unfortunately information that we don't put out publicly.

Operator: Thank you. The next question will be from Gaurav Rateria. Gaurav, please go ahead.

Gaurav: Hi. Am I audible?

Sahil: Yeah, Gaurav. Please go ahead.

Gaurav: Yeah. I'll list down all my questions, and you can take the top two questions. If you have time, you can take the third one as well. The first question is, basically on slide 10. If we look at your services EBITDA margins is 7.6% compare, it to fiscal '22, which was 10.4%, it's a 300 basis point lower. On a similar revenue scale, much reduced infrastructure that you have right now, rationalized infrastructure and a lower cost structure. So what explains the lower services EBITDA margins compared to fiscal '22 on a similar revenue scale? That's question number one.

Question number two is, on the cost side, your incremental GM is 50% on transportation business. For how long you can sustain this? Post which there should be a normalization back to 25, 30% incremental margin on gross margins.

And last question is on the pricing side. On the express parcel yield strategy, do you think the current market situation is ripe for kind of disrupting the market, given the private players will be struggling to raise money; and you can actually try and gain more market share by using your pricing lever, which may not necessarily dip into your unit economics but may help you to gain a significant amount of market share? Thank you.

Sahil: Thanks, Gaurav. Let me answer all three of the questions. I think they're all important. The first one is on the decline in service EBITDA year-on-year, there's actually a pretty simple answer to that. One of the major reasons for the change in service EBITDA is, we do a larger proportion of our trucking now on 46-foot container trucks compared to the same time last year when it was much, much smaller.

You remember that one of the big investments that we have made through this financial year, and that we expect to continue to make, is expanding our fleet of 46-foot container trucks. So essentially, when the volumes are lower, which they are in this quarter compared to the same time last year, you'll see that our line-haul costs, but effectively our line-haul utilization on a network level is lower.

The good news, though, is that the capacities that we have are larger. And so as the business continues to grow, the incremental margins, which sort of link to question number two, the incremental margins will remain high, because these trucks will essentially be able to absorb the excess load that's coming in. This is a key part of our strategy going forward. We will continue to actually expand our fleet of tractor-trailers.

On the fully utilized trucks, Gaurav, as we've mentioned in the past, we continue to see unit economics that are superior by anywhere from 15% to 35% on other truck form factors that the rest of the industry uses.

To your second question on incremental margins, we continue to see 50% incremental margins across the network. Across different pieces of the network, we are seeing capacity utilizations, as load has come back, start to hit the levels of 80, 85% thereabouts. That said, I think we still have some distance to go before the incremental margin starts returning to normalized levels. Because we have, as we mentioned, this year expanded our overall fleet of tractor-trailers; and we continue to run our mega facilities in Tauru, Bhiwandi and Bangalore and have expanded some capacity.

So I think it will still persist for a while. We are probably at least a quarter or two away before margins start normalizing. At which point, again, we'll consider whether or not to expand capacity.

Your third question was on pricing. I think it's a good question, and it's sort of -- I think it's an answer that has never really set in stone, Gaurav. We look at market conditions; we look at our competitors; we look at who's financing them and what kind of runway they have before we make a decision. Fundamentally, because as a market leader, I don't really see any use to us setting fire to our own profit pool.

At this point in time, our competitors do not have a current or a future ability to meet our cost structure. Their inability to meet our cost structure is not driven by a lack of volume. It is driven by an underlying structure of the network, and so our costs are not achievable. In that situation, we really don't have any need to price any lower than we are at this point in time.

What is important, though, like in some sense, is like a nuclear deterrent is that we have the ability to do it. And should we feel the need to defend our market share in any given customer account, or if we see a customer performing exceptionally well for us and growing volumes at the margins that we expect, we are more than happy to pass those efficiency gains on to customers proactively.

So I think it's a good question. It's one where as a management team, I think we will look quarter-on-quarter, customer-by-customer at the incremental margins that we are generating and then decide whether or not to pull a pricing lever.

Operator: Thank you. We'll take the next question from Mukesh Saraf, please. Thank you.

Mukesh: Yeah, hi. Good evening, and thank you for the opportunity. Two questions, largely. So first is on the PTL business. Last quarter I think you had mentioned that you had exited around, say, about 3,500 tons per day on an average. We have done close to 2,980-odd tons this time around on average for the quarter. And December is, in fact, higher. So it seems like this October or November, one of them have been weak, or probably both have been quite weak. So any sense on that? Could you give

some sense if there was some one-time disruption or something of that sort in that month?

Second, on the express parcel business, growth is largely flattish on the number of shipments. Could you give some sense on your market shares that you have in this 3Q? Because industry probably, in the commentary we are hearing from the large players, the likes of Meesho seem to be much higher. So some sense on that would be helpful.

Sahil: Sure. I can start with the first one. On PTL volumes, the start of October was muted for the quarter. The reason for this was, if you remember, on September 24th there was unseasonal rain in Gurgaon. And as a precautionary measure at our Tauru facility, we had taken down the total amount of load that was being transacted both with Tauru as an origin, as well as with Tauru as a cross-docking or destination location.

Given our experiences, when we did the integration in April, I think the conservative call, and in retrospect the right call for the business, was really to inform customers early and to tell them that we had seen an unseasonal rain situation in Tauru which could cause delays. And as a consequence, we would take down loads for a period of time.

We continued to watch that through the September peak and the first part of October. And when we were confident that network delays would not occur, we decided to go ahead and re-admit loads into the network, which is also why loads recovered pretty quickly going into November, as well as December. So it was a conservative call at that time.

