

China / Hong Kong Company Update

Kerry Logistics Network

Bloomberg: 636 HK Equity | Reuters: 0636.HK

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DBS Group Research . Equity

27 Jul 2023

BUY

Last Traded Price (26 Jul 2023): HK\$9.00 (HSI : 19,365)
Price Target 12-mth: HK\$10.50 (17% upside) (Prev HK\$15.12)

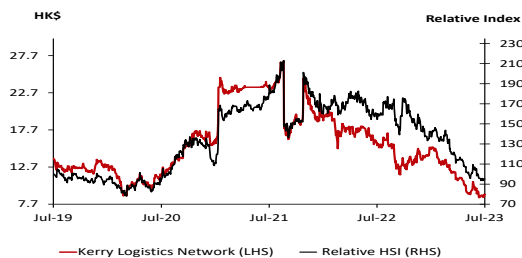
Analyst

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What's New

- IFF segment suffered from tumbling freight rates and weaker demand but the worst should be over
- Disposed some express service subsidiaries in Asia Pacific and Europe to parent SF Holdings
- Cut FY23-24F earnings by 62% and 43% to reflect weaker-than-expected IFF business
- Negatives priced in; Maintain BUY despite lower TP of HK\$10.50

Price Relative



Forecasts and Valuation

FY Dec (HK\$m)	2021A	2022A	2023F	2024F
Turnover	81,771	86,649	66,151	73,021
EBITDA	8,490	6,999	3,828	5,505
Pre-tax Profit	10,391	5,042	1,319	2,735
Core Net Profit	3,692	3,572	978	1,721
Core Net Profit Gth (%)	101.9	(3.2)	(72.6)	75.9
EPS (HK\$)	2.05	1.98	0.54	0.95
EPS Gth (%)	98.8	(3.5)	(72.6)	75.9
PE (X)	4.4	4.6	16.6	9.4
P/Cash Flow (X)	2.4	2.1	4.2	6.4
EV/EBITDA (X)	2.2	2.7	4.9	3.4
DPS (HK\$)	7.99*	0.66	0.18	0.32
Div Yield (%)	88.8	7.33	2.00	3.56
Net Gearing (%)	CASH	CASH	9	16
ROE (%)	15.2	18.1	5.3	8.9
Earnings Rev (%)			(62)	(43)
Consensus EPS (HK\$)			0.96	1.16
Other Broker Recs:		B:5	S:0	H:5

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

*Included special dividend

The worst is past

Investment Thesis

Asia based, global coverage. Kerry Logistics Network (KLN) is a leading Asia-based logistics service provider with a highly diversified business portfolio and global presence. KLN continues to expand its global coverage for international freight forwarding in recent years and is the No.1 Non Vessel Operating Common Carrier (NVOCC) from Asia to the US. The company is now the international arm of S.F. Holding which became its controlling shareholder in Sep-21. Synergies flowing from the integration with S.F. Holding are gradually coming through.

The worst for IFF business should be over. Earnings should see a sharp decline in FY23, as its International freight forwarding ("IFF") business was dampened by weak global demand and significantly lower freight rates. Nonetheless, the segment is expected to stage sequential improvement from 2Q23 on the back of bottoming freight rates and improving business volume from couriers. On the other hand, integrated logistics ("IL") should see modest growth led by post pandemic recovery in China. Elsewhere, synergy with S.F. Holdings should help drive the company's long-term growth.

Integration with SF Holdings is a key long-term share price driver. In Jul-23, KLN announced the disposal of some of its express service subsidiaries in Asia Pacific and Europe to parent SF Holdings. We believe this move should further streamline KLN's operational efficiency and strengthen its focus on IL and IFF business. Further integration with SF Holdings, if successful, could warrant a higher stock valuation over the longer term. Elsewhere, any improvement in the global economic outlook and recovery in freight rates should lead to better sentiment towards the counter.

Reiterate BUY despite lower TP of HK\$10.50. Following the sell-off, the stock is trading at 16.6x PE for FY23 and will improve to 9.4x for FY24, against its 5-year average of 13.3x. Despite the lower TP of HK\$10.50, which is based on 11.0x FY24F PE (0.5 SD below its 5-year average), due to earnings cut, we believe that operating challenges should be largely factored in. Maintain BUY.

Key Risks

Any further deterioration in global demand and supply chain disruption should dampen logistics demand and hence the earnings performance of the company.

