midf RESEARCH

7 March 2019 | Sector Update

Transportation - Logistics

Maintain NEUTRAL

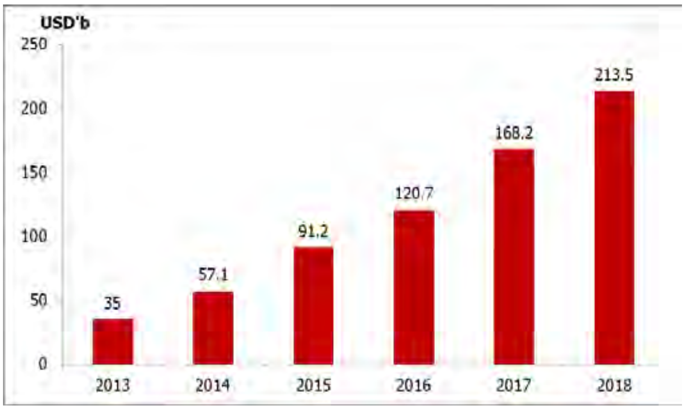
Intense competition necessitates a shift for a niche

KEY HIGHLIGHTS

- **E-commerce activity continues to drive demand for logistics services**
- **Number of courier licence holders remains high at more than 110 with expectancy of more entrants in the future**
- **Existing players will have to diversify their offerings to remain relevant while there is a pressure to keep pricing competitive**
- **As a result, profit margin compression will continue to be seen**
- **Maintain NEUTRAL stance on transportation sector**

Logistic companies continue to benefit from the advent of E-commerce… Last mile delivery companies' strategy of tying up with well-known e-commerce marketplaces has translated into higher demand of their delivery services. This is apparent during events such as the 2018 Singles Day sale where the gross merchandise value (GMV) of Alibaba rose by +26.9% to reach a record of RMB213.5m or USD30.8b. Meanwhile, 11street recorded a six fold rise in its GMV compared to average sales on a regular business day while Lazada Malaysia surpassed its 2017 Singles' Day performance within the first nine hours. According to Statista, the amount spent on consumer e-commerce categories continues to grow with food and personal care experiencing the largest annual change in 2018 in Malaysia. As such, the number of parcels handled domestically is still on the rise *(refer to chart 2).*

Chart 1: GMV of Alibaba on Singles Day



Source: Alibaba via Techcrunch

Table 1: Annual change in total amount spent on consumer e-commerce categories in Malaysia

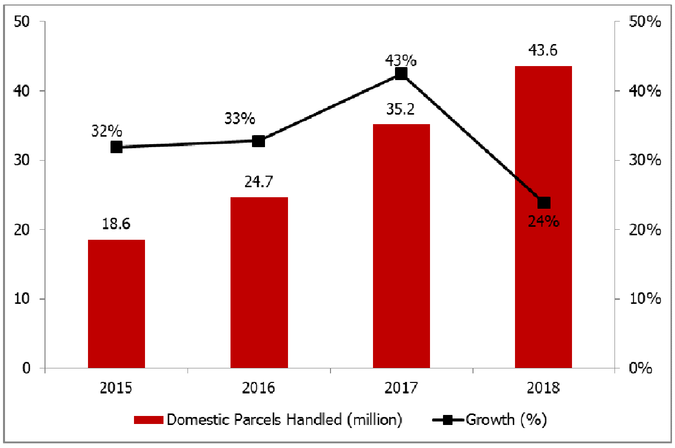
Category	Annual Change (%)
Food and personal care	39
Toys, DIY and hobbies	33
Furniture and appliances	30
Electronics and physical media	29
Fashion and beauty	26
Travel (including accommodation)	18
Video Games	16
Digital Music	10

Source: Statista Digital Market Outlook for E-commerce, E-Travel and digital media industries

*Note-figures are based on estimates of full year consumer spend for 2018

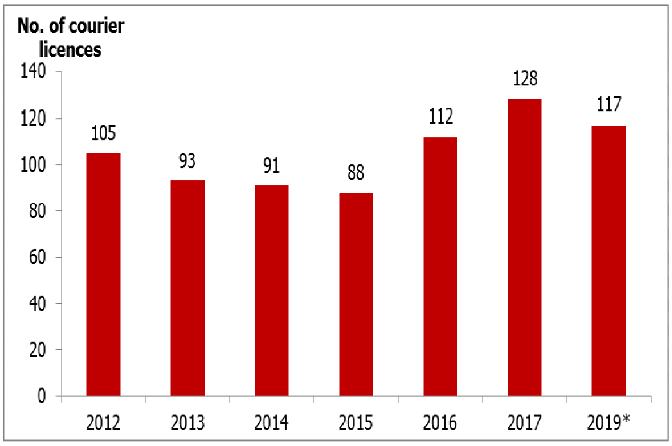
…leading to expansion in operations. In pursuit of meeting such demands, last mile delivery companies are actively expanding operations and networks. In this regard, **GD Express Carrier Berhad (GDEX) (NEUTRAL;TP:RM0.33)** has been aggressively enhancing the average sorting capacity at its Hub 1 in PJ from 110,000 parcels per day to around 130,000 parcels per day. Meanwhile, **Tiong Nam Logistics Holdings Berhad's (Tiong Nam) (SELL;TP:RM0.58)** setup overseas distribution centres in other ASEAN countries and express delivery business called 'Instant'.