On the second question, in terms of volume growth, I think we saw an overall growth of 9 million shipments between quarter 2 and in quarter 3, in absolute terms, which is about 6% growth. We monitored our share of wallet with all of our customers, individually, as well as collectively. It's sort of an estimate that we have because there really aren't published sources of market share data.

Going into January and February as well, as I look at our numbers, I am pretty confident that we have gained share in the market; and we will continue to gain share in the market. Our share of wallet with key customers has increased in this period. We expect it to continue to increase over this quarter and through next financial year.

Vijit: So I do see some questions on the chat panel. Maybe I can take the first one there. This is from Aditya from Macquarie. He has three questions. Could you provide some broad flavor on your express parcel volume mix versus, say, one year ago?

How do you see your volume mix for the year ahead? And what does that mean for your blended yields?

Sahil: Sure. Also, very quickly, we do not declare a break up of our express parcel volume mix by customer, obviously. It's sensitive data. But that said, let me put it this way, we find our customer volume mix highly satisfactory. Unlike other players in the industry, we are not heavily dependent on any single customer. This is something that we have discussed before. It's something that our management team looks at very carefully. The added advantage, of course, that we have is that, express itself is 66% of our business. And so, our overall contribution from any single customer is not particularly significant. So that's one of the things that we manage carefully.

Obviously, on top of that, we are a very large player when it comes to independent players who are not the three marketplaces. We have a high share of wallet with all of these customers; and we continue to maintain that. So across the marketplaces, I think we are a significant and important third-party partner to all of them. And for anybody who's not a marketplace, we are usually partner of choice.

Vijit: Okay. Great. Thanks, Sahil. The next question he's asked is, how has the recent uptick in PTL volumes improved your service margin in Jan?

Sahil: I can't comment on margins for January, unfortunately. But what I can tell you is that operating leverage in the business, you've now seen two quarters where operating leverage has played out. And I think as long as volumes continue to come in, the operating leverage in the business will continue. There will be, obviously, depending on where the volume is coming from and where it's going to, the 50% may vary a little bit if it's going into underutilized versus overutilized locations; and we don't micro-optimize that. But the broad underlying trend of operating leverage will continue.

Vijit: Sahil, and the last question he has asked is, tactically, what are your top three process level KPIs/priorities?

Sahil: In a logistics business, service quality and cost per shipment. There are no top three, there are only two. As long as we deliver high-quality service, as long as we continue to improve efficiencies internally, market share is a direct consequence. It's as simple as that. As I've mentioned multiple times, the strategy behind Delhivery is very simple. We are here to commoditize our space. This is one of the rare industries where it is possible to deliver the lowest cost and the highest quality of service at the same time. We believe that we have the model that allows us to do that. And so, these are the two KPIs that we track at all points in time.

Vijit: Great. Thanks, Sahil. We'll take the next question on the line from Soham Joshi. Soham, you can go ahead, please.

Soham: Yeah. Congratulations for two things, Sahil. I mean, first of all is numbers and second is the entrepreneurship spirit that you guys are supporting like down, but not out. That is amazing, Sahil, I mean, they were superb.

Now the two questions I want to ask is, now, as you have said that we had a pull ahead of e-commerce for 2020 and 2021. So will we compromise our margins for going ahead? And ultimately, will it affect our bottom line? Is it the case which you are seeing going forward?

Sahil: Sure. So I think that's a good question. And it's similar to the question asked earlier. I think, as I mentioned, we already are the lowest-cost player in the market; and our pricing, to a large extent, does reflect our cost advantages. So we do not anticipate that we will pass on broad-based pricing incentives to customers at this point, nor is there any demand for it at this point. So we have no reason to make sort of big pricing changes or to compromise our gross margins in any way. In fact, we will — we need to protect our gross margins.

Soham: Okay. One, just one small question. Even if we have a moderate growth volume, for say 2023 because somewhat various slowdown in e-commerce, will this push back all the plans for starting the two new truck terminals which you had acquired from Welspun and GMR in Mumbai and Bangalore? I mean we were supposed to get operationalized in 2023. So now will we push it to 2024 or 2025? And what is the plan for that too?

Sahil: A great question, Soham. And that's why the PTL business recovery is so important. Our decision to move to these larger facilities is not underpinned by e-commerce. Because, as you can imagine, e-commerce, the shipment volume and count may be high, but the tonnage is very low. So the movement to the larger facilities and the larger truck sizes is really driven by the freight business. We have seen the recovery in the PTL business. We are seeing it continue into January and February. So we will move into our Bombay facility, the Welspun one facility during sometime towards the end of quarter 2 or the early part of quarter 3 of this year, actually, probably the early part of quarter 3, conservatively. The Bangalore facility is only scheduled to arrive in the next financial year.

Soham: Okay. And one last question for Transition Robotics. I mean, what is the way -- I mean, are we seeing the revenues growing from the Transition Robotics? Is government coming with the revenue guideline for drone logistics? What is the way? When the revenue will start reflecting in P&L?

Sahil: Sure. I think it's a good question. Transition Robotics, essentially, what we have built, Soham, is the capability to deliver using a fixed wing aircraft up to a 4 kg

payload over a 40-kilometer distance. In India, so far, what we have been doing is really testing out the drone capabilities that we have. Transferring the technology because drones have to be manufactured in India for them to be used in India. And then we will have the capability to deliver.

