

China / Hong Kong Company Update

Cosco Shipping Energy Transportation

Bloomberg: 1138 HK EQUITY | Reuters: 1138.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

2 Nov 2020

BUY

Last Traded Price (30 Oct 2020): HK\$3.05 (HSI : 24,107)

Price Target 12-mth: HK\$4.00 (31% upside)

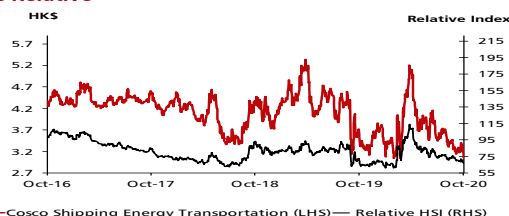
Analyst

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What's New

- 3Q20 net profit was in line with our below-consensus expectation
- Earnings projections largely unchanged
- Current valuation levels do not accurately reflect improving fundamentals
- Maintain BUY with unchanged TP of HK\$4.00

Price Relative



Forecasts and Valuation

| FY Dec (RMBm) | 2019A | 2020F | 2021F | 2022F |
|--------------------------------|--------|--------|--------|--------|
| Turnover | 13,721 | 17,070 | 16,002 | 16,947 |
| EBITDA | 5,195 | 8,493 | 7,035 | 7,861 |
| Pre-tax Profit | 1,002 | 4,445 | 2,882 | 3,654 |
| Net Profit | 414 | 3,706 | 2,055 | 2,673 |
| Net Pft (Pre Ex) (core profit) | 417 | 3,731 | 2,055 | 2,673 |
| Net Profit Gth (Pre-ex) (%) | 330.6 | 794.5 | (44.9) | 30.1 |
| EPS (RMB) | 0.00 | 0.78 | 0.43 | 0.56 |
| EPS (HK\$) | 0.00 | 0.90 | 0.50 | 0.65 |
| Core EPS (RMB) | 0.10 | 0.78 | 0.43 | 0.56 |
| Core EPS (HK\$) | 0.12 | 0.91 | 0.50 | 0.65 |
| EPS Gth (%) | N/A | N/A | (44.5) | 30.1 |
| Core EPS Gth (%) | 330.6 | 657.3 | (44.9) | 30.1 |
| Diluted EPS (HK\$) | 0.00 | 0.90 | 0.50 | 0.65 |
| DPS (HK\$) | 0.02 | 0.05 | 0.32 | 0.17 |
| BV Per Share (HK\$) | 8.08 | 7.70 | 7.88 | 8.36 |
| PE (X) | N/A | 3.4 | 6.1 | 4.7 |
| CorePE (X) | 25.5 | 3.4 | 6.1 | 4.7 |
| P/Cash Flow (X) | 2.0 | 1.9 | 2.3 | 1.7 |
| P/Free CF (X) | 2.7 | 9.3 | 4.3 | 2.4 |
| EV/EBITDA (X) | 7.2 | 4.6 | 5.6 | 4.6 |
| Net Div Yield (%) | 0.8 | 1.5 | 10.3 | 5.7 |
| P/Book Value (X) | 0.4 | 0.4 | 0.4 | 0.4 |
| Net Debt/Equity (X) | 0.9 | 0.8 | 0.7 | 0.6 |
| ROAE (%) | 1.5 | 12.4 | 6.4 | 8.0 |
| Earnings Rev (%) | | (2) | 1 | New |
| Consensus EPS (RMB) | | 0.71 | 0.42 | 0.47 |
| Other Broker Recs: | | B:8 | S:0 | H:0 |

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Emerging out of the storm

Investment Thesis

Compelling valuation with improving prospects. The current price level is a good entry point, in our view – CSET is trading at close to 2 standard deviations (SD) below its five-year mean on both a P/BV (0.4x) and EV/EBITDA (6.4x) basis, which is inconsistent with its earnings growth trajectory. Furthermore, investors can enjoy an attractive dividend yield of 9-10%/5-6% in FY20/21.

We expect a re-rating to be driven by tanker freight rates bottoming out on rising demand as we enter a seasonally stronger fourth quarter, with a more pronounced recovery in FY21F on the back of a more favourable supply-demand set-up. CSET's medium-term prospects also appear promising, as the company continues to expand its LNG transportation division.

