

# Kerry Logistics (636 HK)

## Hold

Target price (HKD)	12.80
Share price (HKD)	11.44
Upside/Downside (%)	11.9

Dec	2013 a	2014 e	2015 e
HSBC EPS	0.66	0.55	0.63
HSBC PE	17.4	20.9	18.3
Performance	1M	3M	12M
Absolute (%)	0.7	-5.5	0.2
Relative <sup>A</sup> (%)	2.2	-10.0	-10.6

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## Disclaimer & Disclosures

This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it

Hold: 2014 EBIT in line, focus on margin in 2015

- ▶ **2014 recurring profit was HKD930m, up 8% y-o-y; 3% below our forecast; strong profit growth in Hong Kong offset weak associates contribution and China business**
- ▶ **Focus on improvement in margins and acquisitions in freight forwarding business. We keep our FY15-16 earnings unchanged, 10-13% below consensus**
- ▶ **We set our fair value target price at HKD12.8 and establish a Hold rating. The stock trades at an 18.3x 2015e PE**

**2014 reported profit was HKD1.7bn, down 10% y-o-y and 46% above our forecast:**

Excluding one-offs (fair value gains), KLN's recurring profit was HKD930m (up 8% y-o-y), 3% below our forecast and 14% below consensus forecast. Operating profits were 1% and 5% below HSBC and consensus forecasts. This implies 2H14 recurring profits grew 16% y-o-y vs. flat growth in 1H14. The increase in profit was driven by higher logistics revenues and improvement in margins in freight forwarding and Hong Kong logistics and warehouse segments, which were partly offset by a decline in contribution from associates and weak China business.

**KLN continues to focus on acquisitions in freight forwarding business and**

**improvement in margin:** For 2015, KLN guided that it expects slower organic revenue growth from freight forwarding due to a decline in overall freight rates (courtesy of lower bunker prices), although for its logistics business, it expects margin improvement (driven by Pharmaceuticals) and normalisation of consumer electronics business to support earnings. Despite expectations for stagnant global demand for global logistics services, the company sees opportunities for expansion in the intra-ASEAN region and investments along the 'New Silk Road'. KLN expects to build a regional express delivery platform across the ASEAN region over the next 12-18 months following its success in Thailand. Outside of Asia, the company is looking for sizeable freight forwarding acquisitions in the US and it said that it is close to a deal with a candidate.

**We keep our 2015-16e recurring earnings largely unchanged:** Our forecasts imply earnings will grow an average 11% in 2015-16e and are 10-13% below Bloomberg consensus. We expect consensus to lower forecasts after the 2014 earnings miss.

**We establish a Hold rating:** Y-t-d, KLN's share price has declined 7% vs. a 4% increase in the local index but outperformed its closest local peer Sinotrans (598 HK, NR) by 8%. KLN is now trading at an 18.3x PE and 1.23x PB on 2015e estimates. We see fair value at a 20.5x 2015e PE, in line with freight forwarders.

Index <sup>A</sup>	HANG SENG INDEX	Enterprise value (HKDm)	21461
Index level	24,528	Free float (%)	27
RIC	0636.HK	Market cap (USDm)	2,495
Bloomberg	636 HK	Market cap (HKDm)	19,351

