Initiation Report | Friday, 30 September 2022

CJ CENTURY LOGISTICS HOLDINGS BERHAD

(7117 | CLH MK) Transportation & Logistics | Industrials

Back in action

***Initiate with* BUY**

***Target Price*: RM0.98**

KEY INVESTMENT HIGHLIGHTS

- **We initiate our coverage on CJ Century with a BUY call and TP of RM0.98**
- **Our valuation was derived by pegging its FY23F EPS to target PER of 16x**
- **We like the Group due to the following: (i) value creation from its CJ Korea Express acquisition, (iii) recent disposal of its loss-making courier business and (iii) strong parental support from CJ Group**

Company Background.

CJ Century Logistics Holdings Berhad (CJ Century or the Group) was founded by Datuk Phua Sin Mo in 1970. The Group was listed on the Main Market of Bursa Malaysia in 2001. CJ Century joined the family of CJ Logistics, South Korea's leading global logistics players, when CJ Logistics Asia (previously known as CJ Korea Express Asia) acquired 30.9% stake in Century Logistics (now known as CJ Century) from Datuk Phua and his family in 2016. In 2020, CJ Century acquired 100% stake in CJ Korea Express Malaysia for RM100.0m via the issuance of 200m new shares to CJ Logistics Asia, thus increasing the latter's shareholding to 54.3%.

Executive Summary.

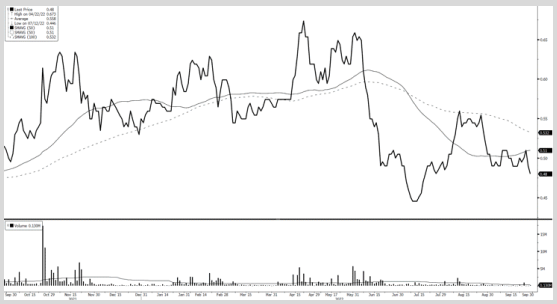
We initiate our coverage on CJ Century with a **BUY** call and TP of **RM0.98**, by pegging its FY23F EPS to target PER of 16x. CJ Century is one of the leading providers of supply chain solutions. Started off as a forwarding agent in the 1970s, the Group has since diversified into integrated logistics, oil logistics, procurement logistics and data management solutions. Its core businesses can be categorised into (i) total logistics and (ii) procurement logistics. In providing its customers with an integrated logistics services, CJ Century owns 130 vehicles that are equipped with fleet management system. It also operates a total of 30 warehouses and distribution centres nationwide that have a total storage capacity of 4.5m sq ft, which effectively places it as the third largest warehouse operator.

Investment Thesis.

i. The acquisition of 100% stake in CJ Korea Express Malaysia has proven to be a value-accretive corporate exercise,
ii. The Group would be able to focus on their core competencies after divesting its loss-making courier business,
iii. New opportunities present themselves with the combined strength and the backing of the "CJ" name.

RETURN STATISTICS	
Price @ 29th September 2022	0.48
Expected share price return (%)	+104.2
Expected dividend yield (%)	+2.1
Expected total return (%)	**+106.3**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	-8.6	-1.8
3 months	-5.9	-1.3
12 months	-7.7	2.2

KEY STATISTICS	
FBM KLCI	1,397.50
Syariah compliant	Yes
Issue shares (m)	586.27
F4BGM Index	No
ESG Grading Band (Star rating)	☆☆☆
Estimated free float (%)	28.64
Market Capitalisation (RM'm)	279.32
52-wk price range	RM0.43 - RM0.69
Beta vs FBM KLCI (x)	0.86
Monthly velocity (%)	65.16
Monthly volatility (%)	22.61
3-mth average daily volume (m)	0.34
3-mth average daily value (RM'm)	0.17
Top Shareholders (%)	
CJ KOREA EXPRESS ASIA PL	55.08
Teow Choo Hing	8.26
Syed Mohammed Syed Ahmad Khali	2.43