We have tested. We've done trials so far, obviously, with the approval of the regulator, both national and local. And as the policy from DGCA becomes clearer, then we will decide what we want to do. We are evaluating other possible revenue streams for the IP that we have created. And we will look at other markets to see whether this IP can be monetized. I think that is something that we will do in fiscal '24.

Vijit: Great. Thanks. We'll take the next question from Aditya Mongia.

Aditya: Yeah, sure. I hope I am audible to you all.

Sahil: Yeah, Aditya. Please go ahead.

Aditya: Great. First of all, congratulations on kind of improving the cost structure quite meaningfully in the matter of a quarter. The question that I had was, firstly, on this lost shipment expense that appears to spike up every second quarter. So it happened in the first quarter. It's happened this time around also that almost 2% of your – say 2.7% of your sales has been expensed as line item.

Also, you have seen service levels become better than the SpotOn in 2Q and then 3Q, the start has been weak. I'm just trying to get a sense of A) what are the learnings from this kind of volatility that has happened in your service levels and on your lost shipment expense? And b), should we be expecting any such spikes incrementally unknown?

Sahil: Sure. Let me address the loss and damage very quickly, Aditya. I think in quarter 3, there is a 12 crore write-off that we have taken. It's a conservative provision that we have made in quarter 3 for one of our customers who is not in the transportation segment. So it doesn't affect the PTL and the express businesses in any way. This is a conservative provision that we have made for one of our customers in the supply chain services business. We're moderately confident actually that we will be able to reverse this provision. But in the interest of being conservative, we've made that in quarter 3.

Going forward, claims are ultimately linked to underlying quality of service, whether it is short deliveries, whether it is damages or service quality-related claims that customers may place. Usually, their claims are a lagging financial metric. So when service quality improves in any given quarter, the reduction in claims is seen typically about three months down the line.

I think I'm pretty comfortable. And Amit and I -- with our CFO and I were discussing this earlier -- I think we're pretty comfortable with the fact that claims will revert to their FY22 levels or below, with the improvement in service levels that we have seen. We already have some early indicators to show that claims are reducing across the entire network. We will, of course, continue to follow a conservative policy of provisioning, which is what we have done in quarter 3 this year. So hopefully that answers the question claims.

What is the other question? I'm sorry, your other question was service quality, yeah. On service quality…

Aditya: Essentially, one would have thought that probably there will be one quarter of problem. And then once you already come back to better than previous quarter levels and I think that was your comments in 2Q. In 3Q, there won't be any surprises. But if I take away the Jan data point and think about October and November, you were still falling below the pre-SpotOn service levels. The question basically is, you're seeing improvement in Jan and Feb. Should we be extrapolating that improvement in volumes or can service levels again kind of be volatile from there?

Sahil: Sure. I don't expect service levels to be volatile unless, of course, we happen to be in a season where there is snow and where there is rain. We are in an operational business. I think the one thing that you should absolutely weigh very carefully is that, Delhivery does not alter its service levels. One of the practices in the logistics industry, of course, is to change the expected date of delivery and to demonstrate a higher service level in response to network events. Our service level is on a constant base. And so in the event that there are weather-related or political disruptions that affect our ability to deliver, we still report service failure as service failure on the original promise that we have with customers.

As I've mentioned, in September end when we saw rain in Tauru, there were obviously consequent delays throughout North India which affected service levels in October. Even one week of service levels being affected in an entire month has the ability to drag the average for the month and the average for the quarter down. In an operations business, Aditya, service is only as good as whatever you did last week or last month. And none of our customers cares about what service level we offered to them in September or October as long as we're doing well beyond.

And so I think the recent history of the last 3.5 months or so is quite important to look at. There are structural changes that we have made. A couple of the important structural changes that we have made are, of course, to bolster the infrastructure across our key hubs as these hubs have gotten consolidated. There is a significant improvement in service quality as you consolidate locations. That's number one.

The larger tractor-trailers also improve service level with time. The reason is that, because we have more fixed capacity versus ad-hoc capacity, typically, we would buy, pre-tractor-trailer, anywhere from 15% to 20% of our trucking requirements in the spot market. Today, we see that having come down to between 9 and 11%. Now, spot market trucks run at significant delays compared to our own network, for obvious reasons. As that comes down, we see service quality improve. And so we should expect that to continue.

Apart from which, our technology systems and our monitoring have been significantly upgraded in the last four months. To give you one example, in the express space, for instance, we have seen misrouting of parcels reduced by nearly 40% with a new data science tool that we launched in the later part of last quarter.

That said, on a service quality basis, Aditya, whether it's Delhivery or any other logistics network in the country, I can assure you that absolutely nobody can give you a picture of exactly what their service quality will look like on a consistent basis in any given month. It depends on the weather. It depends -- yesterday the Prime Minister was in Bombay. That would certainly have affected service levels in Bombay yesterday. So there are events that affect service quality. Our ability to deal with one-time events, whether they are weather, whether they are any other form of disruptions, I think is significantly improved compared to where we were last year.

Aditya: Got that. The second question that I had was, Sahil, to you. It is actually -- so if one of the captives who are there in the market want to basically potentially replicate Delhivery. Okay? Now, if you were to be putting the hat of a consultant and kind of guiding them on steps and timelines to become a Delhivery, and just -- and then I'm just talking about express parcel to start with kind of putting that PTL machine part on top -- what would be your advice to them here?

