

COSCO SHIPPING Energy Transportation (1138); Tanker market is bottoming out

Global demand for oil is projected to have a positive growth despite worries over the US-China trade war and increased tensions in the Middle East. Though the supply side of the market is dim with lots of new tankers to be delivered within these two years, we expect crude tanker demand is strong enough to offset the impact. As the world's largest oil tanker owner, COSCO SHIPPING(COSCO), will be benefited from higher demand for wider distance route, US-Far East, as well as a jump in freight rate ahead of IMO 2020 regulations. We expect COSCO will record robust operating profit in FY19.

Though the freight rates have a seasonal softening after a strong start of the year, we have several **reasons to support the freight rates** through IMO 2020.

- With higher bunker cost to fulfil IMO 2020 rules, we are likely to see further **reductions to sailing speeds** for bulkcarriers, **restrict available tonnage** will support the freight rates.
- Heightened geopolitical risks in Persian Gulf waters, and production cut may extend by OPEC pushing **Asian buyers to snap up oil** in advance while sourcing crude from other suppliers, including US and African despite Middle East remains the biggest exporter to Far East. Notable that recently more crude from the U.S. Gulf of Mexico has been exporting from LOOP with VLCCs to Far East, including China. Since US continues pumping oil from its shale fields and play dominant role in export market, we expect COSCO will benefit from **higher freight rate and longer ton-mile, US-Far East route** which requires 120 days, longer than the average sailing distances, Middle East-Far East 45 days.
- Production of low sulphur fuel from oil refineries around the world will back on-line after their seasonal maintenance. IEA expected the facilities raising throughput by one million barrels per day per month in 2H19.
- China is increasing oil product exports to other Asian countries as they boosted refinery capacity. Data showed diesel exports in April surged 43% from a year earlier.

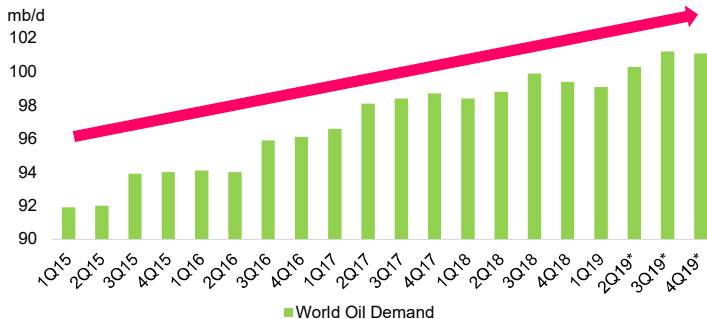
Thus, we expect the VLCC freight rate to increase by 60% YoY and COSCO international shipping business will generate 63% revenue growth in FY19.

Don't worry about the rise of fuel cost.

Singapore indicated that they have ample supply of clean fuel to meet market demand ahead of IMO regulations. Though fuel price is expected to be stable, the new fuel cost for tankers will increase around 40% correspondingly. Yet, we expect the shipping industry is bottoming out, the revenue of COSCO is projected to rise 44% and 48% in FY19 and FY20 respectively, with gross margin growth of 25% to 30%, which is much better than FY18.

Initiate Buy, PT \$ 4.91. Our price target of \$4.91 is based on 0.54X FY19E PB, which is the company's historical PB average plus 1 SD given the industry uptrend. The company is currently trading at 0.45X FY19E PB and 8.0X FY19E PE.