Valuation:

We value CSET on a P/BV peg of 0.5x (-1SD level) on FY20F book value to derive a TP of HK\$4.00.

Where we differ:

Below-consensus EBITDA projection – while we are slightly more conservative on CSET's growth prospects, we believe that the stark disconnect between its growth profile and valuation presents a solid buying opportunity.

Key Risks to Our View:

i) Prolonged OPEC+ production cuts, ii) resurgence in COVID-19 cases globally, and iii) sluggish recovery in global oil demand.

At A Glance

| | |
|---|----------------|
| Issued Capital - H shares (m shs) | 1,296 |
| - Non H shrs (m shs) | 3,467 |
| H shs as a % of Total | 27 |
| Total Mkt Cap (HK\$m/US\$m) | 30,374 / 3,918 |
| Major Shareholders (%) | |
| China Shipping (Group) Co., Ltd. | 44.3 |
| Major H Shareholders (As % of H shares) | |
| GIC Private Limited | 10.9 |
| Eastspring Investments (Singapore) Limited | 5.0 |
| H Shares-Free Float (%) | 84.0 |
| 3m Avg. Daily Val. (US\$m) | 3.87 |
| GICS Industry: Industrials / Transportation | |



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WHAT'S NEW

In-line quarter, anticipate sequential earnings improvement

3Q20 results tracking well against our below-consensus expectations. Cosco Shipping Energy Transportation (CSET) reported net profit of RMB416.8m in 3Q20, bringing 9M20 net profit to RMB3,324.2m, forming 82.6%/87.2% of consensus/DBS full-year estimates respectively. CSET's performance in 4Q20 will likely be similar to 3Q20, given that prevailing freight rates for crude oil/refined oil tankers have largely been moving sideways over the past few months, which suggests that CSET will likely fall short of the consensus full-year projection.

Back down to earth after an out-of-this-world 1H20. As expected, CSET's gross profit plunged sequentially to RMB714.3m (-73.2% q-o-q), due to the supply glut in the sector as floating storage demand continued to dwindle which led to the return of more tankers into the contracting pool. Hence, while CSET's domestic operations remained fairly resilient, its international business, which is primarily exposed to spot rates, saw a significant decline in freight rates (45-47% q-o-q), and consequently gross margin.

Free cash flows decline due to ambitious fleet expansion plans. Free cash flow in 3Q20 was slightly negative as capital spending of RMB1,997m during the period exceeded CSET's operating cash flow of RMB1,830m, while 9M20 free cash flow amounted to RMB1,733m (-32.6%). CSET expects to spend an additional RMB1,819m in 4Q20, which will bring capex for the year to around RMB5,400m, and has set a capital budget of RMB5,000m for FY21F-FY23F. This is expected to expand CSET's VLCC fleet by c1.3dwt (7.7% of existing capacity),

Suzmax and Aframax fleet by 0.32dwt (50% of existing capacity) and 0.22dwt (13.2% of existing capacity) respectively, and LNG fleet capacity by 0.70mcm.

Earnings projections largely unchanged; maintain BUY with unchanged TP of HK\$4.00. Our stance on CSET has remained unchanged since we initiated coverage back in early October. We think that the current crisis levels do not accurately reflect CSET's earnings prospects as its earnings would likely bottom in 2H20, underpinned by gradually improving sector fundamentals and CSET's growing fleet capacity. Yet, the company is trading at around 2 SD below its 5-year average (despite its forward [FY20F] ROE of 11.2%) and enticing 9-10% forward dividend yield.

Company Background

CSET is one of the world's largest crude oil/oil product tanker companies, owning and operating 157 oil tankers with a total capacity of 23.1m dead weight tonnage (DWT) as at Sep-2020. CSET has a dominant presence in the domestic market, with a market share of over 55% in the coastal crude oil transportation market. Furthermore, CSET is also involved in the transportation of LNG via its wholly-owned subsidiary – Cosco Shipping LNG Shanghai (Shanghai LNG) – and China LNG Shipping (CLNG). As at Dec-2019, the group owned a total of 37 LNG carriers, with an aggregate capacity of 6.3mcm.