Sahil: I mean, may I begin on a lighter note simply by saying that imitation is the sincerest form of flattery. And so if there are captives who would insist on becoming Delhivery, I think that speaks -- we are quite proud of that fact and quite happy to hear that's the case.

My advice to captives trying to become Delhivery is one word, which is don't. It's not possible. There is a reason that captives cannot approach the efficiencies that third-party logistics companies have. They are subject to internal volatilities. They are subject to internal processes. They're ultimately, apart from everything else culturally, have never been run as profit centers. There are multiple reasons that are well understood across multiple industries as to why captives cannot be externalized easily.

If you happen to be a captive for a large marketplace and 85% or 90% of your volume comes from the marketplace, it's worth asking whether you're building capacity for average or for peak. If you build capacity for peak, you're never going to make money. If you build capacity for averages, when you have the peak, whose volumes are you going to jettison? So the entire idea of a captive player somehow magically turning into a highly profitable and efficient third-party logistics partner, frankly, is ludicrous.

The second question is that, if you look at the business model between Delhivery and the captives, while we may appear to be doing the same thing in the sense that we move boxes, nothing could be further from the truth. Unless a captive logistics player for a marketplace suddenly decides that it is their business to deliver automotive spare parts from an automotive manufacturing company to its dealers -- which is a completely inexplicable shift and strategy -- they are never going to be able to achieve either the service quality, the scale or the efficiencies that Delhivery is able to achieve.

So the entire idea behind the captives externalizing fully and taking on not just Delhivery -- here I've said multiple times, I don't speak just for ourselves, I speak for the entire industry, whether it's Blue Dart, us, Ecom Express, Safexpress, whoever it is -- our threats come from our own ability to service our customers and not from a misguided attempt from a marketplace to become a third-party logistics company.

Aditya: Now, there is a the third question that I have on the chat box. Do I have to speak that out or whichever way you say?

Sahil: I'm afraid I've lost it, so you might as well.

Aditya: No, I have a limitation of two, that's all, I can speak it out, that's fine. See the question relates to your line-haul expenses, okay. They appear to be down as a proportion of sales, probably even Y-o-Y. And the truckload revenues have only gone up, which should have been better that 2 with this happening. I'm just trying to kind of understand what exactly is happening over here that is leading to an improvement. Is there a fixed cost element of this and the benefits that are happening, at least on a Q-on-Q basis? And is the pieces of tractor-trailers and tonnage share been growing over there so significant?

Amit: So I'll take this question, Aditya. One part is related to business mix, where you can see that in cross-border business, there has been a decline from 96 crores of revenue, 66 crores of revenue. This business has a significantly high proportion of line-haul cost as a percentage of revenue. That has led to reduction. That's one part.

The important part is that, for about 58 crores higher revenue that we have generated, in 59 crores higher revenue we have generated in our express parcel and PTL business put together combined in quarter 3 versus quarter 2, not meaningful incremental line-haul cost was incurred for this revenue. Now that is getting driven from improved utilization of trucks and a higher portion of tractor-trailers in the network.

Vijit: Thank you. We'll take the next question from Alok Deora. Alok, please go ahead.

Alok: Hi. Am I audible?

Sahil: Yes, Alok. Please go ahead.

Alok: Thanks for the opportunity. So just had two questions. So one is, if you could also indicate how or what's your growth outlook in the part truckload segment for FY24? So I think you mentioned about 15 to 20% that's for the e-commerce side. Any view on the PTL segment, what we are targeting or for the industry what we are looking at?

Sahil: Sure, Alok. On the PTL side, in general, what we have seen so far is that, the market grows anywhere between about 10 and 12% a year. Now there are two broad shifts that are happening, though, in the PTL space that are worth noting. One of them is that there is a very significant shift that is happening away from unorganized players towards organized players. Organized players have historically been a very small minority of the total market. As I've mentioned, the top 10 players will form less than 20% of the market.

By way of comparison, in the United States the top 10 players will form 70% of the market. So I think that's one big shift that is positive for all organized players, not just for Delhivery.

And the second is that, there has been a shift from non-express part truckload to express part truckload. As the quality of roads has improved; as the average form factor of trucking has improved; as people have invested in Grade A infrastructure and automation, again, not just Delhivery, multiple players in this space, there has been a shift from non-express to express.

And once again, what that means is that, organized large-scale players who have the ability to invest and build capacity will continue to gain share. And so in some senses, for all of us, again, not just Delhivery, whether it's Delhivery or VRL or TCI or Safexpress, whoever it is, for all of us, the headroom for growth is massive. We are not limited by growth in the market.

On the e-commerce and express side, obviously, growth in the market is one of the factors that influences our ability to grow. But on the PTL side, I think we are limited only by our ability to build capacity, maintain service quality and cost, and obviously, our business development capabilities. So I think our outlook for growth in PTL is very positive. We've seen a pretty significant movement. If you look at it even from November to February, so far, we've seen growth in volumes, which is north of 30% and industry growth is nowhere near 30% in this four-month period.

So I think not just Delhivery, multiple players in this space ultimately have the opportunity to go and grow significantly faster than industry and gain share. We are gaining share at the expense of the unorganized market. And I think that trend will continue, not just next year, but will continue into the midterm.

Alok: Sure. Thanks for the elaborate answer. And also on the express, you mentioned that during one of the questions that you in express, you are looking at a 15% to 20% growth for the industry. But express is not really all the criteria which would kind of lead to the operational efficiency, changing the operational efficiency. So even if the growth was much lower than what it is then 5 to 10%, then also it would not impact. Could you just elaborate a little more on that? Because I'm sure we would not be expecting a single-digit growth rate in that segment, right?

