

Growing pains from transition

Hong Kong Logistics

BALtrans (562 HK, HK\$5.00)

Not Rated

BALtrans announced 1H FY7/07 results on Friday, 20 Apr 2007. Key takeaways were as follows:

Weak as expected. BALtrans announced weak results as expected. Turnover rose 18.8% YoY to HK\$2,433.8m with gross profit surging 39.7% YoY to HK\$442.6m. However, EBITDA dropped 14.0% YoY to HK\$82.2m and net profit fell 48.3% YoY to HK\$36.7m.

Exacerbated by one-off exceptionals. The weak results were exacerbated by one-off exceptional gains of HK\$22.0m in 1H FY7/06A versus HK\$8.4m in 1H FY7/07A. Stripping out the one-off items, EBITDA edged down 0.2% YoY to HK\$73.8m and net profit fell 42.2% YoY to HK\$49.1m.

Table 1: 1H results

6 months to Jan	Turnover (HK\$m)	Gross profit (HK\$m)	Gross margin (%)	EBITDA (HK\$m)	Tax rate (%)	Net profit (HK\$m)	Basic EPS (HK\$)
FY07	2,433.8	442.6	18.2	82.2	23.1	36.7	.0.118
FY06	2,048.1	316.93	15.5	95.6	11.6	71.0	.0.234
YoY (%)	18.8	39.7		(14.0)		(48.3)	(49.5)

Source: Company data

Table 2: 1H results (excluding one-off exceptionals)

6 months to Jan	Turnover (HK\$m)	Gross profit (HK\$m)	Gross margin (%)	EBITDA (HK\$m)	Tax rate (%)	Net profit (HK\$m)	Basic EPS (HK\$)
FY07	2,433.8	442.6	18.2	73.8	27.0	28.3	0.091
FY06	2,048.1	316.93	15.5	73.6	15.5	49.1	0.162
YoY (%)	18.8	39.7		(0.2)		(43.8)	

Note: One-off exceptional gains of HK\$22.0m in 1H FY7/06A relating to gain on disposal of associates (HK\$11.4m), compensation on claims (HK\$10.4m) and gain on partial disposal of an associate (HK\$0.1m). One-off exceptional gains of HK\$8.4m in 1H FY7/07A relating to fair value gain on derivative financial instruments (HK\$10.5m) and net increase in put option liabilities ((HK\$2.1m)).

Source: Company data and SBI E2-Capital

Strong top line aided by contribution from European acquisitions. BALtrans' top line benefited from maiden contribution from several EMEA freight forwarding acquisitions, as well as consolidation of its European associates, both undertaken in the previous financial year. EMEA revenue surged 362.7% YoY to HK\$831.1m. Asia Pacific fell 15.3% YoY to HK\$1303.4m, largely due to restructuring in its China division, and North America contracted 9.2% YoY to HK\$299.3m.

China restructuring crimped Asia Pacific performance. The company streamlined its two business units (BALtrans China and Jardine Logistics) into one. BALtrans had simultaneously operated two entities in China since the JL acquisition in FY7/04. The restructuring was possible only after the full consolidation of BALtrans China last May. Despite its negative short-term impact, this streamlining will ultimately benefit the company. Management indicated that a HK\$3-4m restructuring cost was booked during 1H FY7/07A with a slightly higher charge to come in 2H FY7/07. To date, the company has laid off around one-third of its China-based staff. We estimate that turnover from the China segment, which represents about 20% of Asia Pacific turnover, fell by around 30% as a result.

Headcount expansion on shift from agents to own network. To sustain margins long term, gain better control of its freight forwarding network and cut reliance on third-party agents in overseas destinations, BALtrans has been setting up direct sales offices. The company's workforce grew to 2,021 from 1,752 a year

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ago (including new acquisitions from EMEA region). Consequently, staff expenses surged 56.2% YoY to HK\$233.0m. EMEA continues to be the company's main focus and it opened a new office in France in April 2007.

Growing pains during transition from regional to international focus. Though the company's long term growth prospects remain intact, BALtrans appear to be facing growing pains on several fronts as it transitions from a regional HK/China play, into an international freight forwarder. This has adversely affected its P&L through: 1) changing cost structure with increased overseas revenue; 2) increased effective tax rate due to higher portion of overseas revenue; 3) increased staff costs as the company adds direct sales staff; 4) restructuring cost of China operation; 5) short-term China revenue contraction due to the restructuring. We expect the P&L to normalize in FY7/08 and 6) increased amortization charges after recent acquisitions.

Looking for signs of turnaround. No doubt, the remainder of FY7/07 will continue to be a correction year for BALtrans. Near term, the company will continue to build out its global network, rationalize its Asia Pacific platform and enhance cooperation within its own network. The counter is trading at 13.5x historical P/E and 11.7x forward FY7/07F P/E consensus, prior to earnings revision. We caution that the forward P/E valuation would rise after the market takes into consideration the weak 1H earnings. Long term however, we remain positive on BALtrans and the contract logistics industry as a whole and we will be on the lookout for any signs of turnaround in its operations.