Quarterly revenue breakdown (RMB m)

| | 3Q19 | 4Q19 | 1Q20 | 2Q20 | 3Q20 |
|---|----------------|----------------|----------------|----------------|----------------|
| Domestic crude oil | 662.4 | 670.5 | 664.0 | 704.2 | 818.8 |
| Domestic refined oil | 570.9 | 653.9 | 551.7 | 619.9 | 619.7 |
| Domestic vessel chartering | 28.2 | 27.3 | 25.4 | 23.4 | 27.2 |
| Domestic oil shipping total | 1,261.5 | 1,351.7 | 1,241.0 | 1,347.5 | 1,465.7 |
| International crude oil | 1,249.1 | 1,247.6 | 1,977.8 | 3,025.4 | 1,213.0 |
| International refined oil | 214.7 | 166.9 | 302.8 | 418.6 | 193.4 |
| International vessel chartering | 293.0 | 163.9 | 176.5 | 489.3 | 314.4 |
| International oil shipping total | 1,756.9 | 1,578.4 | 2,457.1 | 3,933.2 | 1,720.8 |
| International LNG Shipping | 332.2 | 336.4 | 329.5 | 320.5 | 333.2 |
| Total revenue | 3,468.1 | 3,190.4 | 4,068.2 | 5,601.3 | 3,616.5 |

Source: Company, DBS HK

Gross profit margin (by segment)

| | 3Q19 | 4Q19 | 1Q20 | 2Q20 | 3Q20 |
|---|--------------|--------------|--------------|--------------|--------------|
| Domestic crude oil | 34.0% | 31.9% | 23.1% | 39.8% | 35.5% |
| Domestic refined oil | 20.8% | 16.5% | 4.7% | 28.3% | 13.9% |
| Domestic vessel chartering | 31.0% | 28.9% | 40.3% | 5.5% | 1.1% |
| Domestic oil shipping total | 27.9% | 24.4% | 15.3% | 33.9% | 25.8% |
| International crude oil | 2.7% | 13.9% | 25.9% | 53.0% | -1.0% |
| International refined oil | 1.3% | -18.2% | 13.8% | 42.2% | -18.3% |
| International vessel chartering | 20.5% | -46.9% | 25.6% | 54.9% | 38.4% |
| International oil shipping total | 5.5% | 4.2% | 24.4% | 52.1% | 4.2% |
| International LNG Shipping | 55.9% | 48.8% | 57.6% | 53.3% | 54.3% |
| Aggregate gross profit margin | 18.1% | 17.9% | 24.5% | 47.7% | 19.8% |

Source: Company, DBS HK

Quarterly Income Statement (RMBm)

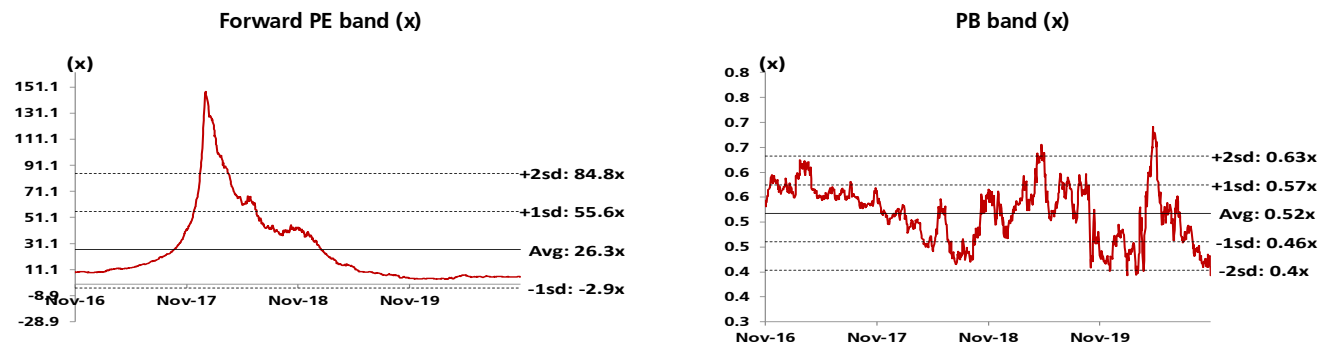
| FY Dec | 3Q2019 | 2Q2020 | 3Q2020 | % chg yoy | % chg qoq |
|-------------------------|--------------|----------------|--------------|---------------|----------------|
| Revenue | 3,392.2 | 5,601.3 | 3,524.3 | 3.9% | (37.1%) |
| Cost of Goods Sold | (2,764.1) | (2,930.3) | (2,809.5) | | |
| Gross Profit | 629.1 | 2,671 | 714.9 | 13.5% | (73.3%) |
| Other Oper. (Exp)/Inc | (184.6) | (149.8) | (148.7) | | |
| Operating Profit | 447.0 | 2,521.2 | 566.2 | 23.0% | (78.3%) |
| Other Non Opg (Exp)/Inc | 11.8 | (42.2) | 34.8 | | |
| Associates & JV Inc | 186.5 | 263.4 | 205.5 | | |
| Net Interest (Exp)/Inc | (400.0) | (211.1) | (279.1) | | |
| Exceptional Gain/(Loss) | | | | | |
| Pre-tax Profit | 242.8 | 2,531.3 | 508.1 | 109.3% | (79.9%) |
| Tax | (55.8) | (112.2) | (27.7) | | |
| Minority Interest | (73.1) | (93.3) | (63.6) | | |
| Net Profit | 113.9 | 2,325.9 | 416.8 | 266.0% | (82.1%) |
| Net profit bef Except. | 113.9 | 2,325.9 | 416.8 | 266.0% | (82.1%) |