Fig 1. Global oil demand remains high despite oil organizations cut their forecast

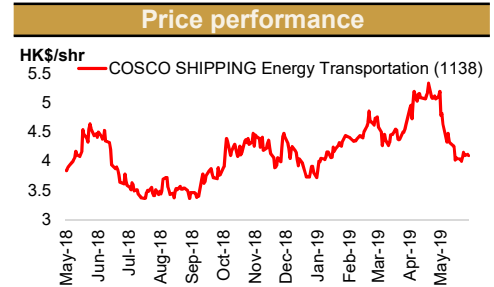


Sources: OPEC estimates, Anli Research

Key data	
Sector	Marine Shipping
Rating	Buy
Price target	HK\$4.91
Upside +/- (%)	21%
Price (HK\$/shr) as of Jun 4 2019	4.05
52wk range (HK\$)	3.3-5.38
Market cap (HK\$)	5.25 bn
Shrs outstanding	4.03 bn
Main ownership (H Share)	Prudential plc (12.87%)

Key indicator forecast					
	FY16	FY17	FY18	FY19E	FY20E
EPS(HKD)	0.56	0.51	0.02	0.51	1.07
BPS(HKD)	7.97	8.17	8.46	9.03	11.75
P/B(X)	0.51	0.50	0.48	0.45	0.34
P/E(X)	7.3	7.9	186.9	8.0	3.8
ROE	6.5%	6.4%	0.3%	6.0%	11.6%
ROA	2.7%	3.0%	0.1%	2.7%	5.0%

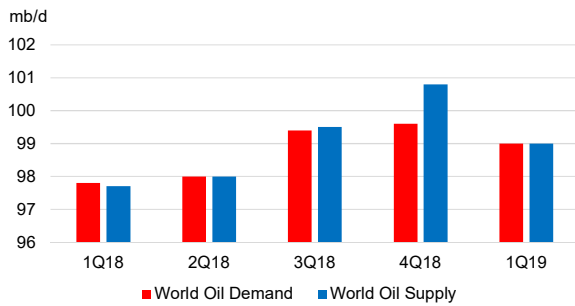
Sources: Company Data, Bloomberg, Anli Research estimates



Source: Bloomberg as of Jun 4 2019

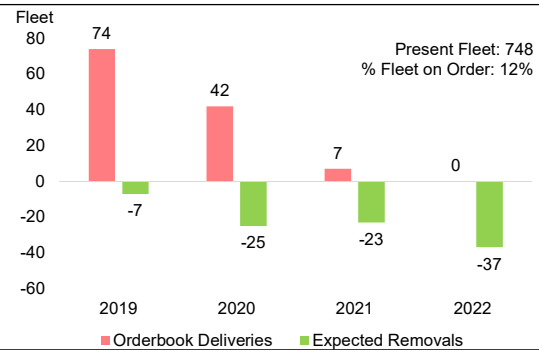
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Fig 2. World Oil demand and supply remain balance amid trade war and Middle East tensions



Sources: OPEC, Anli Research

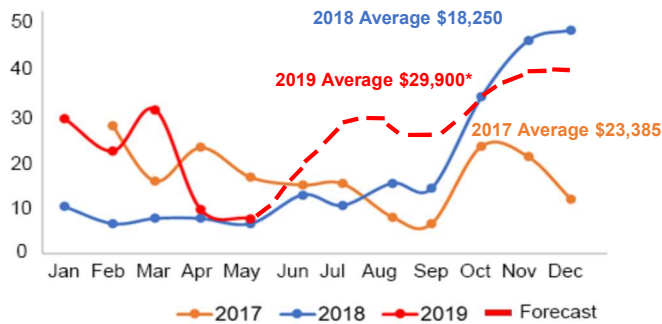
Fig 3. Demolition of VLCC will accelerate from 2020 onwards



Sources: Charles R Weber, Anli Research

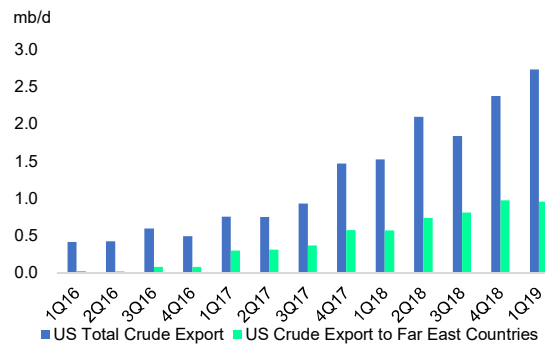
Fig 4. VLCC freight rate may pick up in 2H19

