

China / Hong Kong Company Update

Kerry Logistics Network

Bloomberg: 636 HK Equity | Reuters: 0636.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

31 Aug 2022

BUY

Last Traded Price (30 Aug 2022): HK\$16.54 (HSI : 19,949)
Price Target 12-mth: HK\$19.80 (20% upside) (Prev HK\$21.90)

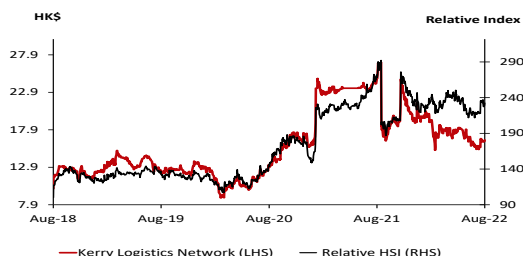
Analyst

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What's New

- Excluding discontinued operations, 1H22 core net profit jumped 96%, exceeding our estimate by 26%
- Contribution from international freight forwarding more than doubled in 1H22
- Narrowing losses from Kerry Express Thailand in 2Q22
- Maintain BUY with HK\$19.80 TP

Price Relative



Forecasts and Valuation

FY Dec (HK\$m)	2020A	2021A	2022F	2023F
Turnover	53,361	81,771	88,873	73,778
EBITDA	5,469	8,490	8,402	7,675
Pre-tax Profit	4,240	10,391	5,885	4,735
Core Net Profit	1,828	3,692	3,636	3,089
Core Net Profit Gth (%)	33.1	101.9	(1.5)	(15.1)
EPS (HK\$)	1.03	2.05	2.01	1.71
EPS Gth (%)	28.3	98.8	(1.7)	(15.1)
PE (X)	16.1	8.1	8.2	9.7
P/Cash Flow (X)	5.8	4.5	5.0	3.9
EV/EBITDA (X)	5.6	3.6	3.7	4.0
DPS (HK\$)	0.49*	7.99*	0.61	0.61
Div Yield (%)	2.9	48.3	3.7	3.7
Net Gearing (%)	3	CASH	5	9
ROE (%)	7.2	15.2	17.4	14.2

Earnings Rev (%): 4 (7)
Consensus EPS (HK\$): 1.91 1.69
Other Broker Recs: B:7 S:0 H:4

*Include special DPS of HK\$0.14 and HK\$7.28 for FY20 and FY21 respectively

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Navigating challenges.

Investment Thesis

BUY with HK\$19.80 TP. The stock is trading at a PE of 8.2x and 9.7x for FY22 and FY23 respectively, against its five-year average of 13.0x. While softening freight rates would weigh on the company's near-term profitability, synergies with S.F. Holding should add to its long-term growth outlook.

Freight rate softening on weaker global demand. Macro uncertainties led by surging energy prices, rising interest rates and higher inflation have resulted in softening global demand. This should exert pressure on freight rates which have started to normalize, and affect the profitability of Kerry Logistics Networks' (KLN) international freight forwarding operations.

Well placed to deliver long-term growth. KLN has been consolidating its position in international freight forwarding via acquisitions such as Topocean. Synergies with S.F. Holding is also coming through. This should help to offset the earnings shortfall led by freight rate normalization and propel the company's long-term growth.

Valuation:

Our TP is based on 11.6x FY23F PE, 0.5 SD below its average PE over the past five years.

Where we differ:

We are more positive on the company's long-term growth supported by its integration with S.F. Holding, and stronger network coverage for international freight forwarding business.

Key Risks to Our View:

Delayed retail market recovery and recurring pandemic lockdowns in China would drag the integrated logistics business in Hong Kong. Failure to execute on the M&A strategy and weaker-than-expected synergies with S.F. Holding would undermine growth prospects. Freight rate volatility could lead to lower earnings visibility.

