Asia Credit Research

Earnings Review: Singapore Post Ltd ("SPOST")

Issuer Profile: Positive (2)

Ticker: **SPOST**

Background

Singapore Post Ltd ("SPOST") is the incumbent mail operator in Singapore and was granted the Public Postal License in 1992. Other business segments SPOST participates in include logistics and e-commerce solutions. Through Singapore Telecom Ltd and a few other corporations, Temasek Holdings has an indirect ownership of ~22% of SPOST. Alibaba Group Holdings is the 2nd largest shareholder with ~14% of SPOST.

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Recommendation

- With capex trending lower (down 65.2% y/y), it is crucial for SPOST to balance its steadily declining domestic postal business with the fairly faster growing but less lucrative international postal business. Despite the slow turnaround in the logistics and e-Commerce segments, improvement in credit fundamentals has persisted on the back of steady property rental income. We continue to hold SPOST's **Issuer Profile at Positive (2)**.
- We prefer SPOST PERP over SPOST'20s given the higher ask yield and wider spread for a slightly longer duration. We view risk of non-call for the perpetual as low as it resets to 10Y SDSW + 370bps at first call date, approximately 6.12% as at 27 August 2018. Given 6.12% is higher than the implied cost of funding, SPOST will most likely be able to raise a replacement perpetual at a lower cost.
- Comparing to SingTel, also an issuer profile of Positive (2), SPOST curve seems to provide greater value given that SPOST is in a net cash position.

Relative Value:

Bond	Maturity/Call date	Net Gearing	Ask Yield	Spread
SPOST 3.5% '20s	30/03/2020	net cash	2.3%	41bps
SPOST 4.25%-PERP	02/03/2022	net cash	3.2%	114bps
STSP 3.4875% '20s	08/04/2020	0.22x	2.2%	34bps
STSP 2.58% '20s	24/09/2020	0.22x	2.4%	44bps
STSP 3.25% '22s	29/09/2022	0.22x	2.9%	80bps

Indicative prices as at 27Aug 2018 Source: Bloomberg
Net gearing based on latest available quarter

Key Considerations

- **Postal remains the key business driver**: SPOST reported its first quarter results for the financial year ending March 2019 ("1QFY2019"). Revenue was up 3.3% y/y to SGD372.6mn, driven by the Post & Parcel and Property segments which have more than offset declines in Logistics and e-Commerce. Post & Parcel (49.9% of SPOST's total revenue) saw revenue increase by 5.7% y/y to SGD186mn. Specifically, international mail revenue rose 13% y/y to SGD99.7mn and SP parcels revenue increased 3.9% y/y to SGD22.6mn due to higher e-Commerce deliveries for both cross-border and domestic Singapore. Domestic mail revenue, on the other hand, dipped 2.5% y/y to SGD56.9mn due to decline in domestic letter mails. The drift towards international mail revenue contribution continued with the international/domestic split at 64%/36% versus 60%/40% a year ago. As of 1st April 2018, SP Parcels has been reclassified to be part of Post & Parcels instead of logistics. Taking only the Domestic and International postal business ("Post"), we find that operating profit has increased 7% y/y, led by increases in International postal though overall segment margins are likely to have fallen given the drift. Although international mail revenue grew 13% y/y this quarter, the growth level is significantly lower compared to previous quarters which have been in the 30-40% range (Q4FY2018: 38.8%y/y).

- **Strong Property drove credit fundamentals**: Property segment, which accounted for 6.1% of total revenue, saw a 32.7% y/y increase in its rental income to SGD22.6mn due to higher committed occupancy of 96.7% as at 30 June 2018 (30 June 2018: 95.6%) at the SingPost centre retail mail which reopened in October 2017 after a period of redevelopment. Committed occupancy rate has been increasing albeit at a slower pace since the opening of the mall. We expect this positive trend in committed occupancy rate to continue given the retail mall manager - CapitaLand's established track record of successful marketing and management of retail spaces in Singapore. Operating profit under Property rose 67.1% y/y to SGD13.2mn (Q1FY2018: SGD7.9mn), highest across all segments and contributed 28.9% of the total profit excluding others and exceptional items this quarter (Q4FY2018: 26.3%). Both the Postal and Property segments helped compensate for the wider operating losses at e-Commerce.

- **E-Commerce and Logistics underperformed**: Performance of the e-Commerce segment remained disappointing with revenue down 4.3% y/y to SGD55.2mn (1QFY2018: SGD57.7mn) and operating losses higher at SGD9.3mn (1QFY2018: SGD4.8mn) due to the US businesses, which experienced pricing pressures, change in sales mix from higher margin fulfilment services towards lower margin freight services, as well as an increase in technical labour cost to support business integration efforts. The recovery demonstrated in the previous quarter did not persist as the US market remains challenging. Taking into account the reclassification of business units, logistics segment revenue performance was down 2.2% y/y to SGD120.4mn (1QFY2018: SGD123mn) due to lower volumes recorded in freight forwarding business. Although operating profit has improved to SGD0.1mn from SGD2.5mn losses a year ago due to the turnaround in Quantium Solutions which narrowed its losses by 44.6%, operating profit remains very low relative to previous quarter (4QFY2018: SGD5.3mn). As such, these two segments of the business continue to be areas of concerns going forward.

- **Defensive credit health**: Credit fundamentals of SPOST strengthened further in 1QFY2019. Net operating cash flow improved 22.0% y/y to SGD71.3mn (1QFY2018: SGD58.4mn), on the back of higher working capital as a result of shortening of trade and other receivables. Free cash flow grew strongly to SGD62.1mn from SGD32mn a year ago due to lower capex following the completion of SingPost Centre retail mall. SPOST's also reported a stronger cash surplus position of SGD129.4mn (1QFY2018: SGD70.1mn). As at 30 June 2018, perpetual securities (which rank *pari passu* with the claims of all its unsecured debt at the SPOST holding company level) made up 18% of total capital. Taking the perpetual as debt, adjusted net gearing was lower at 0.16x (unadjusted net gearing: 0.14x) compared to previous quarter of 0.19x. Although operating profit from the Property segment was up 25.9% y/y, it only brought about a 3.5% y/y increase in EBITDA (SGD53.2mn for 1QFY2019 based on our calculation). Further operating losses by e-Commerce and lower operating profit from the Post and Parcel chipped away the earnings from Property. Interest expense declined 39.4% to only SGD2.7mn following the significant drop in average debt balance. Consequently, EBITDA/Interest improved significantly to 20.0x versus 11.7x in 1QFY2018. These suggest that SPOST has strong liquidity and financial flexibility.

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Explanation of Issuer Profile Rating ("IPR") / Issuer Profile Score ("IPS")

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 ("IPR") into a 7 point Issuer Profile Score ("IPS") 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.

Analyst Declaration
The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

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