Source: HSBC

Source: HSBC

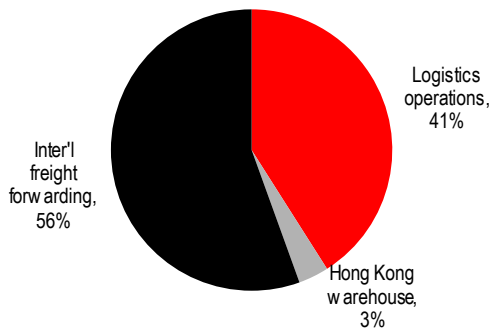
## 1. KLN: 2H14/2014 results summary

(HKDm)	2H14	2H13	vs. 2H13	1H14	vs. 1H14	2H14e	vs. 2H14e	2014	2013	vs. 2013	2014e	vs. 2014e	Remarks
Revenues	11,131	10,447	6.5%	9,984	11.5%	11,395	-2.3%	21,115	19,969	5.7%	21,379	-1.2%	Below our forecast on lower than expected growth in logistics business (China in particular)
Operating costs	(10,088)	(9,524)	5.9%	(8,993)	12.2%	(10,321)	-2.3%	(19,081)	(18,135)	5.2%	(19,314)	-1.2%	
EBITDA	1,043	923	13.1%	991	5.3%	1,074	-2.8%	2,034	1,834	10.9%	2,065	-1.5%	
Depreciation and amortisation	(240)	(234)	2.5%	(231)	3.9%	(254)	-5.8%	(470)	(450)	4.6%	(485)	-3.0%	
<b>EBIT</b>	<b>804</b>	<b>689</b>	<b>16.7%</b>	<b>760</b>	<b>5.7%</b>	<b>819</b>	<b>-1.9%</b>	<b>1,564</b>	<b>1,384</b>	<b>13.0%</b>	<b>1,580</b>	<b>-1.0%</b>	<b>EBIT margin in line with our forecast, overall EBIT value lower due to lower than expected revenues</b>
Share of profits/(losses) from associates	47	57	-17.4%	44	5.4%	57	-17.6%	91	128	-28.8%	101	-9.9%	Declined more than our forecast
Net interest expenses	(34)	(32)	5.4%	(37)	-7.1%	(22)	54.6%	(71)	(57)	24.2%	(59)	20.5%	Higher than our forecast on higher loan balance
Other non-recurring	549	526	4.5%	183	199.7%	0	NM	733	985	-25.7%	183	299.7%	Mainly fair value changes of investment property
<b>Reported PBT</b>	<b>1,366</b>	<b>1,239</b>	<b>10.3%</b>	<b>951</b>	<b>43.6%</b>	<b>854</b>	<b>59.9%</b>	<b>2,317</b>	<b>2,441</b>	<b>-5.1%</b>	<b>1,806</b>	<b>28.3%</b>	
<b>HSBC Recurring PBT</b>	<b>817</b>	<b>713</b>	<b>14.5%</b>	<b>768</b>	<b>6.3%</b>	<b>854</b>	<b>-4.4%</b>	<b>1,585</b>	<b>1,456</b>	<b>8.8%</b>	<b>1,622</b>	<b>-2.3%</b>	
Taxes	(188)	(158)	18.7%	(165)	13.9%	(182)	3.4%	(353)	(305)	15.8%	(347)	1.8%	
Reported PAT	1,178	1,080	9.0%	786	49.8%	673	75.2%	1,964	2,136	-8.1%	1,459	34.6%	
HSBC Recurring PAT	629	555	13.3%	603	4.2%	673	-6.5%	1,232	1,151	7.0%	1,276	-3.4%	
Non-controlling interests	(154)	(149)	2.8%	(152)	1.1%	(167)	-8.0%	(306)	(302)	1.2%	(319)	-4.2%	
<b>Reported PAT to equity holders</b>	<b>1,024</b>	<b>931</b>	<b>10.0%</b>	<b>634</b>	<b>61.4%</b>	<b>506</b>	<b>102.6%</b>	<b>1,659</b>	<b>1,835</b>	<b>-9.6%</b>	<b>1,140</b>	<b>45.5%</b>	
<b>HSBC Recurring PAT to equity holders</b>	<b>474</b>	<b>408</b>	<b>16.1%</b>	<b>456</b>	<b>3.8%</b>	<b>506</b>	<b>-6.3%</b>	<b>930</b>	<b>862</b>	<b>7.9%</b>	<b>962</b>	<b>-3.3%</b>	<b>Reflects weaker than expected contribution from associates and higher interest expenses</b>
Diluted EPS (HKD)	0.60	0.71	-15.1%	0.37	61.4%	0.30	102.6%	0.98	1.40	-30.4%	0.67	45.3%	
HSBC Recurring EPS (HKD)	0.28	0.31	-10.4%	0.27	3.8%	0.30	-6.3%	0.55	0.66	-16.9%	0.57	-3.5%	
DPS (HKD)	0.08	0.11	-25.8%	0.06	33.4%	0.09	-8.2%	0.14	0.11	29.9%	0.15	-4.9%	
<b>Key ratios</b>													
EBITDA margin (%)	9.4%	8.8%	0.5ppt	9.9%	-0.6ppt	9.4%	0.0ppt	9.6%	9.2%	0.4ppt	9.7%	0.0ppt	
<b>EBIT margin (%)</b>	<b>7.2%</b>	<b>6.6%</b>	<b>0.6ppt</b>	<b>7.6%</b>	<b>-0.4ppt</b>	<b>7.2%</b>	<b>0.0ppt</b>	<b>7.4%</b>	<b>6.9%</b>	<b>0.5ppt</b>	<b>7.4%</b>	<b>0.0ppt</b>	<b>In line with our forecast</b>
Annualised ROE (%)	6.6%	7.2%	-0.6ppt	6.7%	-0.1ppt	7.1%	-0.5ppt	6.6%	7.9%	-1.3ppt	6.9%	-0.2ppt	
Tax rate (%)	24.4%	24.1%	0.3ppt	22.8%	1.6ppt	22.8%	1.6ppt	23.6%	23.0%	0.7ppt	22.8%	0.8ppt	