At A Glance

Issued Capital (m shrs)	1,807
Mkt Cap (HKm/US\$m)	29,526 / 3,763
Major Shareholders (%)	
S.F. Holding Co. Ltd.	51.5
Kerry Properties Ltd	20.8
Kerry Group Ltd.	12.0
Free Float (%)	15.6
3m Avg. Daily Val. (US\$m)	1.35
GICS Industry: Industrials / Transportation	



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Kerry Logistics Network

WHAT'S NEW

Boosted by international freight forwarding operations

Excluding discontinued operations and net fair value changes on investment properties, Kerry Logistics' 1H22 core net profit surged 96% to HK\$2.37bn mainly boosted by substantially higher contributions from international freight forwarding. The result was 26% above our estimate mainly due to stronger-than-expected profit contribution from integrated logistics and international freight forwarding, and gains on stake disposal of Asia Airfreight Terminal. Interim DPS grew 33% to HK\$0.28.

Core operating profit was 37% higher at HK\$3.46bn thanks to significantly improved earnings from international freight forwarding. Excluding the shortfall from the Taiwan business and the Hong Kong warehouse that were sold in 2H21, segment profits from continuing operations would have grown by 74% despite the earnings drag from e-commerce & express business.

Operating profit from international freight forwarding more than doubled to HK\$3.4bn, with substantial growth from the Americas region. Thanks to high freight rates and the acquisition of Topocean in Apr-22, profit contribution from Americas more than tripled to HK\$1.61bn, accounting for 47% of the total profit from international freight forwarding. Meanwhile, despite the lingering pandemic situation, profit from China and Asia rose by 61% and 129% respectively. Overall gross profit margin improved 3ppts to 7.4% (1H21: 4.4%).

Despite weaker performance from China, profit from integrated logistics increased 28% to HK\$717m aided by higher contributions from Hong Kong. Driven by the additional pandemic-related contracts from the government, the Hong Kong segment, representing c.55% of the total integrated logistics segment profit, registered 88% growth to HK\$393m, with margin advancing by 8.3ppts to 17.4% in 1H22 from 1H21's 11.1%. On the other hand, profit contribution from China fell 11% to HK\$159m due to disruptions amid pandemic-led lockdowns.

In 1H22, the e-commerce & express segment recorded an operating loss of HK\$393m, compared to a profit of HK\$209m in 1H21. This was mainly due to the aggressive pricing approach in response to the intense price competition faced by Kerry Express Thailand (KET). Despite a loss, the company has continued to gain market share with delivery volume growing by 35.7% in 1H22. Market competition has exhibited signs of easing and losses from KET has gradually narrowed since May-22. As such, the

segment is expected to reach close to breakeven by the end of 2022.

Due to the acquisition of Topocean and K-Apex, the company turned into a net debt position of HK\$1.6bn in Jun-22 from Dec-21's HK\$3bn net cash. This represents 8.8% of the shareholders' fund. The company remains financially sound to pursue accretive acquisitions when the opportunity arises.

Soaring energy prices and growing inflation would inevitably dampen the global economic growth, thus lowering global demand. This should exert pressure on freight rates which has been normalising since mid-22.

While the near-term outlook of international freight forwarding becomes more challenging, KLN has expanded its global coverage through M&As. Following the acquisition of Topocean, KLN has grown to be No.1 NVOCC in transpacific trades. This enables KLN to offer innovative and customized solutions to its clients amid supply chain disruptions.

Moreover, synergy from the integration with its parent S.F. Holding has been coming through and should be growing over time. KLN is now the international arm of S.F. Holding. As the principal service provider outside Mainland China for S.F. Holding's international business, KLN should be able to secure new customers in Mainland China, China-based companies in particular. It also serves as the exclusive cargo General Sales Agent (GSA) for S.F. Airlines from May-22. The integration should expand KLN's scale and coverage. This should help to make up the earnings shortfall caused by the normalisation of freight rates and play a crucial role in driving the company's long-term growth.

Kerry Logistics is trading at 8.2x and 9.7x PE for FY22 and FY23, which compares favourably with its 5-year average of 13.0x. While softening freight rates should weigh on the company's near-term profitability, we remain positive on the company's long-term outlook. The acquisitions of Topocean and remaining stake in K-Apex should solidify its competitive edge in international freight forwarding business. Integration with its parent company, SF Holdings, should add spice to its earnings growth and consolidate its leading position among Asia logistics plays in the long run. Maintain BUY with TP of HK\$19.80, premised on 11.6x FY23F PE.