At A Glance

Issued Capital (m shrs)	1,807
Mkt Cap (HKm/US\$m)	16,263 / 2,085
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)	0.61
GICS Industry: Industrials / Transportation	

Kerry Logistics Network**WHAT'S NEW****Wounded by tumbling freight rates**

Global freight rates have experienced unprecedented declines, resulting from subdued global demand and increased carrier capacity. This, coupled with lower business volume due to weaker trade flows amid the global economic slowdown and heightened geopolitical tension, has dealt a blow to the performance of the International freight forwarding (IFF) segment, which used to be the growth engine for KLN. Margin, has thus, normalised to the pre-COVID level of 3-4%, vs a peak of c.7.4% in 1H22. Overall, we forecast IFF's segment profit to post a sharp decline of 79% in FY23. Nevertheless, freight rates are seeing signs of bottoming out in 2Q23 as shipping companies have decided to pull out capacities. Shipment orders are also picking up with the destocking campaign by manufacturers coming to an end. As such, segment profit from IFF business should stage >25% growth q-o-q in 2Q23, with sequential improvement envisaged for the rest of the year.

Meanwhile, integrated logistics (IL) saw modest segmental profit growth in 1H23, primarily led by the business rebound in China which was battered by COVID outbreak and city lockdown in 1H22. Were it not for weaker earnings from Hong Kong IL operations, which benefitted from pandemic-related demand in 1H22, the growth would have been stronger. Overall, we expect the IL business to deliver modest earnings growth in FY23.

Kerry Express Thailand (KETH) continued to record loss amid tapered private consumption and lackluster economic outlook. It is expected to return to profitability by the end of 2024.

In Jul-23, KLN announced the disposal of its express business in Asia Pacific and Europe, excluding Hong Kong and Kerry Express Thailand (KETH), to its parent company, S.F. Holding, for a total consideration of no more than HK\$250m. We believe this move aims to further streamline its operations and strengthen its focus on IL and IFF businesses. We do not rule out more business restructuring within the group. The proceeds will be used for debt repayment and working capital requirement.

Overall, we cut our core earnings forecast for FY23 and FY24 by 62% and 43%, reflecting weaker profitability of IFF and continued losses from Kerry Express Thailand (KETH).

YTD, share price of KLN has fallen 36%, underperforming the broad market by 34ppts. Following the heavy sell off, the stock is now trading at a PE of 16.6x in FY23, which will improve to 9.4x in FY24, against its 5-year average of 13.3x. We believe that operating challenges should be largely factored in. The worst should be behind us with a gradual recovery expected from 2H23 onwards. Longer term, a higher stock valuation is warranted should the benefits from integration with SF Holdings come through. Maintain BUY despite a lower TP of HK\$10.50. This is based on 11.0x FY24F PE, 0.5 SD below its 5-year average.

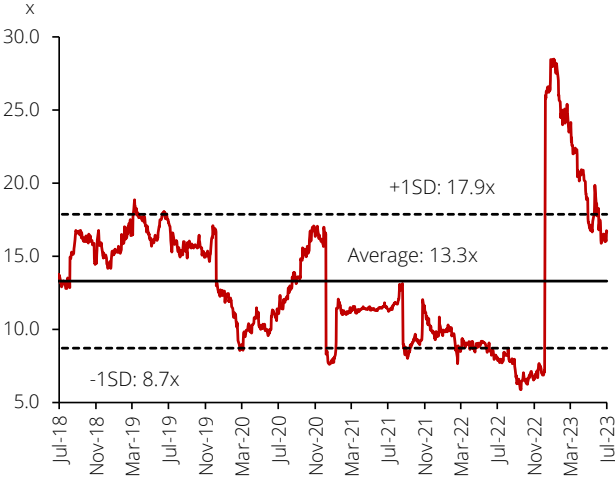
Company Background

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.

Kerry Logistics Network

PE band

Forward PE band (x)



Source: Thomson Reuters, DBS HK

Kerry Logistics Network

Segmental Breakdown (HK\$ m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Revenues (HK\$ m)					
Integrated Logistics and e-commerce & express	17,821	19,803	19,246	21,152	22,471
International freight forwarding	31,796	59,152	67,403	45,000	50,550
Discontinued operations	3,743	2,816	0	0	0
Total	53,361	81,771	86,649	66,151	73,021