Source: Company data, HSBC estimates

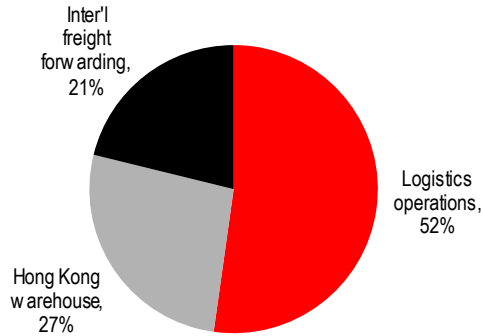
## Kerry Logistics – Key charts (1)

2. Revenue breakdown by business segment (2014)



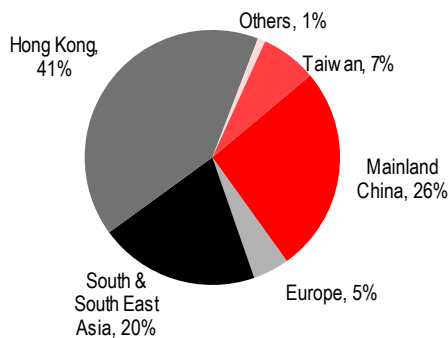
Note: Revenue includes intersegment revenues  
Source: Company data, HSBC

3. Segment earnings breakdown (2014)



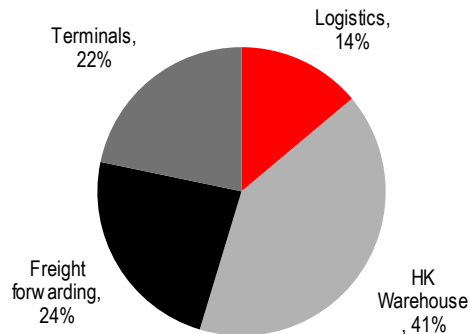
Source: Company data, HSBC

4. Operating results breakdown by region (1H14)



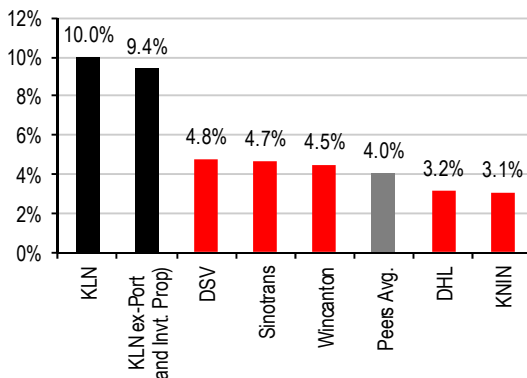
Source: Company data, HSBC

5. Recurring profit breakdown by business segment (2014)



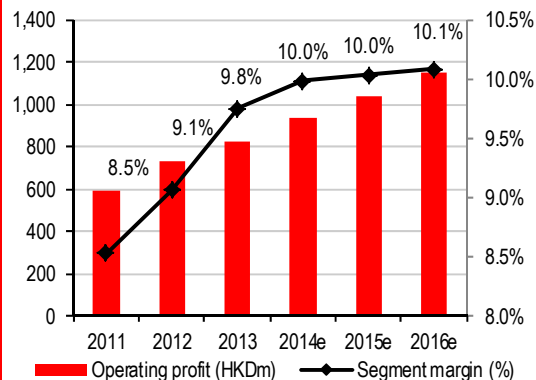
Note: Terminals includes KLN's associates AAT and CCT, and Thailand SIAM Seaport  
Source: Company data, HSBC

