

07 September 2017 | Visit Note

Tiong Nam Logistics Holdings Berhad

Expecting lower margins in FY18

INVESTMENT HIGHLIGHTS

- **Analyst briefing centered on poor 1QFY17 performance**
- **Higher costs incurred from expanding, revenue yet to follow**
- **New ventures progressing well with new customers secured**
- **Operating margins took a hit, hence we are reducing forecasts**
- **Downgrade to NEUTRAL with lower TP of RM1.72**

1QFY18 analyst briefing. We attended Tiong Nam's 1QFY17 analyst briefing which was hosted by Mr. Victor Ong (ED), Mr. Law Tik Long (FC) and Ms. Nam Jing Rou (IR). The briefing centered on Tiong Nam's poor first quarter performance, where core profits fell by -58%oyoy. We were also given updates on Tiong Nam's last-mile delivery and cross-border trucking services as extensions to its current range of logistics and warehousing services.

Rapid expansion, with revenue yet to follow suit. Tiong Nam's poor first quarter performance stemmed from a surge in expenses due to its rapid expansion of assets for its logistics and warehousing operations. Revenue growth, on the other hand, lagged as new assets typically require a 3 to 9 month gestation period before turning profitable. Over the span of 6 months (Jan 2017 to June 2017), Tiong Nam aggressively expanded its warehousing space by +13% or 618k ft² to 5.5m ft².

Gradual pick-up in utilisation rate. Upon receiving possession of a new warehouse, pallet racking systems are installed and customisation according to different customer requirements is implemented. In addition, new capacity is usually absorbed over a 6 month timeframe, causing a less than optimal utilisation rate of assets. Meanwhile, expenses such as staff salaries, rental of warehouses & equipment, as well as interest on borrowings continue to be incurred at full value.

New ventures progressing well. Besides serving an e-commerce parcel consolidator from China, we understand that Tiong Nam has also secured a large electronics customer for its cross-border business, with daily trips made to Thailand. Meanwhile, Tiong Nam's last-mile delivery business, "Instant" currently handles 500 parcel deliveries per day for a popular direct marketing company and an e-commerce platform from China. It is in the midst of securing a new local e-commerce platform which specialises in halal products, for its cold chain logistics service. We have yet to impute any contributions from these new businesses.

**Downgrade to NEUTRAL
(From: BUY)**

**Reduced Target Price (TP): RM1.72
(From: RM2.08)**

RETURN STATS

Price (6 Sep 2017)	RM1.59
Target Price	RM1.72
Expected Share Price Return	+8.2%
Expected Dividend Yield	+2.2%
Expected Total Return	+10.4%

STOCK INFO

KLCI	1,769.49
Bursa / Bloomberg	8397/ TNL MK
Board / Sector	Main/ Trading Services
Syariah Compliant	Yes
Issued shares (mil)	453.78
Market cap. (RM'm)	721.51
Price over NA	1.07
52-wk price Range	RM1.48 - RM1.83
Beta (against KLCI)	0.74
3-mth Avg Daily Vol	0.42m
3-mth Avg Daily Value	RM0.73m
Major Shareholders	
TNTT Realty SB	24.75%
Ong Yoong Nyock	19.75%
EPF	5.01%

Operating margins declined due to rapid expansion. Besides the costs associated to its new warehouses, Tiong Nam also incurred start-up expenses related to its last-mile and cross-border trucking businesses. As a result, EBIT margins for the logistics and warehousing division eroded to 4% (FY16 & FY17 average: 14%). We expect expenses to remain heightened, with a propensity to rise further, with RM100m in capex budgeted for FY18.

Reducing our earnings forecasts. With revenue only expected to compensate for the rising costs gradually over the coming quarters, we raise our assumptions for operating expenses which led to a reduction in our EBIT margin forecast for the logistics and warehousing division from 12% to 9%. In addition, we cut our earnings forecast for the property division, as unbilled sales have fallen to RM119m (Jan 2017: RM167m). As such, our earnings forecast for FY18 and FY19 is lowered by -26% and -17% respectively.

We downgrade our call to NEUTRAL with a target price of RM1.72. While we like Tiong Nam's long-term prospects as a market leader in logistics and warehousing, we believe the company could face earnings pressure in the short-medium term as a result of rapid expansion and the start-up of new businesses. Our TP of RM1.72 is based on its sum-of-parts, consisting of 1) its core logistics & warehousing business, 2) its property development arm and 3) the value of its warehouses if it were listed under a REIT structure. 

Business segment/asset	Valuation Methodology	Value (RM'm)	Fully diluted value Per Share (RM)
Logistics and warehousing	Price-to-earnings multiple of 12x FY18 Core PAT	147.9	0.32
Property development	RNAV @ WACC of 12%	205.4	0.45
Tiong Nam logistics REIT	Valued @ capitalization rate of 6.6%	772.7	1.69
Subtract: Debt related to warehouse financing	Outstanding value	-250.0	-0.55
Value per share	Before conversion of warrants	875.98	1.92
Add: Proceeds from exercise of warrants	Exercise price @ RM1 by CY2018	210.0	0.33
Value per share	After conversion of warrants	1,085.98	1.72

Source: MIDF Research

INVESTMENT STATISTICS

FYE Dec	FY15A	FY16A	FY17F	FY18F	FY19F
Revenue (RM'm)	618.0	568.5	575.6	668.0	724.5
EBIT (RM'm)	124.5	124.9	129.5	113.3	126.0
Pre-tax Profit (RM'm)	110.7	105.8	100.6	85.0	100.4
Core PATAMI (RM'm)	68.6	53.6	59.7	65.7	78.2
FD EPS (sen)	15.0	11.7	13.1	9.8	11.7
EPS growth (%)	44.3	-21.8	11.3	-24.6	19.1
PER(x)	11.7	14.9	13.4	17.8	14.9
Net Dividend (sen)	4.0	5.0	4.8	3.9	4.7
Net Dividend Yield (%)	2.3	2.9	2.7	2.2	2.7

Source: MIDFR, Company

DAILY PRICE CHART



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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.