Sahil: We don't expect it, obviously, but Alok, but the reality is that ultimately, in the e-commerce marketplace any given quarter anything could happen. Our expectation is that the underlying market conservatively will support a 15 to 20% growth. Our numbers in terms of new customers coming into the market, new categories seems to suggest that.

That said, what I meant was, when I was talking about our economics is, when you look at our business as a whole, because we run an integrated mid-mile between express and part truckload, that is the one that is most sensitive to utilization. On the express business, outside of the mid-mile, which it shares with the PTL business, on the first mile, as well as at the last mile, our capacity utilizations are significantly higher; and we have developed the ability over the years to maintain and run those at consistently high capacity utilizations.

And so a decline in volumes is not necessarily going to immediately translate into a drop in our -- or a reduction in our cost-per-shipment because we will adjust capacities accordingly. It's also variable. The mid-mile is where the bulk of the cost obviously sits. And if express volume drops, it doesn't cause a major change in utilization of the trucks.

Let me give you an example. The average weight of an express parcel is approximately, let's call it, I don't know, in any given month, it's probably somewhere between 800 grams and a kilogram. Now, if you deliver 170 million

shipments in a given quarter, you're talking about 170,000 tons of freight. By comparison, even in our lowest quarter, which was quarter 3, our total PTL tonnage was 258,000 tons of freight. So it is already about in a ratio of 60:40.

And as the PTL business grows, the relative share that the PTL business has in mid-mile will be larger. And so even if express volumes drop, our utilization of the mid-mile will not drop. And so, in that sense, the express unit economics are impervious to changes in express volumes. We have variablized the first and the last mile. And at the mid-mile, we have the ability to absorb the decline in volumes. By the way, to all of the questions that were asked earlier, that is also the fundamental difference between an integrated network and a stand-alone network.

Vijit: Thanks, Sahil. Once again I'll just remind participants to limit themselves to just two questions. We'll take the next question from Shri. Please go ahead. We can't hear you, Shri. Can you please unmute yourself?

Sahil: I can actually read out Mr. Shri's question. The first one is, again, on captive e-commerce logistics companies, what will be the impact on our share? I think I've already answered that question. And I think there's a specific question he's asked about B2C customers and long-tail customers.

Again, I'll just point out that for a captive logistics company, which is used to servicing large fulfillment centers and warehouses, it will be interesting to see how they manage to service a small long-tail customer who wants to ship one parcel in a week. And again, on behalf of not just Delhivery but the entire third-party logistics industry, I can assure you that this is a harder problem than it sounds, looks better on Excel than it does in real life.

Question two is on slide #12 of presentation. What is the vehicle rental cost? Amit, would you like to comment on this?

Amit: So the vehicle rental cost is a combination of intra-city vehicle that is hired to either pick up goods from customer doorstep or to deliver goods to the consignee; and to deliver goods to the consignee and for movement of goods between the various facilities of Delhivery; plus it also includes payments to agents and vendors who do deliveries for us on a per-parcel basis.

This expense should typically be looked in combination with the line-haul expense to calculate the total fleet expenses for us, primarily because some change in network design or mix of shipments, whether being picked from the interiors of cities versus the outskirts of cities could have an impact on where the proportion of cost is lying in.

Vijit: Thank you. We'll take the next question from Sachin Dixit. Sachin, please go ahead.

Sachin: Hi. Congratulations on a decent set of results. I have the first question on the lines of the improvement in adjusted EBITDA? So of the 58 CR gross profit that we are seeing, almost 29 CR seems to have come in from improvement in, say, realization from customers or from cost optimization. I wanted to understand how sustainable is it? Like can this realization upward move or cost optimization continue quarter-over-quarter over the next fiscal year?

Sahil: So there are two factors here. One of them is just underlying -- of the 58 crores, as you pointed out, 29 crores is from just basic operating leverage, which is greater utilization and greater productivity of our staff. I think as I mentioned, we still have spare capacity in a number of locations. And as volumes continue to go up, I think that increase in utilization is natural and should continue.

Now obviously, all locations across the network are not at exactly the same capacity utilization. And so some locations we may have to expand some capacity. But broadly, the incremental gross margin trend we expect through this quarter -- and we have no reason to believe into the next quarter -- it will not reverse. Eventually, as capacity utilization across the entire network sort of gets to 80, 85% kind of levels, our overall incremental gross margin will converge to the business' natural gross margin, which will be close to the 26 to 30% kind of range. But we expect that to continue.

On the cost optimization, I think you asked an important question. We have seen about 29 crore of improvement in the last quarter, come even from cost optimization measures. This has included two or three things. One of them actually has been prevention of revenue leakage, which comes from weights. Logistics companies all over the planet have this issue. We are increasingly directing a larger and larger percentage of our consignments through automated weighing machines.

One of the advantages that we have because we do dynamic routing is, we have the ability to route consignments through weight-capturing locations. And so that has also had an impact on our yield. We are more accurately capturing yield. We are also more accurately capturing shipment densities.

Another piece that I think will continue into the next financial year on cost optimization is, we continue to get better at filling our trucks. The axle of every truck has a payload capacity which is what we are trying to optimize apart from just the volumetric capacity of the container, which is a unique advantage that we have as an integrated network. I think we will continue to deploy our algorithms and our technology on truck filling. And as we get better, there will be some natural improvement that comes through that as well.