6. Contract logistics operating margins – KLN vs. peers (2014)



Note: Operating margin for Wincanton are for half year ending September 2014  
Source: Company data, HSBC

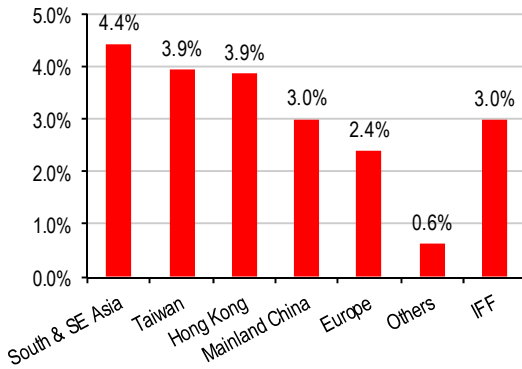
7. Logistics operations: Operating profit and margins



Note: Margins computed as percentage of gross revenues (including inter-segment revenues)  
Source: Company data, HSBC estimates

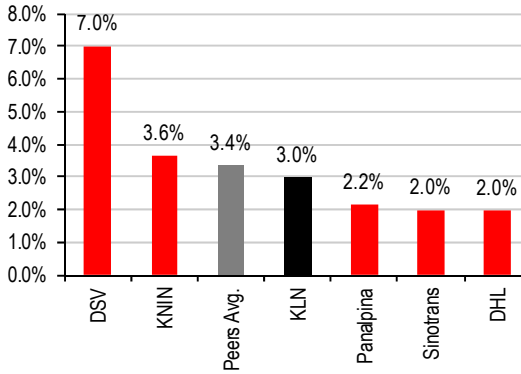
## Kerry Logistics – Key charts (2)

8. KLN: International freight forwarding segment margins (2014)



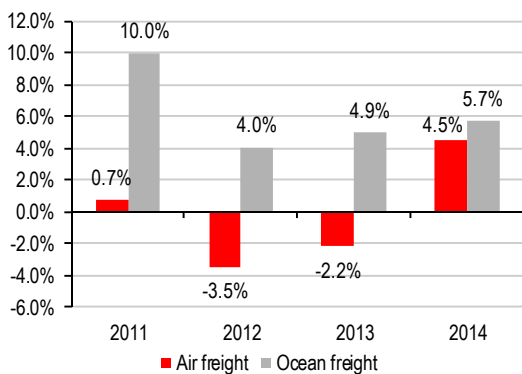
Source: Company data, HSBC

9. Freight forwarding operating margins – KLN vs. peers (2014)



Note: Operating margin for Panalpina is for Asia-Pacific region; For KNIN and DSV FF margins are excluding Road and Rail  
Source: Company data, HSBC

10. Sector freight forwarding volume growth rebounded in 2014



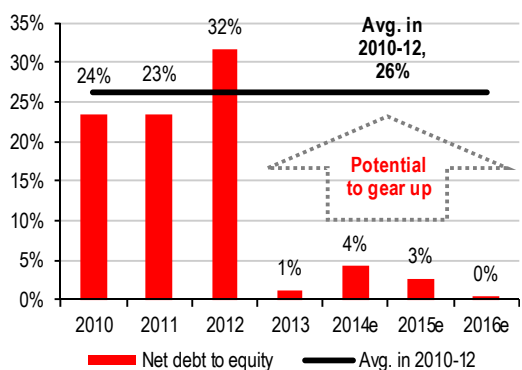
Note: Includes DSV, DHL, Kuehne & Nagel, Panalpina and Sinotrans  
Source: Company data

11. Freight forwarders guide for similar volume growth in 2015e

	2014	2015e
<b>Air freight</b>		
Kuehne & Nagel	3-4%	4-5%
DSV	3-5%	3-5%
Panalpina	3.5%	3-4%
<b>Ocean freight</b>		
Kuehne & Nagel	4-5%	4-5%
DSV	3-5%	3-5%
Panalpina	4-5%	4-5%