Chart 2: Number of domestic parcels handled is still on a positive trajectory



Source: MCMC, MIDFR

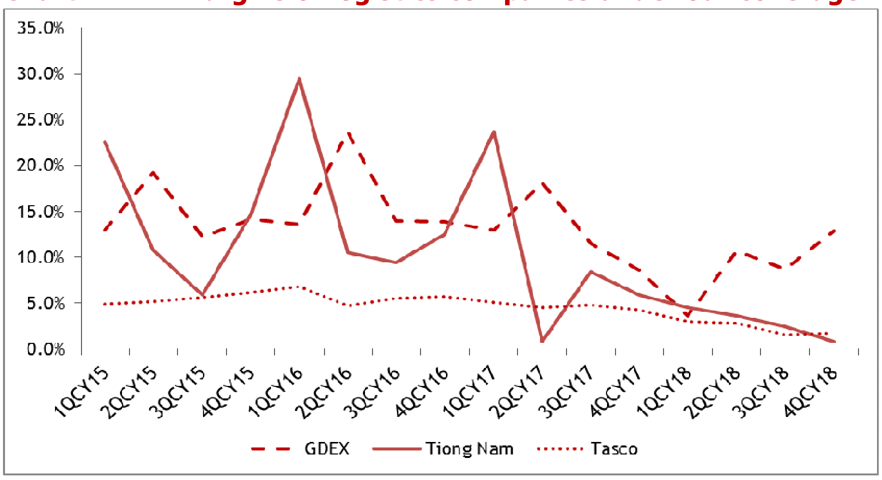
Chart 3: Number of courier licenses granted by MCMC as of January 2019



Source: MCMC, MIDFR

However, winning more business comes at a cost amidst increased competition. The local e-commerce industry is projected to register a +20.8% growth by 2020 indicated by the increasing number of domestic parcels handled. We view that this will entice more last mile deliveries companies to pursue strategic tie up with the various e-commerce companies including startups such as J&T Express and Lalamove which will lead to intense price competition. Existing last-mile delivery companies will need to continuously revise the delivery fees downward in order to remain competitive in view of the high number of players in the industry *(refer to chart 3).* This will inevitably lead to compression in profit margin which, in turn, impacted the earnings of these companies *(refer to chart 4).*

Chart 4: PAT margins of logistics companies under our coverage



Source: Companies, MIDFR

*Note: PAT margins of GDEX was partly caused by gain from redemption of convertible bonds in SAP Express

The need to offer niches services become essential. Competition is expected to remain stiff as new entrants seeks to tap into the growth in Southeast Asian e-commerce which is expected to grow from USD23.2b in 2018 to USD102b by 2025 (>+300%) according to a study by Google and Temasek. In order to circumvent this situation logistics companies need to develop their own niche. For example, GDEX has used its 'myGDEX' online portal to firm up its C2C segment in Malaysia while expanding its footprint by acquiring a 44.5% stake in Indonesia-based courier player, SAP Express. Competition is much tougher in Indonesia given its large demographics of 280m people spread across islands. However, we view that SAP Express's extensive coverage to more than 6000 delivery points will serve as a competitive advantage. Based on our understanding, SAP Express was still loss-making in FYE17 and we are cautiously optimistic on its path to break even in the coming quarters.

Tapping on the growth of online grocery shopping. As highlighted in *Table 1*, food and personal care make up the largest portion of goods purchased online. Although the food products are primarily non-refrigerated this presents a great opportunity for cold chain service providers in the long-run, as the emergence of online shopping for groceries should create additional demand for refrigerated (reefer) trucks and warehouses near major urban areas. Aside from that, opportunities to provide retailers from various industries such as pharmaceuticals, agri-business and halal food production are still ample. **Tasco Berhad's (NEUTRAL; TP:RM1.23)** growth in the cold chain logistics business is a testament to this as PBT margins of the segment has remained healthy above 10% for the past five consecutive quarters. Nonetheless, competition in cold chain logistics is not high in view of high setup costs which also include higher financing costs. We expect profit margin to improve further as the elevated finance costs is expected to taper within three to four years.

Table 2: Growth of industries relying on cold chain logistics

Category	FY15-FY20 CAGR
Pharmaceuticals	10% p.a.
Agri-business	6% p.a.
Halal food production	5% p.a.

Source: PWC, MIDFR

Figure 1: Tasco's freezer room

Source: Company, MIDFR

Figure 2: Tasco's reefer trucks

Source: Company, MIDFR

Maintain NEUTRAL. The presence of the start-ups in the logistics industry will continue to bite into margins of existing players in the wake of higher demand from e-commerce activities. As such, we opine that logistics players will need to continue adapting to the consumer dynamics that prevail over time to remain relevant in the wake of stiff competition coming from these start-ups. All things considered, we reiterate our **NEUTRAL** stance on logistics sector.

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DISCLOSURES AND DISCLAIMER

MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% 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.