USD ('000) / day



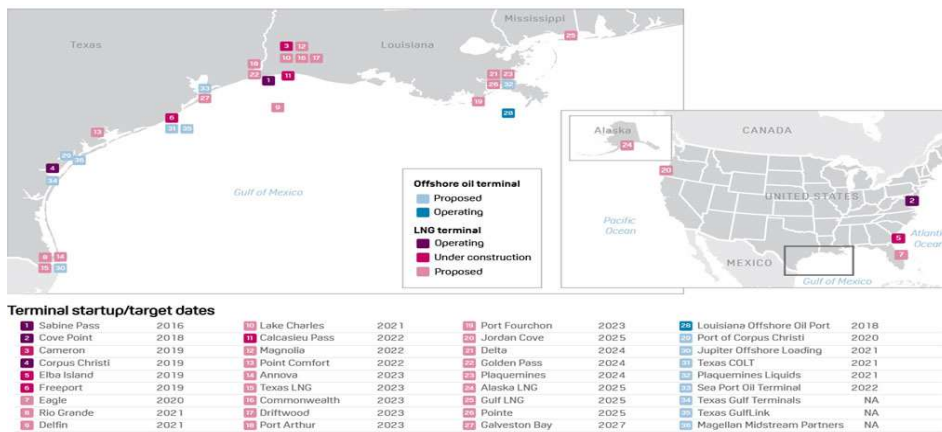
Sources: Baltic Exchange, Anli Research estimates *Forecast

Fig 5. US crude export continues to rise, particularly to Far East countries



Sources: EIA, Anli Research

Fig 6. US new oil ports constructing in progress



Sources: S&P Global Platts, Anli Research

Fig 7. Rise in US to Far East route widens shipping distance in comparison to traditional route TD1-TD4

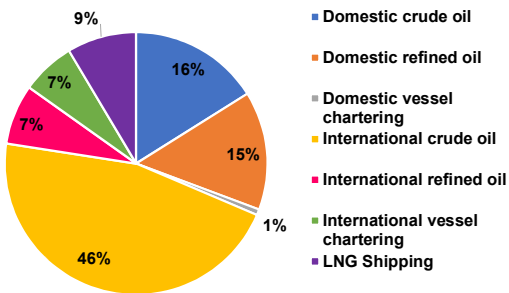


Traditional VLCC Route		Days
TD1	AG to US	48.3 days
TD3	AG to Japan	52.1 days
TD3C	AG to China	49.6 days
TD4	West Africa to US	41.4 days
	US to Far East	120 days

Remarks. Assume 10 knots speed

Sources: tankerinternational.com, port.com, Anli Research

Fig 8. COSCO 1Q19 Revenue Mix



Sources: Company Data, Anli Research

Fig 9. COSCO new oil tanker delivery schedule

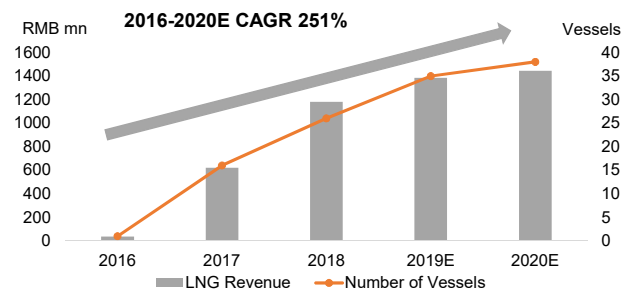
	VLCC	Suezmax	Aframax	Panamax	DWT
2019	0	0	1	0	114K
2020	4	2	3	2	2048.7K
2021	2	1	1	0	894.9K
Total	6	3	5	2	3057.6K

Vessels Types	In operation	Average Age (Years)
VLCC	52	5
Suezmax	3	14.6
Aframax	12	7.9
Panamax	33	8.5
Handysize & below	51	10.3

Remarks: 2020 is an important year for oil tanker delivery.