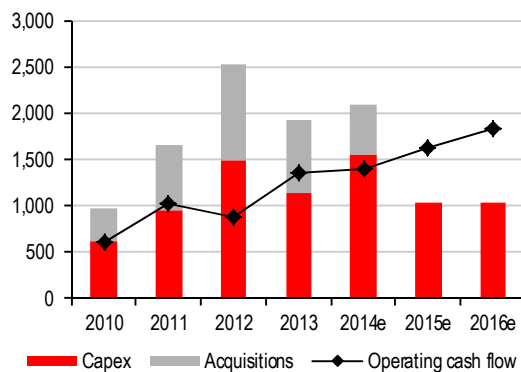
Source: Company data

12. Net debt-to-equity: Significant potential to increase leverage



Source: Company data, HSBC estimates

13. Capex and acquisitions trend



Note: Acquisitions in 2014e are as reported by company for 1H14  
Source: Company data, HSBC estimates

## Earnings outlook

We keep our earnings forecasts largely unchanged for 2015-16e, reflecting a steady margin in its integrated logistics business and some improvement in the international freight forwarding business margin. Our revised earnings imply a recurring profit CAGR of 11% in 2015-16e. This compares to a CAGR of 9% over 2010-13, which was driven by acquisitions and the full consolidation of Kerry TJ Logistics (NR). We also note that earlier this year, KLN submitted a proposal to the local authorities to convert one of its warehouses into a columbarium (project cost of HKD2bn) and it believes that this will help to unlock asset value and improve return.

### 14. KLN: Earnings forecast revisions, 2014-16e

	New		Old		Difference	
	2015e	2016e	2015e	2016e	2015e	2016e
Revenues	22,440	24,067	23,035	24,730	-3%	-3%
EBITDA	2,245	2,415	2,270	2,440	-1%	-1%
EBIT	1,741	1,870	1,742	1,873	0%	0%
<b>HSBC net profit</b>	<b>1,061</b>	<b>1,150</b>	<b>1,061</b>	<b>1,150</b>	<b>0%</b>	<b>0%</b>
<b>HSBC EPS (HKD)</b>	<b>0.63</b>	<b>0.68</b>	<b>0.63</b>	<b>0.68</b>	<b>0%</b>	<b>0%</b>
<b>Margins</b>						
EBITDA margin	10.0%	10.0%	9.9%	9.9%	0.2ppt	0.2ppt
EBIT margin	7.8%	7.8%	7.6%	7.6%	0.2ppt	0.2ppt

Source: HSBC estimates

## HSBC vs. consensus

We are 10-13% below Bloomberg consensus on 2015-16e recurring earnings forecasts.

### 15. KLN: HSBC estimates vs. Bloomberg consensus on recurring earnings

(HKDm)	HSBC	Consensus	Difference
2015e	1,061	1,185	-10.5%
2016e	1,150	1,329	-13.4%