MIDF Research
research@midf.com.my

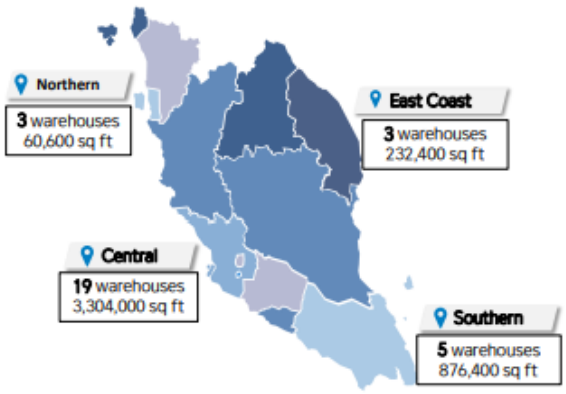
A. BUSINESS ACTIVITIES

CJ Century's business comprises 2 major segments, namely Total Logistics Services and Procurement Logistics Services. The former contributed c.78% to the Group's total revenue in FY21. This segment can be further broken down into 3 divisions: (i) integrated logistics, (ii) oil logistics and (iii) data management solutions. In offering an integrated logistics services to its customers, CJ Century has 130 owned vehicles that are equipped with fleet management. Additionally, it operates 30 warehouses and distribution centres nationwide with a total storage capacity of 4.5m sq ft. They are located within the vicinity of the main seaports, of which 2.0m sq ft are self-owned. This effectively places the Group as the 3rd largest warehouse operator after Tiong Nam Logistics Holdings Berhad (Tiong Nam) and Tasco Berhad (Tasco). Currently, the warehouse space optimisation is at more than 95%.

Under the oil logistics division, the Group operates 2 floating storage units near Port of Tanjung Pelepas (PTP), Johor that has a capacity ranging between 0.32m DWT to 0.35m DWT where it provides ship-to-ship transfer of fuel and crude oil on behalf of its principals. 360 transfer jobs were completed with a total handling of fuel, crude, and gas oil of more than 9.2m MT in FY21. Meanwhile, the data management solutions division is the provision of cost effective and comprehensive document storage services, but this division does not make meaningful contribution to the Group.

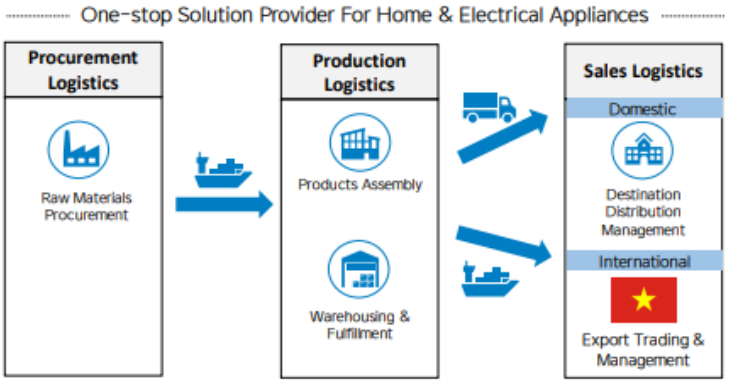
Under the Procurement Logistics Services segment, CJ Century specialises in raw materials sourcing, product assembly, packaging, warehousing, and distribution of home & electrical appliances. This segment contributed the remaining c.22% to the Group's topline. Indonesia and Vietnam are the 2 key export markets for this segment. The Group has assembled approximately 500,000 units of home and electrical appliances in FY21.