Margins (%)

| | | | |
|--------------------------|-------|-------|-------|
| Gross Margins | 18.5% | 47.7% | 20.3% |
| Operating Profit Margins | 13.1% | 45.0% | 15.5% |
| Net Profit Margins | 3.4% | 41.5% | 11.8% |

Source: Company, DBS HK

Historical PE and PB band



Source: Thomson Reuters, DBS HK

Income Statement (RMB m)

| FY Dec | 2018A | 2019A | 2020F | 2021F | 2022F |
|----------------------------|--------------|--------------|--------------|--------------|--------------|
| Revenue | 12,100 | 13,721 | 17,070 | 16,002 | 16,947 |
| Cost of Goods Sold | (10,304) | (11,125) | (11,483) | (12,074) | (12,388) |
| Gross Profit | 1,796 | 2,596 | 5,587 | 3,928 | 4,558 |
| Other Opng (Exp)/Inc | (771) | (926) | (888) | (928) | (932) |
| Operating Profit | 1,025 | 1,670 | 4,699 | 3,000 | 3,626 |
| Other Non Opg (Exp)/Inc | 81 | (64) | (11) | 0 | (5) |
| Associates & JV Inc | 508 | 715 | 873 | 968 | 1,099 |
| Net Interest (Exp)/Inc | (1,179) | (1,316) | (1,091) | (1,086) | (1,067) |
| Dividend Income | 0 | 0 | 0 | 0 | 0 |
| Exceptional Gain/(Loss) | (22) | (3) | (25) | 0 | 0 |
| Pre-tax Profit | 413 | 1,002 | 4,445 | 2,882 | 3,654 |
| Tax | (120) | (330) | (489) | (576) | (731) |
| Minority Interest | (219) | (258) | (250) | (250) | (250) |
| Preference Dividend | 0 | 0 | 0 | 0 | 0 |
| Net Profit | 75 | 414 | 3,706 | 2,055 | 2,673 |
| Net Profit before Except. | 97 | 417 | 3,731 | 2,055 | 2,673 |
| EBITDA | 3,795 | 5,195 | 8,493 | 7,035 | 7,861 |
| Growth | | | | | |
| Revenue Gth (%) | 27.3 | 13.4 | 24.4 | (6.3) | 5.9 |
| EBITDA Gth (%) | (17.3) | 36.9 | 63.5 | (17.2) | 11.7 |
| Opg Profit Gth (%) | (35.6) | 63.0 | 181.4 | (36.1) | 20.9 |
| Net Profit Gth (%) | (95.8) | 454.2 | 795.4 | (44.5) | 30.1 |
| Margins & Ratio | | | | | |
| Gross Margins (%) | 14.8 | 18.9 | 32.7 | 24.5 | 26.9 |
| Opg Profit Margin (%) | 8.5 | 12.2 | 27.5 | 18.7 | 21.4 |
| Net Profit Margin (%) | 0.6 | 3.0 | 21.7 | 12.8 | 15.8 |
| ROAE (%) | 0.3 | 1.5 | 12.4 | 6.4 | 8.0 |
| ROA (%) | 0.1 | 0.6 | 5.5 | 2.9 | 3.8 |
| ROCE (%) | (1.8) | (1.5) | 4.2 | 1.5 | 2.4 |
| Div Payout Ratio (%) | 270.0 | 19.5 | 5.1 | 63.1 | 26.9 |
| Net Interest Cover (x) | 0.9 | 1.3 | 4.3 | 2.8 | 3.4 |