And finally, there's obviously an element of engineering and design. As an example, in Bombay, as we consolidate multiple transportation facilities, whether it's our sortation center or our hub or our service centers or our return processing centers into a single large facility -- as an example, at Welspun one -- we will see improvement in economics for that facility as well. So cost optimization measures in an operational business are -- I gave you an all answer, but they are sort of never-ending for us.

Sachin: And on the realization piece?

Sahil: On the realization piece, I think what's important to understand is that we will not, we are not in the business of increasing prices. We have the cost structure that allows us to pass on efficiency gains to customers while maintaining extremely healthy gross margins at a business line level and at a client level. So we will not push up realizations because we have no need to. We will, in fact, use that to bolster our competitive position and to make sure that we maintain or grow market share.

Sachin: Understood. And quickly, on the second question, can you explain the seasonality that you talked about in supply chain services, how should we think of it? I mean, last year same quarter, we did not see a similar sort of seasonality happening.

Sahil: Yeah, sure, happy to. In different businesses that are our clients in this business, we see a certain amount of seasonality. As an example, one of our large customers is a consumer durables company. Now, we would expect the consumer durables company to see significant outflow in this quarter and quarter 1 as opposed to quarter 2 and quarter 3. So there's a natural seasonality then.

The second thing that's also, that I should point out in the supply chain services, business is that it also depends on the stage of every customer. Last year you saw growth because our pace of acquisition on a smaller base was larger. And so even though seasonality existed, given the fact that we were coming off of a smaller base, it looked like the seasonality didn't exist. Whereas in this year, overall client starts are still happening, we will still continue to see new client warehouses coming in, in quarter 4 and quarter 1 and so on.

And so to some extent, in any given pair of quarters, that seasonality is kind of not easy to read into. The way I would put it is this, it depends on customer mix. Individual customers, depending on which business we are in, have their seasonality. Our businesses overall seasonality depends on the mix of customers that we have.

Sachin: Got it. One final question, if I can squeeze in?

Vijit: Sorry, can you please jump back into the queue, Sachin?

Sachin: Sure. Okay.

Vijit: Thank you. We'll take the next question from Vikram Kotak. Thank you. Vikram, can you please go ahead? Okay. So we'll just -- in the interest of time, we'll just read out some questions on the chat.

The next question I can see on the chat, which was not answered is,. ESOP expense, can you share how it will fare in future, a road map? And I'll just combine a couple of questions. Why has PTL tonnage declined Q-o-Q? This, you've already answered, I suppose? And then the next question is, what will be the impact of Shopee in Q4? So ESOP expense, can you share how it will fare in future, a road map? And then the second question will be what will be the impact of Shopee in Q4?

Sahil: I think I can answer the second one very quickly, which is Shopee has ceased to exist in the Indian market. And so they will have zero impact on our Q4, because they're not there, overall. I think when you adjust for Shopee volumes from last year's Q4, versus this year's Q4, you will see growth in our volumes year-on-year. Amit, you may want to answer the ESOP question.

Amit: Yes. So there is a detail that has been added in the presentation that was uploaded, which shows what our granted and granted stock options are and out of which how much invested, which basically means has been costed for in the P&L and what is not. Corresponding to these grants, there is a cost schedule as well that has been given where the expected cost of time-based stock options that have been granted will cost about 143 crores in FY24.

And corresponding to the performance-based stock options, which are linked to company achieving a stock price of 800 rupees a share, 1,000 rupees a share and 1,200 rupees a share in about six to eight years timeframe from listing has a 94 crores of cost corresponding to it. This is the total cost corresponding to the -- of 477 crores and 204 crores for time-based options and performance-based options, based on the grants done so far.

The right-hand table also lays down the schedule of costing that is done based on accounting principles, where year one has about 42.5% of costing in that year one. You can see nearly 75% that's accounted for in the first two years for stock option grants.

Vijit: Great. Thanks, Amit. The next question I'll read out from the chat. It's from Mukesh Saraf. On the margin improvement in 3Q, would it be fair to assume that a good portion of that would have come from the PTL business? The reason is that,

I see the number of freight service centers come off to 150. Is the overlap that SpotOn and Delhivery had in its system now entirely out of the system?

Amit: So the freight service centers and the fixed infrastructure cost improvement was called out in one of our slides at about 3 crore apiece. If you look at it, where we had explained the walk from -125 crore in quarter 2 to -67 crore in quarter 3. So total reduction in network optimization is 3 crore. The remaining bit of it is 58 crore improvement is coming in from the operating leverage in the business and additional efforts being undertaken on improving the profitability of the business.

Vijit: Thanks, Amit. The next question is, any thoughts on the management on a potential buyback, given the return to cash profitability again this quarter, large cash balance and stock price significantly below IPO price? I also saw a question related to that, if you can comment on Q-o-Q cash and cash equivalents.

Sahil: So I can take that, Amit. On Q-o-Q cash balance, our cash -- as I had mentioned, our cash PAT actually was positive this quarter. Overall, apart from that, we've continued to have over 5,000 crores of cash on the balance sheet. So we are adequately capitalized.

On the buyback, I don't think it would be appropriate for us to comment on any such sort of moves on this call. And at this point in time, I think we have a massive growth opportunity ahead of us. Our service quality has remained consistent. Our costs have been in line. We continue to improve profitability. We continue to gain market share. I think investors should be looking at us to deliver growth and profitability going forward.