Figure 1: Location of Warehouses



Source: Company

Figure 2: Procurement Logistics Segment

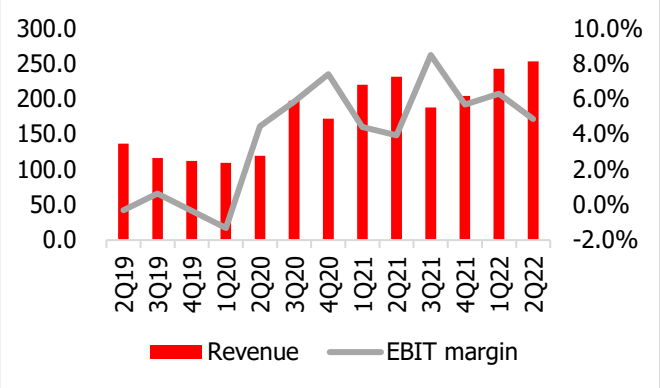


Source: Company

B. INVESTMENT THESIS

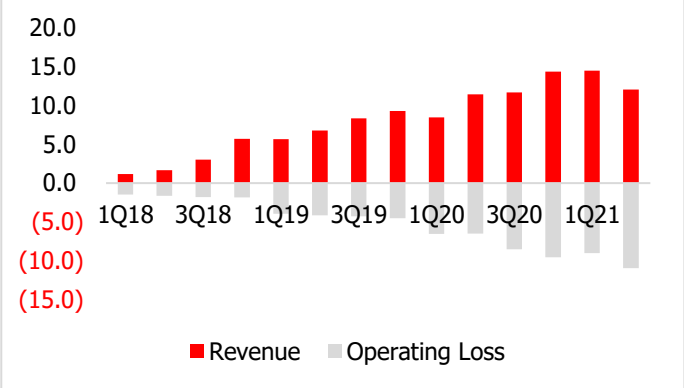
Value creation from the acquisition of CJ Korea Express Malaysia. To recap, CJ Century has completed the acquisition of 100% stake in CJ Korea Express Malaysia Sdn Bhd (CJKX) in 2QFY20 for RM100.0m via the issuance of 200m new ordinary shares to CJ Logistics Asia, thus allowing the latter to increase its shareholding in CJ Century from 30.9% to 54.3%. Similar to the Group, CJKX is a total logistics services provider which is involved in the freight forwarding, warehousing and distribution, as well as transportation. Post-acquisition, CJ Century is able to increase its nationwide presence via the sharing of key logistics hubs and networks as the North and East Coast regions of Peninsula Malaysia was previously underserved. The value creation from this acquisition can be observed by looking at the Group's financial performance from 3QFY20 onwards in Chart 1.

Chart 1: Revenue and EBIT Margin (RM'm/%)



Source: Company

Chart 2: Courier Segment Performance (RM'm)



Source: Company

Disposal of loss-making courier business. CJ Century has divested its loss-making last mile delivery business in FY21 which has cumulatively made a loss of -RM70.0m since it commenced operations in FY18. Bulk of the losses was attributed to the costs incurred for the expansion of trucks, network, and manpower. The boom in e-commerce is seen as an opportunity for new entrants to enter the market and this has made the last mile business an increasingly competitive market throughout the years. Interestingly, the emergence of on-demand delivery services such as Lalamove and GrabExpress has forced courier companies to re-evaluate the quality and speed of their services, but one of the challenges faced by the courier companies is that their existing manpower and infrastructure may not be growing at the same pace as the demand. Throughout the 4 years of its operations, CJ Century has greatly suffered from the stiff competition and cut-throat margins. We view the exit from this business as a necessary move for CJ Century to stem further losses to the Group by reprioritising their resources on their core competencies.

Strong parental support. The acquisition of CJKX by CJ Century has effectively made it the only logistics subsidiary under CJ Group in Malaysia. We believe with the backing of CJ Group, this has opened up new opportunities to be leveraged on, especially in terms of securing tenders and servicing contracts from multinational companies (MNC). The Group would also be able to enhance their operational synergies by making full use of each other's resources and technical know-how to achieve greater scale in their operations and market presence beyond the local market. CJ Century derives about 30%-35% of its total revenue from its Korean customers including Coway, CJ Bio, Hankook Tires, Hanwa Q Cell as well as Lotte Chemical. According to the management, there are currently about 15 Korean employees within the Group who solely focus on tapping and serving the ever-expanding Korean businesses operating in Malaysia.