Source: Company, DBS HK

Balance Sheet (RMB m)

| FY Dec | 2018A | 2019A | 2020F | 2021F | 2022F |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|
| Net Fixed Assets | 49,331 | 51,576 | 54,044 | 53,477 | 52,336 |
| Invt in Associates & JVs | 5,208 | 5,542 | 6,415 | 7,383 | 8,482 |
| Other LT Assets | 1,933 | 1,797 | 1,797 | 1,797 | 1,797 |
| Cash & ST Invt | 3,468 | 3,920 | 2,882 | 2,849 | 5,718 |
| Inventory | 927 | 774 | 1,617 | 1,360 | 1,016 |
| Debtors | 752 | 938 | 1,307 | 1,323 | 1,462 |
| Other Current Assets | 1,798 | 1,296 | 1,758 | 1,430 | 1,423 |
| Total Assets | 63,416 | 65,842 | 69,820 | 69,619 | 72,233 |
| ST Debt | 8,602 | 8,598 | 8,307 | 8,161 | 8,015 |
| Creditors | 1,454 | 1,922 | 2,797 | 2,297 | 2,930 |
| Other Current Liab | 825 | 1,828 | 2,166 | 1,957 | 2,235 |
| LT Debt | 22,387 | 20,908 | 20,200 | 19,845 | 19,491 |
| Other LT Liabilities | 875 | 3,418 | 3,418 | 3,418 | 3,418 |
| Shareholder's Equity | 28,192 | 28,125 | 31,640 | 32,398 | 34,352 |
| Minority Interests | 1,081 | 1,043 | 1,293 | 1,543 | 1,793 |
| Total Cap. & Liab. | 63,416 | 65,842 | 69,820 | 69,619 | 72,233 |
| Non-Cash Wkg. Capital | 1,198 | (742) | (280) | (140) | (1,263) |
| Net Cash/(Debt) | (27,522) | (25,587) | (25,624) | (25,157) | (21,789) |
| Debtors Turn (avg days) | 25.7 | 22.5 | 24.0 | 30.0 | 30.0 |
| Creditors Turn (avg days) | 56.2 | 74.7 | 100.7 | 103.2 | 103.2 |
| Inventory Turn (avg days) | 35.6 | 37.6 | 51.0 | 60.3 | 46.9 |
| Asset Turnover (x) | 0.2 | 0.2 | 0.3 | 0.2 | 0.2 |
| Current Ratio (x) | 0.6 | 0.6 | 0.6 | 0.6 | 0.7 |
| Quick Ratio (x) | 0.4 | 0.4 | 0.3 | 0.3 | 0.5 |
| Net Debt/Equity (X) | 0.9 | 0.9 | 0.8 | 0.7 | 0.6 |
| Net Debt/Equity ex MI (X) | 1.0 | 0.9 | 0.8 | 0.8 | 0.6 |
| Capex to Debt (%) | 11.1 | 4.3 | 18.9 | 8.9 | 7.3 |
| Z-Score (X) | NA | NA | NA | NA | NA |