Vijit: Thanks, Sahil. The next question is, what is the pricing differential between you and the next best competitor in PTL? I guess you can answer that on a like-to-like basis.

Sahil: It's hard, again, because it depends on every single account and what our strategic objectives for each of those accounts are. What I can tell you is that we do not offer a discounted pricing compared to anybody else in the market of any size in the PTL space. I think PTL pricing is something that is well understood and has persisted in the market for a period of time.

Our objective, as I had mentioned, will remain the same. We will continue to establish cost leadership in the PTL space as well. We believe that an integrated network and a network at our scale will be significantly more efficient than a network of any other size. Most PTL networks in the country are significantly smaller than ours, especially when you add our SCS volumes and our express volumes as well. That allows us to be more efficient.

Now whether we will, whether that will ultimately manifest as higher gross margins because we will maintain market prices, or pass some efficiency gains on to specific customers will depend on our relationship with those customers.

Vijit: Thanks. The next question is rental expense as a percentage of revenue has increased from 2 to 4%, despite number of gateways and total infra going down? What explains this?

Amit: I'll take this, Vijit. So the rent expense should be looked in conjunction with what is expensed plus what is amortized under Ind AS 116. If you add the cash payout or the rent paid out against the capitalized leases to the rent as well, then the total rent for the quarter has increased on a year-on-year basis from 118 crores rupees about 134 crores rupees.

Out of this, primarily the rent is getting increased on two counts. One is an annual inflation in rent, which typically ranges between 6 and 9% for our facilities. And the remaining bit is about expansion of offices that were undertaken in the early part of the previous calendar year, because of expansion in teams. But as Sahil has called out, there is no expansion of management cost and hence, do not see any expansion of overheads related to offices either.

Vijit: Thanks, Amit. The next question is, you mentioned Jan/Feb — this is from Lavina Quadros. You mentioned Jan/Feb you gained market share in express parcel. On 3Q, did we gain share?

Sahil: I think our share in quarter 3 towards the end would have increased, but we would broadly have remained constant prior to that. Post the end of, towards the end of Q3, as the service improvements and network speed have become more apparent, and as we have had strategic discussions with a number of customers, I think it's quite evident that we have gained share.

Vijit: Thank you. The next question is from Mr. Pugazh Manohar. I hope I spell your name right, pronouncing your name right? Sorry, can you go ahead, please? I see you have also raised your hand. Pugazh, please go ahead.

Pugazh: So Sahil, yeah, is it audible?

Sahil: Yes. Please go ahead.

Pugazh: Sahil, like just on the margin side, just like I'm a retail investor, so this EBITDA margin, like say five years down the line or like where do we see this EBITDA margin percentage? Or are we anytime closer to any of the competitors, say, like 15%, 20% EBITDA margin? Is there anything that the team is thinking on? In

which financial 5 years, 10, whatever the numbers, what are the number of years, you have any road map or anything that we can think through?

Sahil: Certainly, Mr. Manohar. I think from our standpoint, as we mentioned, if you look at the margins and compared to our competitors, the two businesses that obviously are the most comparable are the express parcel business and the PTL business. On the express parcel business, at the service level, we have always enjoyed margins which are supernormal compared to our competitors as well. It's a business where the money that we generate is used to finance the growth of the other businesses, which are critical to our overall strategy.

And this has happened while we have continued to compress rates, and we have continued to do that in response to improving operational efficiency in our business. So I think there, we are pretty well set overall.

On the LTL side, I think as volumes continue to grow, margins in that business will keep improving. As I had mentioned, the gross margins in the LTL business should look like 25 to 30% sort of range. And then depending on our operational efficiency and operating leverage, which depends on engineering and technology ultimately, we should see EBITDA margins in the range of 16 to 20%.

In our estimation, we expect that we should start seeing gross margins in the range that we expect probably sometime towards the end of the next financial year or early part of the financial year subsequent. But that said, this is highly dependent on sort of volume and mix of volume. But there's nothing structurally in our business that prevents us from achieving those.

The second thing I should point out is given the sensitivity of the PTL business to mid-mile costs, and specifically in mid-mile costs to trucking, since we run a highly-efficient fleet of trucks, which is the 46-foot tractor-trailer truck and our ability to actually fill those trucks up to their maximum axle load limit, there is an opportunity for us to gain supernormal margins even by sheer design of our trucking. That's something that we are seeing positive movement on.

So if you look at our line-haul costs, they actually have significantly reduced and our per-unit costs actually are at target levels that we had designed actually for slightly higher tonnages. So I don't think it will take us five years. I can't comment on exactly when we will get to those target margins. But I don't think that it will take us five years to get there.

Pugazh: Thank you, sir. All the best.

Sahil: Thank you very much.

Vijit: Thank you. I'll just read out a couple more questions on the chat from Abhisek Banerjee. Number one is, can we share a market share number for Q4FY23 3PL express parcel?

Sahil: Well, Abhisek, we cannot because this is not something where there is a Nielsen or somebody who is doing this. That said, we are the market leader in this space. And obviously, we have a daily relationship with tens of thousands of shippers across the country and a pretty good sense of what is moving out of their warehouses. And I think we're very confident with where we are from a market share standpoint and very confident that we've gained share in this quarter.

Vijit: Right. The next question is, given the new expressways nearing completion, are your efficiencies from using 40-foot tractor-trailers not increasing further? Can you share your experience using the Shirdi-Nagpur expressway?