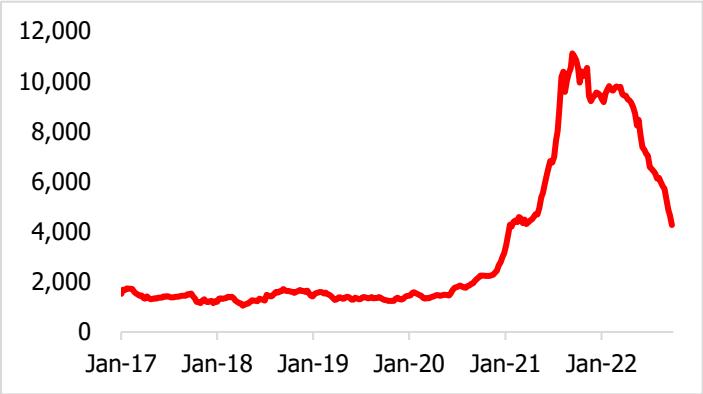
C. KEY CATALYSTS & OUTLOOK

Shortage of warehousing space. Due to the prolonged supply chain issues, businesses have been bulking up their inventories, leading to growing demand for warehouse space since the start of the pandemic and the trend looks set to continue in CY23. Other than anticipating further disruption in the supply chain, manufacturers have opted to keep more inventory on hand in view of the elevated freight costs and shortage of labour. Additionally, demand was also partially driven by multinational companies that are setting up their new distribution centres within the Asean region. Judging by the numbers, rental rates for industrial warehouse space have gone up by about 20%-30% relative to the pre-pandemic levels. To seize the booming demand for storage space, CJ Century aims to invest up to RM350.0m to increase its warehouse capacity by 1.0m sq ft by FY25 and these facilities might be equipped with automated storage and retrieval system, which could fetch higher rental rates. We foresee the take up rate to be high as most warehouse operators have been reporting high occupancy rates of more than 80% especially in prime locations.

Favourable freight rates in the near-term. According to Freightos Baltic Index, which reflects the spot rates for 40-foot containers on 12 trade lanes, ocean freight rates have been on a downtrend after peaking in Sep-21 at USD11,109/FEU. The declining rates was largely attributed to the easing of port congestion globally, gradual return of capacity and change in consumption patterns after lockdowns. Even during the current peak season for seaborne trade (Aug-Oct), the rates are still falling as cargo shippers have reportedly shipped goods for the holiday season in advance.

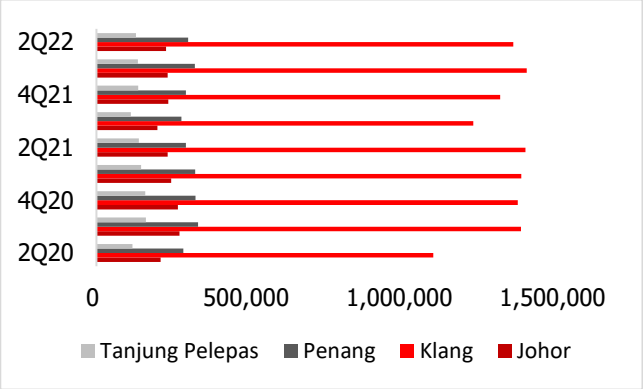
Nonetheless, ocean freight rates are still about 3-4x times higher relative to pre-pandemic levels – hovering above the USD4,200 per FEU level currently. Although we expect shipping freight rates to moderate further going into CY23 on the back of softening global consumer demand, they might remain elevated in the near-term due to the high fuel prices. The rates could be pushed down further in the intermediate term as there was a flurry of new vessel orders being placed in the recent quarters. Elevated freight rates would benefit CJ Century's freight forwarding segment whereby the management has targeted to grow their freight volumes by 10% to 15% for CY23.

Chart 3: Freightos Baltic Index (USD/FEU)



Sources: Freightos & Bloomberg

Chart 4: Gateway Container Volume (m TEU)



Source: Ministry of Transport

Ratification of RCEP and CPTPP. The Regional Comprehensive Economic Partnership Agreement (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) are expected to spur renewed momentum for intraregional trade. The 15 nations in RCEP account for c.29% of the global GDP and c.25% of global trade, while the 11 nations in CPTPP account for c.13% of the global GDP and c.14% of global trade. According to the Asian Development Bank, the CPTPP is estimated to increase world real income by USD147.0b by CY30, with RCEP adding USD186.0b. We believe the logistics players of the participating nations would stand to benefit from the flows of goods with the eventual reduction of up to 90% of the tariffs on goods traded between the members over the next 20 years.

D. SWOT ANALYSIS

Table 2: SWOT Analysis

Strengths	Weaknesses
▪ Strong parental support from CJ Group. ▪ Value-added procurement logistics. ▪ Diversified client base. ▪ Experienced management team.	▪ Competitive operating landscape in the fragmented logistics industry. ▪ Top 10 customers contributing close to 40% of total revenue.
Opportunities	**Threats**
▪ Booming demand for warehousing storage. ▪ Ratification of both RCEP and CPTPP. ▪ Securing MNC accounts. ▪ Malaysia being well-positioned to be a regional logistics hub and gateway to ASEAN.	▪ Scarcity of landbank to build warehouses. ▪ Shortage of truck drivers. ▪ Economic slowdown or recession risk.