Sources: Company Data, Anli Research

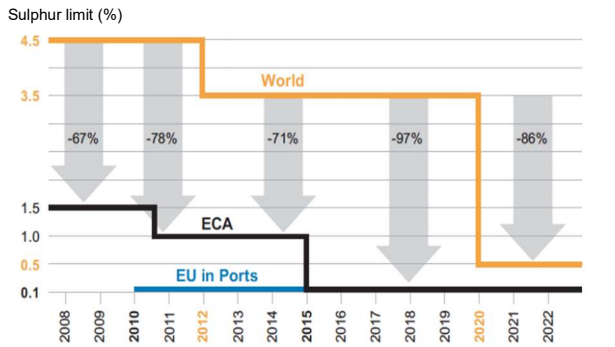
Fig 10. LNG revenue keeps growing along with more vessels to be delivered



LNG Project	Number of Vessel	Year of Delivery
YAMAL Project	1	Delivered in 1Q19
	2	Expected in 2019
	3	Expected in 2020
YAMAL DSC Project	2	Delivered in 1Q19
YAMAL TC Project	4	Expected in 2019

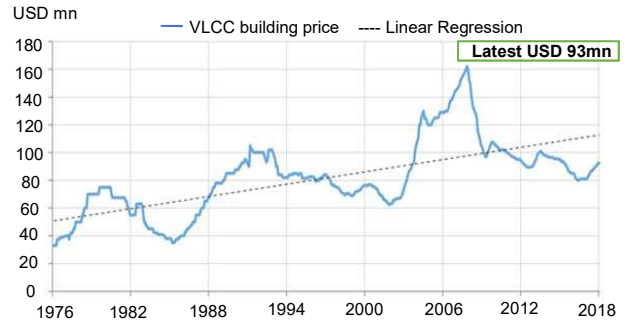
Sources: Company Data, Anli Research estimates

Fig 11. IMO Sulphur regulation schedule



Sources: IHS Markit, Anli Research

Fig 12. VLCC building price has been climbing over years



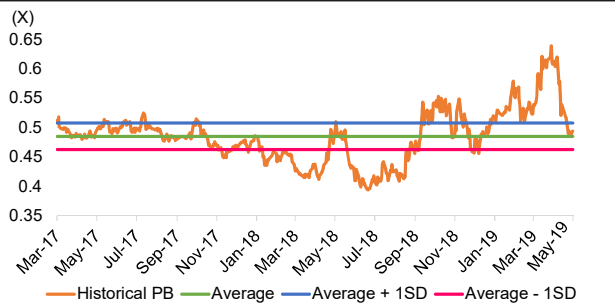
Sources: Company Data, Anli Research

Fig 13. Compliance options of vessels by 2020



Sources: DNV LNGi, EGCSA, Platts, Anli Research

Fig 14. TP of \$4.91 based on average PB plus 1SD



Sources: Bloomberg, Anli Research estimates

COSCO SHIPPING Energy Transportation (1138): Financial summary

Income statement (RMB \$mn)	FY16	FY17	FY18	FY19E	FY20E
Revenue	9,809	9,505	12,100	17,476	25,886
COGS	(7,059)	(7,251)	(10,304)	(13,027)	(18,046)
Gross Profit	2,750	2,254	1,796	4,449	7,840
Admin. expense	(708)	(634)	(770)	(1,171)	(1,734)
Marketing expense	(15)	(29)	(23)	(52)	(78)
Other income	15	879	222	222	222
Other expense	(66)	(54)	(32)	(32)	(32)
Operating profit	1,976	2,415	1,193	3,415	6,218
Financial cost	(874)	(779)	(1,288)	(1,325)	(1,525)
Share of profit or losses from JV & Asso.	432	418	508	570	627
Profit before tax	1,533	2,055	413	2,660	5,320
Income tax	(323)	(162)	(120)	(665)	(1,330)
Net profit	1,933	1,775	75	1,757	3,708

Earnings growth	FY16	FY17	FY18	FY19E	FY20E
YoY growth					
Revenue	-8.4%	-3.1%	27.3%	44.4%	48.1%
Gross profit	-14.2%	-18.0%	-20.3%	147.7%	76.2%
Operating profit	-45.7%	22.2%	-50.6%	186.3%	82.1%
Net profit	63.7%	-8.2%	-95.8%	2242.6%	111.0%
Margin analysis					
Gross margin	28.0%	23.7%	14.8%	25.5%	30.3%
Operating margin	20.1%	25.4%	9.9%	19.5%	24.0%
Net margin	19.7%	18.7%	0.6%	10.1%	14.3%
SG&A and others/sales	7.4%	7.0%	6.6%	7.0%	7.0%

Ratios	FY16	FY17	FY18	FY19E	FY20E
Current ratio(X)	1.2	0.8	0.6	0.5	0.8
ROE	6.5%	6.4%	0.3%	6.0%	11.6%
ROA	2.7%	3.0%	0.1%	2.7%	5.0%
Inventories days	30	28	28	27	26
Receivable days	45	37	23	13	15
Payable days	70	53	52	45	36
Cash conversion cycle	6	12	-1	-5	5

Source: Company Data, Anli Research estimates

Balance Sheet (RMB \$mn)	FY16	FY17	FY18	FY19E	FY20E
Property, plant and equipment	42,261	44,891	49,331	52,291	60,703
Investment properties	1,105	1,137	21	21	21
Goodwill	58	58	73	73	92
Investment in Asso. and JV.	4,000	4,434	5,208	5,778	6,405
Loan receivables	1,454	2,093	1,447	1,067	1,578
Available for sales investments	280	396	0	0	0
Others	132	127	391	2,924	2,909
Total non-current Assets	49,289	53,136	56,472	62,155	71,709
Inventories	457	656	927	997	1,588
Cash and Cash equivalents	6,385	5,011	3,468	2,343	4,326
Trade and bills receivables	1,216	954	752	632	1,061
Prepayment and receivables	919	594	723	852	767
Loan receivables	19	27	13	8	3
Contract assets	0	0	1,057	1,062	1,062
Tax recoverable	0	11	4	0	0
Pledged bank deposits	24	0	1	1	1
Total current Assets	9,020	7,253	6,945	5,895	8,808
Total Asset	58,309	60,389	63,416	68,049	80,516
Trade and bill payables	1,354	1,047	1,454	1,600	1,766
Borrowings	4,625	6,879	7,037	7,523	8,217
Tax payable	122	11	22	17	20
Other payables	1,198	799	731	670	710
Contract liabilities	0	0	60	60	53
Provision and other liabilities	303	55	0	0	0
Other loans	2	74	67	62	68
Bond payable	0	0	1,498	999	499
Employee benefits payable	13	12	12	12	13
Total current liabilities	7,616	8,875	10,882	10,943	11,347
Borrowings	16,953	17,272	18,786	20,086	23,556
Provision and other liabilities	208	15	15	2,467	2,467
Derivative financial instruments	475	423	352	352	352
Other loans	1,050	1,069	1,110	1,249	1,406
Bond payable	3,982	3,986	2,491	1,163	0
Employee benefits payable	141	130	142	143	144
Deferred tax liabilities	296	353	366	379	409
Total Non-Current liabilities	23,105	23,248	23,262	25,840	28,334
Total liabilities	30,721	32,123	34,144	36,782	39,680
Equity	27,588	28,265	29,272	31,267	40,657

Important legal disclosures

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