Source: Bloomberg consensus, HSBC estimates

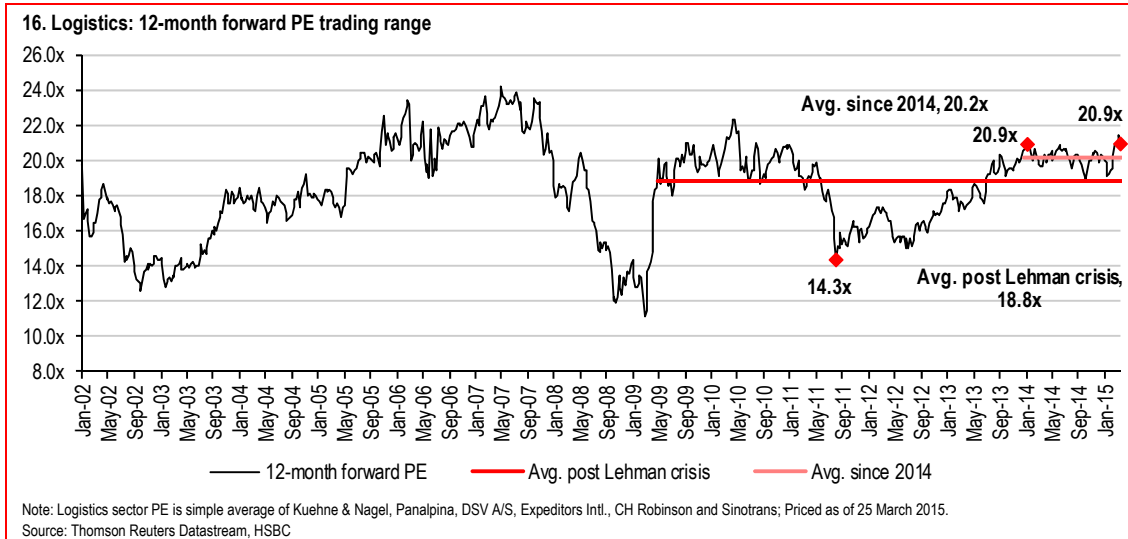
## Valuation and rating

We continue to value KLN using an average PE (implied from consensus target price) of comparable freight forwarders and contract logistics players weighted by market capitalisation of peers. Based on this approach, we see the fair value for the stock at a 20.5x 2015e PE (unchanged), in line with freight forwarders and set a fair value target price of HKD12.8 (unchanged).

Our target price implies 11.9% upside from the current share price; therefore we establish a Hold rating on the stock. Under the old rating system, the stock was rated Neutral (V).

## Risks

**Key upside risks are:** Better-than-expected economic development in China could lead to an increase in domestic consumption, which would positively impact KLN's customers and its own volumes; a decrease in trade restrictions or embargoes in key countries in which KLN operates; positive changes in government policies within China to stimulate domestic consumption; an increase in outsourcing trends stimulating Asia outbound volumes; accretive acquisitions; a positive movement in property values in Hong Kong or mainland China; and better-than-expected general trading or significant new contract wins.



**Key downside risks are:** lower-than-expected growth in global trade; higher-than-expected competition, ability to identify suitable acquisitions and integrate them with existing operations, aggressive M&A at expensive valuations; higher trade barriers and failure or delay in commencement of regional free trade agreements; loss of key clients; lack of new contract wins or renewals and potential regulatory barriers to foreign logistics operators in China.

## Financials & valuation

### Financial statements

Year to	12/2013a	12/2014e	12/2015e	12/2016e
<b>Profit &amp; loss summary (HKDm)</b>				
Revenue	19,969	21,115	22,440	24,067
EBITDA	1,834	2,034	2,245	2,415
Depreciation & amortisation	-450	-470	-504	-545
Operating profit/EBIT	1,384	1,564	1,741	1,870
Net interest	-60	-72	-67	-57
PBT	2,441	2,317	1,781	1,931
HSBC PBT	1,456	1,585	1,781	1,931
Taxation	-305	-353	-386	-417
Net profit	1,835	1,659	1,061	1,150
HSBC net profit	862	930	1,061	1,150

### Cash flow summary (HKDm)

Cash flow from operations	941	953	1,149	1,326
Capex	-1,126	-1,550	-1,025	-1,025
Cash flow from investment	-1,443	-1,858	-984	-985
Dividends	-182	-284	-268	-276
Change in net debt	510	526	-240	-423
FCF equity	134	-584	535	731

### Balance sheet summary (HKDm)

Intangible fixed assets	1,969	1,835	1,789	1,743
Tangible fixed assets	13,453	14,690	15,257	15,784
Current assets	9,070	8,934	9,003	9,208
Cash & others	4,228	3,816	3,556	3,480
Total assets	25,674	26,613	27,299	28,092
Operating liabilities	4,760	4,415	4,611	4,815
Gross debt	4,190	4,303	3,803	3,303
Net debt	-38	487	247	-176
Shareholders funds	13,426	14,671	15,464	16,337
Invested capital	15,504	17,227	17,881	18,440

### Ratio, growth and per share analysis

Year to	12/2013a	12/2014e	12/2015e	12/2016e
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#### Y-o-y % change

Revenue	3.5	5.7	6.3	7.3
EBITDA	9.2	10.9	10.3	7.6
Operating profit	5.5	13.0	11.3	7.4
PBT	47.3	-5.1	-23.1	8.4
HSBC EPS	1.9	-16.9	14.1	8.4

#### Ratios (%)

Revenue/IC (x)	1.6	1.3	1.3	1.3
ROIC	7.4	7.4	7.8	8.1
ROE	7.9	6.6	7.0	7.2
ROA	9.2	7.8	5.5	5.7
EBITDA margin	9.2	9.6	10.0	10.0
Operating profit margin	6.9	7.4	7.8	7.8
EBITDA/net interest (x)	30.5	28.2	33.7	42.6
Net debt/equity	-0.2	2.8	1.3	-0.9
Net debt/EBITDA (x)	0.0	0.2	0.1	-0.1
CF from operations/net debt		195.6	465.0	