Source: MIDFR

E. RISKS RELATED TO THE BUSINESS AND INDUSTRY

Inability to secure the land for its warehouse expansion. In the next 3 years, the Group aims to invest a total of RM350.0m for the additional 1.0m sq ft in warehouse storage. The management mentioned that they are still scouting for a suitable piece of land that is of the right size and at an appropriate location. There could be a downward revision in ours earnings forecast should they fail to find a piece of land that matches their requirements within the period.

Shortage of drivers. This is an inherent risk for most players in the logistics industry, but we believe CJ Century is able to mitigate this as it does not have a large fleet of vehicle relative to its peers, considering most of its truck requirements are outsourced to third parties.

Economic slowdown or recession risk. The logistics services sector has a moderate correlation with business cycle and could be sensitive to changes in GDP growth due to their dependency on trade. However, barring any sharp external shocks, we expect Malaysia's economy to record sustained growth. Based on our preliminary inhouse projections, real GDP is expected to grow by +4.2% in CY23, with exports and imports expected to increase by +2.9% and +4.4%.

F. FINANCIALS

Recap of 1HFY22 results. CJ Century's revenue from its continuing operations (excluding the disposed courier segment) rose to RM495.7m (+9.9%yoy) in 1HFY22 mainly due to the higher overall volumes handled by the total logistics segment. This segment's revenue saw an improvement of +24.5%yoy due to higher export volumes recorded by the freight forwarding segment following the global easing of movement restrictions. This has more than offset the underperformance in the contract logistics operation which faced higher operating costs. Meanwhile, the procurement logistics segment's revenue was down by -3.2% attributed to a disruption of components from its suppliers in China due to the lockdowns in 1QFY22. The export volumes were reduced but will be deferred to later quarters hence this segment might perform better in 2HFY22. Overall, core PATAMI of RM16.9m rose substantially compared to a loss of -RM10.6m in the corresponding quarter thanks to the divestment of its loss-making courier business.

CJ CENTURY: 2Q22 RESULTS SUMMARY

Profit & Loss	2Q22	1Q22	2Q21	QoQ	YoY	6M22	6M21	YoY
Revenue	252.9	242.8	231.1	4.2%	9.4%	495.7	451.0	9.9%
Operating profit	12.3	15.3	9.1	-19.6%	35.4%	27.6	18.8	46.8%
Finance costs	(2.0)	(2.0)	(2.4)	-1.2%	18.0%	(3.9)	(4.9)	19.0%
PBT	10.3	13.3	6.7	-22.7%	54.7%	23.7	13.9	69.7%
Taxation	(3.1)	(4.0)	(3.6)	22.0%	12.3%	(7.1)	(3.9)	-82.6%
PATAMI	7.2	9.3	(8.2)	-23.1%	187.8%	16.5	(10.4)	258.6%
Core PATAMI	7.5	9.4	(8.4)	-20.4%	188.7%	16.9	(10.6)	259.4%
OP margin (%)	4.9%	6.3%	3.9%			5.6%	4.2%	
PBT margin (%)	4.1%	5.5%	2.9%			4.8%	3.1%	
Core PATAMI margin (%)	3.0%	3.9%	-3.6%			3.4%	-2.3%	
Tax rate (%)	-30.2%	-29.9%	-53.3%			-30.1%	-27.9%	

Sources: Suria & MIDFR

Earnings forecast. We expect CJ Century to record a 3-year revenue CAGR of 4.8% up until FY24F, underpinned by favourable freight rates coupled with increasing freight volume. As mentioned previously, the management has budgeted to grow their freight volumes by +10% for FY23. Additionally, we have factored in the Group's warehousing capacity expansion plan that is to build and additional 1.0m sq ft by FY25 and we expect the average utilisation rates of these warehouses to remain high within the 85% to 90% range. In terms of minimum wage impact, about 22% of its employees were earning between RM1,200-RM1,5000 per month prior to the revision. The impact of the revision on the Group's cost is expected to be minimal, which is in the range of an additional c.1% to the total labour cost or c.0.1%

to the total direct cost. As for the fuel cost, it is an industry-wide practice to have the fuel adjustment factor in place to adjust prices in their quotation and/or contract terms based on the fluctuating diesel pump price. Overall, we expect PATAMI margin to be stable between the 3.5%-4.5% range.