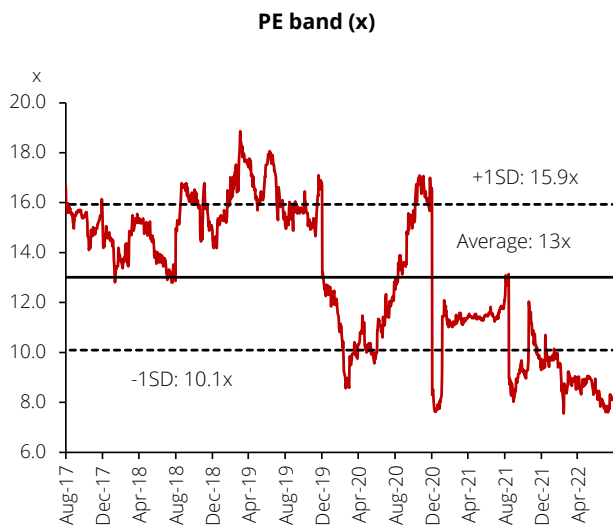
Kerry Logistics Network

Company Background

Kerry Logistics Network (KLN) is the largest international logistics company listed on Hong Kong Stock Exchange. Its business comprises two components namely integrated logistics, which involves a wide range of logistics and ancillary services primarily across Asia, and international freight forwarding, referring to air freight, ocean freight and cross-border road freight forwarding services across Asia and the globe. In 2021, S.F. Holding became the controlling shareholder of KLN. KLN is now become the international arm of S.F. Holding, serving as its principal service provider

for its business outside China and is the exclusive cargo General Sales Agent for S.F. Airlines. The recent acquisitions of Topocean and remaining stake in K-Apex has further consolidated its position in the IFF sector, being the largest non-vessel ocean common carrier (NVOCC) for the Asia to US trade lanes.

PE band



Source: Thomson Reuters, DBS HK

Kerry Logistics Network

Result Summary

FY Dec (HK\$m)	1H21	1H22	% Chg	Comments
Turnover	36,708.7	48,034.3	31	1H22: mainly led by the international freight forwarding segment
Integrated logistics	560.0	717.0	28	
International freight forwarding	1,416.0	3,398.3	140	1H22: Contribution from Greater China: 28%, ex-Greater China: 72%
E-Commerce & Express	209.3	(393.4)	n.a.	1H22: primarily caused by a price war in Thailand
Segmental profit before discontinued operations	2,185.3	3,721.9	70	
Discontinued operations	544.0	-	n.a.	1H21: from the Hong Kong Warehouses and Taiwan Operations sold in 2H21
Total segmental profit	2,729.3	3,721.9	36	
Unallocated administrative expenses	(193.8)	(260.7)	35	
Finance income	16.4	23.5	43	
Finance costs	(149.5)	(150.6)	1	
Associates & JV	81.4	92.5	14	
Gain on disposal of an associate	-	127.3	n.a.	
Profit before taxation	2,483.9	3,553.8	43	
Taxation	(478.1)	(864.2)	81	
Non controlling interest	(475.4)	(317.8)	(33)	
Core net profit	1,530.4	2,371.8	55	
Fair value change on investment properties	1,980.6	6.7	(100)	
Deferred tax on fair value change on investment	(2.6)	(1.7)	(35)	
Non-controlling interest of after-tax fair value change on investment properties	2.0	(0.0)	n.a.	
Impairment	(130.0)	-	n.a.	
Net profit	3,380.3	2,376.8	(30)	

Source: Kerry Logistics Network

Kerry Logistics Network

Segmental Breakdown (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (HK\$ m)					
Integrated Logistics and e-commerce & express	19,512	17,821	19,796	19,398	20,770
International freight forwarding	21,627	31,796	59,159	69,475	53,009
Discontinued operations	0	3,743	2,816	0	0
Total	41,139	53,361	81,771	88,873	73,778

Source: Company, DBS HK

Income Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Turnover	41,139	53,361	81,771	88,873	73,778
EBITDA	4,686	5,469	8,490	8,402	7,675
Depr / Amort	(1,921)	(2,149)	(2,261)	(2,487)	(2,736)
EBIT	2,765	3,320	6,229	5,915	4,939
Associates Inc	86	118	159	182	155
Interest (Exp)/Inc	(317)	(265)	(243)	(339)	(359)
Exceptionals	2,414	1,067	4,247	127	0
Pre-tax Profit	4,947	4,240	10,391	5,885	4,735
Tax	(605)	(771)	(1,365)	(1,530)	(1,231)
Non-controlling Interest	(554)	(574)	(1,087)	(719)	(415)
Net Profit	3,788	2,896	7,939	3,636	3,089
Core Net Profit	1,374	1,828	3,692	3,636	3,089
Sales Gth (%)	8	30	53	9	(17)
Net Profit Gth (%)	55	(24)	174	(54)	(15)
EBITDA Margins (%)	11	10	10	9	10
EBIT Margin (%)	7	6	8	7	7
Tax Rate (%)	12	18	13	26	26

Source: Company, DBS HK

Kerry Logistics Network

Balance Sheet (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Fixed Assets	21,652	23,196	9,466	10,867	11,060
Long-term Investments	343	365	593	593	593
Other LT Assets	3,986	4,766	4,348	4,348	4,348
Intangibles Assets	4,765	4,772	4,303	5,001	8,345
Deferred Tax Asset	74	98	156	156	156
Associates/JVs	1,387	1,971	2,281	2,408	2,408
Bank Balance/Cash & Liquid	5,846	8,485	9,096	10,066	6,164
ST Investments	469	470	817	817	817
Inventory	505	405	375	375	375
Debtors	10,154	12,362	16,663	19,663	17,663
Other Non Cash Current	25	10	64	64	64
Total Assets	49,204	56,900	48,162	54,359	51,995
ST Debt	2,182	4,163	3,848	3,848	3,848
Creditors	7,426	9,297	11,863	12,863	11,363
Other Current Liab	1,373	1,449	2,129	2,129	2,129
LT Debt	6,174	5,069	2,262	7,262	4,262
Deferred Tax Liabilities	656	744	406	406	406
Other LT Liabilities	4,319	3,698	2,817	2,817	2,817
Non-controlling Interests	4,061	4,997	3,793	4,293	4,442
Shareholder's Equity	23,013	27,483	21,044	20,741	22,727
Total Cap. & Liab.	49,204	56,900	48,162	54,359	51,995
Share Capital (m)	1,712	1,775	1,803	1,807	1,807
Net Cash/(Debt)	(2,509)	(747)	2,986	(1,044)	(1,946)
Working Capital	6,018	6,823	9,174	12,144	7,742
Net Gearing (%)	10	3	CASH	5	9

Source: Company, DBS HK

Cash Flow Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
EBIT	2,765	3,320	6,229	5,915	4,939
Tax Paid	(602)	(699)	(921)	(1,530)	(1,231)
Depr/Amort	1,921	2,149	2,261	2,487	2,736
Profit or loss on disposal of FAs/subsidiaries/investment	(2,115)	(59)	(2,197)	(127)	0
Chg in Wkg.Cap	(521)	(128)	(1,671)	(2,000)	500
Other Non-Cash	1,756	(256)	2,072	(273)	(450)
Operating CF	3,204	4,326	5,773	4,472	6,494
Net Capex	1,490	(1,285)	11,786	(3,889)	(2,929)
Investments	205	12	(1,173)	0	0
Associates & JVs	82	(544)	33	0	0
Associates' Dividends	76	170	99	182	155
Others	75	66	57	61	91
Investing CF	1,927	(1,581)	10,802	(3,646)	(2,683)
Net Chg in Debt	(1,412)	725	53	5,000	(3,000)
Non-controlling interests	27	1,487	(71)	(2,730)	(3,195)
New Capital	118	46	103	0	0
Dividend	(1,450)	(1,306)	(14,523)	(2,127)	(1,518)
Other Financing CF	(984)	(1,208)	(1,281)	0	0
Financing CF	(3,701)	(256)	(15,719)	144	(7,713)
Chg in Cash	1,430	2,489	856	970	(3,902)

Source: Company, DBS HK

Kerry Logistics Network

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	8-Jul-22	HK\$16.52	HK\$21.90	Buy
2:	13-Jul-22	HK\$16.76	HK\$21.90	Buy

Source: DBS HK

Analyst: Jeff Yau

Percy Leung

Kerry Logistics Network

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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