Sahil: Yes. Absolutely correct. As highway infrastructure has improved, yes, we do see improvement in service time and therefore, improvement in utilization of our vehicles. There are obviously a whole bunch of other externalities which also go away. As an example, wear and tear and damage of the trucks reduces as the quality of expressways increases. So it's a very good question. Yes, we have seen improvement in efficiencies.

I can't comment exactly on Shirdi-Nagpur because that's a fragment of one of the expressways that we will be operating on. But I can tell you that across the last two years, as expressway quality has improved, as even general highway quality has improved, we have seen an improvement in service times. We've seen an improvement in service speed and an improvement in linehaul costs.

Amit: Yes. I'll just add a data point, this is a very important question to our overall strategy. Roughly in about 2015 or '16, I think the average truck for Delhivery would have operated about 10,000 to 12,000 kilometers in a month, which increased to about 17,000 to 18,000 kilometers in 2019, 2020. And today, many of our trucks, if not all, are clocking well above 20,000 to 23,000 kilometers per month.

Vijit: Thanks, Amit. We are almost on time. So maybe we'll just -- if you guys don't mind taking a couple of questions from me, and then we'll close it out.

Sahil: Sure. Please go ahead, Vijit.

Vijit: Thanks. My first question is, just looking at that weekly table that you provided on PTL volumes, if I just look at the February number, just multiply that by 52 weeks, it seems like you're back to 90% of pre-integration volumes there. I'm just wondering if there is some seasonality to be mindful of in that number. And if you

can clarify whether on an account basis, are you pretty much close to 100% pre-integration wallet share, given you did let go of some customers here?

Sahil: Sure. The PTL business, Vijit, does not see seasonality in February. Typically, there is an annual seasonality where March, obviously, is the big month because it's year end and quarter end, but there's also an intra-quarter seasonality. So there's an intra-month seasonality where the end of the month is significantly larger than the first two weeks of the month. There's an intra-quarter seasonality where the end of the quarter is larger than the averages for the previous months. And then there is, obviously, an intra-year seasonality, which is the end of the year and the end of the quarter.

So February first week meets none of those criteria. It is not the end of a month. It's not the end of a quarter, it's not the end of a financial year. And so, that isn't seasonality that you're seeing. I think what you're seeing is the consequence of consistently delivered high-quality service over the last several months.

We've spoken about this multiple times. When we integrated SpotOn in quarter 1, of course, it was a challenging period for the company. We had to go back and assure customers that service quality would be maintained. And fortunately, the changes that we've made, which are very real specific changes in operations, infrastructure upgrades, training, more technology and automation in our hubs has led to service levels which are beyond what they were receiving even prior to the integration. And so they rewarded us in that regard with a higher share of wallet and more loads.

And I think one of the questions that was always asked is, would we have to discount to get these customers back? I think the good news -- and we've consistently maintained this -- is that customers react to service, and that's what we're seeing here.

Vijit: Got it. Thanks, Sahil. Sahil, my last question is, this acquisition that you talked about of Algorhythm Tech to build out some more capabilities in the supply chain services business, if you can talk a little bit about the choice between building out these capabilities versus acquiring this company? And how are you looking at M&A in the near future going forward? Specifically, also within PTL, any acquisitions of smaller or regional players still on the table or not in the foreseeable future?

Sahil: Sure. On Algorhythm, very narrowly this was an acquihire situation. What we were particularly interested in was the product capability. It added very well on top of our warehouse management system. Because a number of our enterprise customers, not just want us to run warehouses, would also want us to help them optimize

inventory placement and optimize transport selection. And this is a product that enables supply chain planning.

Every acquisition that we make, every single one on the tech side, specifically, the first thing that we weigh off is, what is the cost if we were to do it ourselves, and not just what is the speed to market and so on. And so, very simply put, let me put it this way, our cost to do this ourselves would have been higher than the price that we paid to make the acquisition. None of our tech acquisitions are very large ticket acquisitions in any case. The other thing, obviously, is that, unless it's a special situation like Falcon, where we have a strategic stake, we typically tend to do a complete buyout. That remains sort of our broad M&A strategy.

In terms of the PTL business, in terms of acquisition in general, I think we've been clear. The Indian market is rapidly changing. There's a huge change from unorganized players to organized players. And as that happens, there is an opportunity for us to consolidate the market under us.

And when you think about it, one of the reasons why consolidation has not happened in India so far is that small companies cannot make large acquisitions. You have to be a large player making acquisitions to make it meaningful. We are that large player in the market. We have been, we are, and we will continue to be the natural consolidator in this space.

Our consolidation, though, is driven by very simple factors. One is, is there a geographic or a customer sort of capability that we want to acquire? So as an example, networks, in specific regions that are complementary to us, of course, we will look at those. Networks which operate in specific industries where we want to gain share, of course, we will look at those as well. We, however, are not interested in networks that overlap exactly with ours. We're not interested in paying for revenue because we believe with our service quality and our cost structure, we have the ability to get revenue in any case.

So we will look at acquisitions. Or let me put it this way, I don't think in the logistics space, there are any acquisitions that will happen that will not first pass through or at some point, pass through our team.

Vijit: Got it. Thanks, Sahil. We are almost on time. So we close this call for now. Thank you to the team at Delhivery for taking the time out and doing this call on behalf of the rest of us. Thank you so much.

Sahil: Thank you all. Thank you for joining.

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