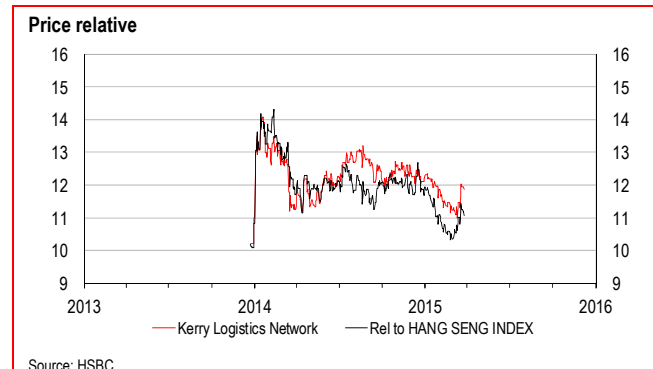
#### Per share data (HKD)

EPS reported (fully diluted)	1.40	0.98	0.63	0.68
HSBC EPS (fully diluted)	0.66	0.55	0.63	0.68
DPS	0.11	0.14	0.16	0.17
Book value	8.10	8.85	9.33	9.86

### Valuation data

Year to	12/2013a	12/2014e	12/2015e	12/2016e
EV/sales	1.1	1.0	1.0	0.9
EV/EBITDA	11.8	10.9	9.8	9.0
EV/IC	1.4	1.3	1.3	1.2
PE*	17.4	20.9	18.3	16.9
P/Book value	1.4	1.3	1.2	1.2
FCF yield (%)	-0.4	-2.1	2.9	3.9
Dividend yield (%)	1.0	1.2	1.4	1.5

Note: \* = Based on HSBC EPS (fully diluted)



Note: price at close of 26 Mar 2015

# Disclosure appendix

## Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Parash Jain and Mark Webb

## Important disclosures

### **Equities: Stock ratings and basis for financial analysis**

HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations and that investors utilise various disciplines and investment horizons when making investment decisions. Ratings should not be used or relied on in isolation as investment advice. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations and therefore investors should carefully read the definitions of the ratings used in each research report. Further, investors should carefully read the entire research report and not infer its contents from the rating because research reports contain more complete information concerning the analysts' views and the basis for the rating.

### **From 23rd March 2015 HSBC has assigned ratings on the following basis:**

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

### **Prior to this date, HSBC's rating structure was applied on the following basis:**

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile\*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile\*). Stocks between these bands were classified as Neutral.

\*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.



## Rating distribution for long-term investment opportunities

As of 27 March 2015, the distribution of all ratings published is as follows:

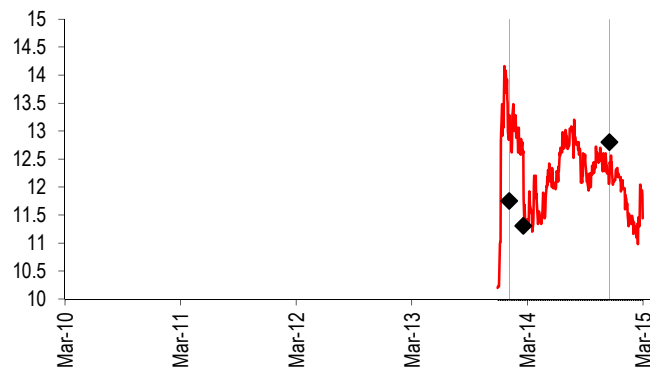
<b>Buy</b>	41%	(29% of these provided with Investment Banking Services)
<b>Hold</b>	39%	(28% of these provided with Investment Banking Services)
<b>Sell</b>	20%	(20% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

## Share price and rating changes for long-term investment opportunities

Kerry Logistics Network (0636.HK) Share Price performance HKD Vs HSBC

rating history



Source: HSBC

### Recommendation & price target history

From	To	Date
N/A	Underweight (V)	28 January 2014
Underweight (V)	Neutral (V)	11 December 2014
Target Price	Value	Date
Price 1	11.75	28 January 2014
Price 2	11.30	14 March 2014
Price 3	12.80	11 December 2014

Source: HSBC

## HSBC & Analyst disclosures

### Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
KERRY LOGISTICS NETWORK	0636.HK	11.44	26-Mar-2015	1, 2, 5, 7

Source: HSBC

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