Dividend. The management has declared a dividend of 0.5 sen per share in 2QFY22 which implies dividend payout of 18%. Note that the last dividend declared was back in 4QFY18. Thanks to the positive synergy with CJKX as well as the disposal of its underperforming courier business, the Group has been recording healthy level of profits. Although the Group currently does not have a formal dividend policy, we were made to understand that the management is weighing the possibility of setting the policy after the release of its 4QFY22 results early next year. Currently, we assume a dividend payout of 20% for FY22E-FY24F, yielding between 2%-3%.

G. VALUATION

We value CJ Century at **RM0.98** per share by pegging its FY23F EPS to the 5-year historical mean of its peers of 16x. We believe this is justified given the anticipated post-pandemic demand for transportation services, the synergies and backing of the CJ Group and the structural changes brought about by the prolonged supply chain challenges. Currently, the stock is trading at PER of about 8x FY23F EPS, which is at -1.5 SD of its 5-year historical mean of 15x.

INCOME STATEMENT

Profit & Loss	FY2020A	FY2021A	FY2022E	FY2023F	FY2024F
Revenue	589.9	843.0	935.8	951.2	971.0
Gross profit	104.4	125.8	131.0	142.7	155.4
EBITDA	66.5	72.7	81.9	94.5	110.6
PATAMI	0.9	6.7	30.9	35.7	43.1
Core PATAMI	7.8	10.0	30.9	35.7	43.1
Core EPS (sen)	1.3	1.7	5.3	6.1	7.3
PER (x)	36.0x	28.1x	9.1x	7.9x	6.5x
DPS (sen)	0.0	0.0	1.0	1.0	1.5
Dividend yield (%)	n.a.	n.a.	2.1%	2.1%	3.1%

Balance Sheet	FY2020A	FY2021A	FY2022E	FY2023F	FY2024F
Assets					
PPE	461.1	428.2	490.1	549.6	606.8
Others	46.1	47.7	48.7	45.7	38.8
Non-Current Assets	507.2	475.9	538.8	595.3	645.6
Inventories	36.4	25.8	29.0	29.1	29.3
Receivables	220.1	222.5	247.0	251.1	256.3
Cash	60.2	54.6	107.0	169.3	185.4
Current Assets	316.8	302.9	382.9	449.5	471.1
Total assets	824.0	778.8	921.7	1,044.8	1,116.7
Liabilities					
Borrowings	148.7	126.9	176.9	256.9	276.9
Others	16.1	14.5	14.5	14.5	14.5
Non-Current Liabilities	164.8	141.4	191.4	271.4	291.4
Borrowings	62.1	36.1	40.3	45.6	50.5
Payables	167.8	163.2	183.2	184.0	185.6
Others	12.2	15.9	56.3	64.7	75.6
Current Liabilities	242.2	215.2	279.8	294.3	311.7

Total liabilities	407.0	356.6	471.2	565.7	603.1
Equity					
Share capital	300.0	300.0	300.0	300.0	300.0
Reserves	119.2	125.7	150.5	179.1	213.5
Others	(2.3)	(3.5)	0.0	0.0	0.0
Equity	417.0	422.3	450.5	479.1	513.6
Total Liabilities & Equity	824.0	778.8	921.7	1,044.8	1,116.7

Cash Flow	**FY2020A**	**FY2021A**	**FY2022E**	**FY2023F**	**FY2024F**
PBT	27.2	28.8	41.3	47.6	57.4
D&A	31.7	36.5	33.2	39.5	45.7
Change in WC	(23.9)	4.8	47.6	5.1	7.1
Tax paid	(5.3)	(6.3)	(10.3)	(11.9)	(14.4)
Others	(23.0)	(9.5)	-	-	-
CFO	6.7	54.3	111.7	80.2	95.9
CAPEX	(55.9)	(37.6)	(96.0)	(96.0)	(96.0)
Others	84.7	34.9	-	-	-
CFI	28.8	(2.7)	(96.0)	(96.0)	(96.0)
Dividends paid	0.0	0.0	(6.2)	(7.1)	(8.6)
Borrowings	(6.7)	(36.2)	54.3	85.3	24.8
Others	(10.8)	(11.2)	-	-	-
CFF	(17.5)	(47.4)	48.1	78.1	16.2
Net cash flow	18.0	4.2	63.8	62.4	16.1
Beginning cash	20.9	38.9	43.1	107.0	169.3
Ending cash	38.9	43.1	107.0	169.3	185.4

Sources: Suria & MIDFR

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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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology