Asia Credit Research

Earnings Review: Singapore Airlines Ltd ("SIA")

Issuer Profile:
Neutral (3)

Ticker: **SIASP**

Background

Singapore Airlines Ltd ("SIA Group"), listed on the SGX has a market cap of SGD13.6bn as at 18 May 2018. Apart from its flagship carrier, Singapore Airlines ("SQ"), the company also operates other airlines and businesses via subsidiaries: SIA Engineering Company, SIA Cargo, SilkAir and Budget Aviation Holdings (holds Scoot and Tiger Airways which had merged). SIA Group is ~55.6% owned by Temasek while the remaining shareholding is dispersed.

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Recommendation

- SIA Group reported a significantly stronger set of operating profits though profits at SQ and SilkAir was boosted by incidental income (eg: KrisFlyer air miles) and compensation for changes in aircraft delivery slots rather than passenger seats. SIA Group is projected to spend more capital expenditure in the next five years and has announced higher dividends, both which are likely to tilt net gearing higher. In light of its very healthy interest coverage ratio and that SIA Group is starting from a lowly geared position, we are maintaining our Neutral (3) issuer profile.
- Overall we think the SIA curve is trading tight against other issuers that have a similar major shareholder, though within its own curve, we prefer the SIASP 3.75% '24s. We have both StarHub Limited and CapitaLand's issuer profile at Neutral (3).

Relative Value:

Bond	Maturity/Call date	Net gearing	Ask Yield	Spread
SIASP 3.75% '24	08/04/2024	3.8%	3.14%	62bps
SIASP 3.035% '25	11/04/2025	3.8%	3.20%	60bps
SIASP 3.13% '26	17/11/2026	3.8%	3.32%	63bps
STHSP 3.55% '26	08/06/2026	n.m	3.56%	90bps
CAPLSP 3.8% '24	28/08/2024	49.0%	3.26%	71bps

Indicative prices as at 18 May 2018 Source: Bloomberg
(1) Net gearing based on latest available quarter
(2) Net debt-to-EBITDA for StarHub which we see as a better indication of gearing at StarHub was 1.09x against 0.20x at SIA Group

Key Considerations

- **Significant increase in reported operating profit:** SIA Group reported its 4th quarter and full year financial results for the year ended March 2018 ("4QFY2018"). In 4QFY2018, revenue increased 8% y/y to SGD4.0bn, driven by top line growth in the main airline SQ, SIA Cargo and the low cost carrier arm Scoot. Reported operating profit grew significantly by 677% to SGD214.5mn (4QFY2017: SGD27.6mn) from higher contribution from SQ, SIA Cargo and Scoot. SQ's fuel hedging gains of SGD84.1mn (against a fuel hedging loss of SGD10.4mn in 4QFY2017) helped to keep a lid on fuel costs despite the rising fuel prices. Net fuel cost was relatively stable at 25% of revenue in 4QFY2018. Going forward for FY2019, only 20% of jet fuel had been hedged at USD65/BBL (against 40.7% hedged at USD65/BBL in 4QFY2018) which may indicate higher unit cost amidst a rising oil price environment. In 4QFY2018, profit before tax was also boosted by (1) healthier share of profits from joint ventures and associates (SGD21.6mn in 4QFY2018 against SGD1.2mn in 4QFY2017) and (2) the absence of a fine in 4QFY2017 (made up bulk of SGD148.7mn non-operating loss). SIA Group reported a profit before tax of SGD236.5mn in 4QFY2018 against a loss before tax of SGD132.1mn in 4QFY2017.

- **Interest coverage had declined though still very healthy:** EBITDA was up 56% y/y to SGD670mn in 4QFY2018 while interest expense almost doubled to SGD22mn, rendering a still very healthy, albeit lower interest coverage of 30.2x against 33.8x in 4QFY2017. Interest expense had increase following increase in average total debt to SGD3.1bn in 4QFY2018 (against SGD1.6bn in 4QFY2017).

- **SQ profits driven by incidental income and compensation for changes in aircraft delivery slots:** For 4QFY2018, SQ reported SGD137mn in operating profit (up from an operating loss of SGD41mn in 4QFY2017). SQ saw passenger carriage (measured in revenue passenger-kilometre) grow by 1.4% y/y though the negative spread between passenger load factor at 81.1% and passenger breakeven load factor of 84.5% indicate that it was still making losses from seats on scheduled services in 4QFY2018. In our view, the stellar improvements in operating profits at SQ was driven by higher incidental income (eg: air miles sold to programme partners on its KrisFlyer programme) and compensation for changes in aircraft delivery slots. SQ contributed ~63% of total operating profit at SIA Group in 4QFY2018.

- **SilkAir to fully merge with SQ:** SilkAir reported only SGD3mn in operating profit in 4QFY2018 (down from SGD27mn in 4QFY2017). While SilkAir saw passenger carriage increase 12.8% y/y, passenger yield declined by 11.4% (ie: passengers paid less for each km flown). Similar to SQ, SilkAir showed negative spreads between passenger load factor and breakeven load factor. SIA Group had merged the finance operations of SQ and SilkAir in 2017. Along with its results announcement, SIA Group also announced its intention to fully merge the operations of the two, post upgrading of SilkAir cabins (earliest in 2020). Post-merger, SilkAir will cease to operate as a separate brand. At least SGD100mn would be dedicated towards the cost of cabin upgrade.

- **Scoot as the growth driver:** Scoot reported SGD29mn in 4QFY2018 operating profits, up from SGD22mn in 4QFY2017. Passenger carriage increased 16.7% y/y and passenger ticket sales are profitable. SIA Group is targeting an 8% y/y overall passenger capacity growth for FY2019, with Scoot passenger capacity growth targeted to be higher at 17%. Encouragingly, SQ's capacity growth is only targeted at 5%, slightly lower than projected demand growth by industry analysts in the Asia-Pacific region. Assuming SQ's market share stays constant, the targeted capacity growth is unlikely to narrow yields.

- **SIA Cargo turned around and has been re-merged into SQ since April 2018:** For 4QFY2018 and FY2018, SIA Cargo was still a separate business segment though since 1 April 2018, the segment has been re-merged into SQ. In 4QFY2018, operating profit at SIA Cargo was SGD28mn against an operating loss of SGD5.0mn in 4QFY2017. SIA Cargo saw stronger operating performance, with freight carriage growing 4.6% y/y and cargo yield improving 8.5%.

- **Net gearing to tilt upwards from projected capex:** As at 31 March 2018, unadjusted net gearing at SIA Group was 4%, still very low, though had turned from the cash surplus position at the beginning of the financial year. Optically, cash balance at SIA Group was still reasonable at SGD2.6bn, though sales in advance of carriage and deferred revenue (eg: sale of KrisFlyer miles) totalled SGD3.0bn. These are current liability items which represent services which SIA Group would need to carry out down the road. This is a common item across airlines and we are of the view that this cash needs to be kept as party of day-to-day operations. SIA Group has shared that it targets to spend SGD6.2bn in FY2019 and SGD5.7bn p.a on average over the next five years (until FY2023) on capital expenditure, largely on aircraft purchases. Post 4QFY2018, in April 2018, Scoot raised SGD480mn in secured 10 year term loan. Including this additional debt, we estimate that unadjusted net gearing would have increased to 7%.

- **Higher dividends likely to be debt funded:** In FY2018, SIA Group's net cash flow from operations was SGD2.6bn. Removing a one-time fine paid of SGD139mn, this would have been SGD2.7bn vis-a-vis SGD248.3mn of cash paid in dividends to shareholders during the financial year. SIA Group had also proposed to pay a final dividend of SGD0.30 per share (representing a further SGD355mn to be paid out in August 2018, likely to be approved by shareholders). We expect SIA Group's net gearing levels to increase as cash flow generated from operations is insufficient to fund the large capex needs and simultaneously sustain its dividend payments at current levels.

- **Air India not in our base case:** There have been no further announcements with regards to SIA Group's initial possible interest in Air India. The Air India deal itself has been delayed from the original timeline with bid conditions relaxed.

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Explanation of Issuer Profile Rating / Issuer Profile Score

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

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