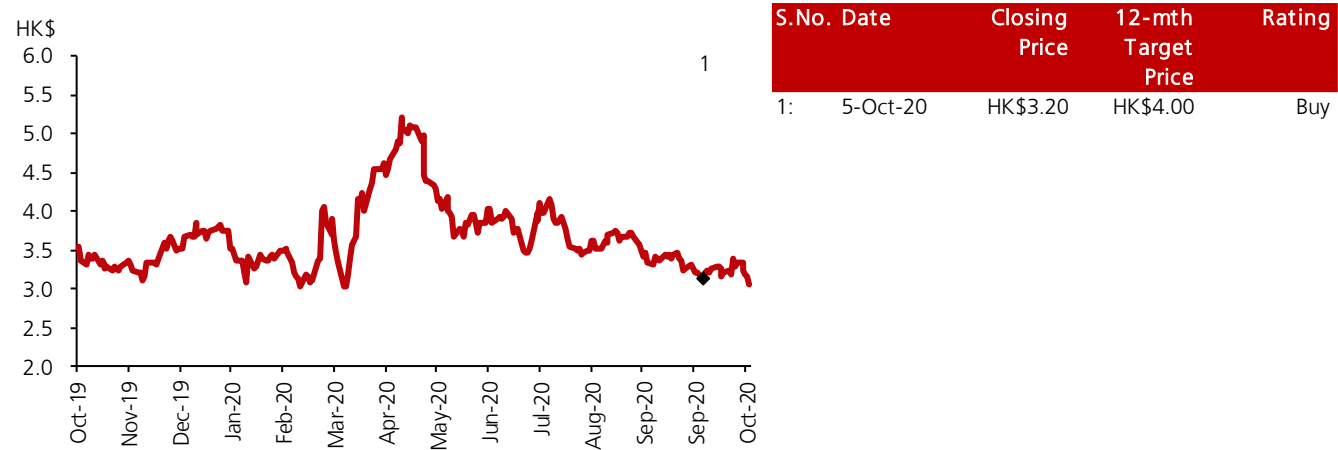
Source: Company, DBS HK

Cash Flow Statement (RMB m)

| FY Dec | 2018A | 2019A | 2020F | 2021F | 2022F |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|
| Pre-Tax Profit | 413 | 1,002 | 4,445 | 2,882 | 3,654 |
| Dep. & Amort. | 2,181 | 2,874 | 2,932 | 3,067 | 3,141 |
| Tax Paid | (92) | (115) | (489) | (576) | (731) |
| Assoc. & JV Inc/(loss) | (508) | (715) | (873) | (968) | (1,099) |
| (Pft)/ Loss on disposal of FAs | 0 | 0 | 0 | 0 | 0 |
| Chg in Wkg. Cap. | (1,031) | 852 | (461) | (140) | 1,123 |
| Other Operating CF | 1,193 | 1,333 | 1,189 | 1,159 | 1,138 |
| Net Operating CF | 2,156 | 5,230 | 6,742 | 5,423 | 7,226 |
| Capital Exp.(net) | (3,445) | (1,276) | (5,400) | (2,500) | (2,000) |
| Other Invt.(net) | 15 | 0 | 0 | 0 | 0 |
| Invt in Assoc. & JV | 0 | 0 | 0 | 0 | 0 |
| Div from Assoc & JV | 220 | 461 | 0 | 0 | 0 |
| Other Investing CF | 862 | 139 | 0 | 0 | 0 |
| Net Investing CF | (2,348) | (675) | (5,400) | (2,500) | (2,000) |
| Div Paid | (202) | (81) | (191) | (1,297) | (719) |
| Chg in Gross Debt | 524 | (1,893) | (1,000) | (500) | (500) |
| Capital Issues | 0 | 0 | 0 | 0 | 0 |
| Other Financing CF | (1,731) | (2,195) | (1,189) | (1,159) | (1,138) |
| Net Financing CF | (1,408) | (4,169) | (2,380) | (2,956) | (2,357) |
| Currency Adjustments | 57 | 65 | 0 | 0 | 0 |
| Chg in Cash | (1,543) | 452 | (1,037) | (33) | 2,868 |
| Opg CFPS (RMB) | 0.79 | 1.09 | 1.51 | 1.17 | 1.28 |
| Free CFPS (RMB) | (0.32) | 0.98 | 0.28 | 0.61 | 1.10 |

Source: Company, DBS HK

Target Price & Ratings History



Source: DBS HK
Analyst: Pei Hwa HO

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

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Sources for all charts and tables are DBS HK unless otherwise specified.

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