Source: Company, DBS HK

Income Statement (HK\$ m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Revenue	53,361	81,771	86,649	66,151	73,021
Cost of Goods Sold	(49,726)	(75,043)	(81,397)	(64,282)	(69,693)
Gross Profit	3,635	6,728	5,252	1,870	3,327
Other Opng (Exp)/Inc	(315)	(499)	(462)	(471)	(495)
Operating Profit	3,320	6,229	4,790	1,398	2,832
Associates & JV Inc	118	159	167	150	162
Net Interest (Exp)/Inc	(265)	(243)	(320)	(230)	(260)
Exceptional Gain/(Loss)	1,067	4,247	405	0	0
Pre-tax Profit	4,240	10,391	5,042	1,319	2,735
Tax	(771)	(1,365)	(1,222)	(264)	(602)
Minority Interest	(574)	(1,087)	(241)	(64)	(386)
Perpetual Securities	0	0	0	(13)	(26)
Net Profit	2,896	7,939	3,579	978	1,721
Core Net Profit	1,828	3,692	3,572	978	1,721

Growth

Revenue Gth (%)	29.7	53.2	6.0	(23.7)	10.4
EBITDA Gth (%)	16.7	55.2	(17.6)	(45.3)	43.8
Opg Profit Gth (%)	20.1	87.6	(23.1)	(70.8)	102.5
Core Net Profit Gth (%)	33.1	101.9	(3.2)	(72.6)	75.9

Source: Company, DBS HK

Kerry Logistics Network

Balance Sheet (HK\$ m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Fixed Assets	23,196	9,466	9,689	10,188	10,445
Long-term Investments	365	593	561	561	561
Other LT Assets	4,766	4,348	3,221	3,221	3,221
Intangibles Assets	4,772	4,303	5,856	9,200	9,200
Deferred Tax Asset	98	156	463	463	463
Associates/JVs	1,971	2,281	1,643	1,393	1,393
Bank Balance/Cash & Liquid	8,485	9,096	9,253	4,272	3,799
ST Investments	470	817	38	38	38
Inventory	405	375	482	482	482
Debtors	12,362	16,663	13,407	11,407	12,447
Other Non Cash Current	10	64	722	722	722
Total Assets	56,900	48,162	45,334	41,946	42,770
ST Debt	4,163	3,848	2,310	2,310	2,310
Creditors	9,297	11,863	11,146	9,646	8,146
Other Current Liab	1,449	2,129	1,689	1,689	1,689
LT Debt	5,069	2,262	6,586	3,586	4,586
Deferred Tax Liabilities	744	406	614	614	614
Other LT Liabilities	3,698	2,817	1,739	1,739	1,739
Non-controlling Interests	4,997	3,793	2,821	2,970	2,970
Perpetual Securities	0	0	0	780	780
Shareholder's Equity	27,483	21,044	18,429	18,612	19,936
Total Cap. & Liab.	56,900	48,162	45,334	41,946	42,770
Share Capital (m)	1,775	1,803	1,807	1,807	1,807
Net Cash/(Debt)	(747)	2,986	356	(1,625)	(3,098)
Working Capital	6,823	9,174	8,756	3,275	5,342
Net Gearing (%)	3	CASH	CASH	9	16

Source: Company, DBS HK

Cash Flow Statement (HK\$ m)

FY Dec	2020A	2021A	2022A	2023F	2024F
EBIT	3,320	6,229	4,790	1,398	2,832
Tax Paid	(699)	(921)	(2,199)	(264)	(602)
Depr/Amort	2,149	2,261	2,209	2,430	2,673
Profit or loss on disposal of FAs/subsidiaries/investment	(59)	(2,197)	(461)	0	0
Chg in Wkg.Cap	(128)	(1,671)	843	500	(2,540)
Other Non-Cash	(256)	2,072	201	(443)	(406)
Operating CF	4,326	5,773	5,384	3,621	1,958
Net Capex	(1,285)	11,786	(2,631)	(2,679)	(2,929)
Investments	12	(1,173)	928	0	0
Associates & JVs	(544)	33	957	0	0
Associates' Dividends	170	99	100	150	162
Others	66	57	72	200	120
Investing CF	(1,581)	10,802	(574)	(2,329)	(2,647)
Net Chg in Debt	725	53	3,039	(3,000)	1,000
Non-controlling interests	1,487	(71)	(3,501)	(3,195)	0
New Capital	46	103	1	0	0
Dividend	(1,306)	(14,523)	(2,305)	(859)	(783)
Other Financing CF	(1,208)	(1,281)	(1,381)	780	0
Financing CF	(256)	(15,719)	(4,146)	(6,274)	217
Chg in Cash	2,489	856	664	(4,981)	(473)

Source: Company, DBS HK

Kerry Logistics Network

Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	Target Price	Rating
1	31-Aug-22	HK\$16.54	HK\$19.80	BUY
2	29-Mar-23	HK\$13.04	HK\$15.12	BUY

Source: DBS HK

Analyst: Jeff Yau, CFA

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

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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