OCBC Bank

Earnings Review: Singapore Airlines Ltd ("SIA")

Asia Credit Research

Issuer Profile: Neutral (3)

Ticker: **SIASP**

Background

Singapore Airlines Ltd ("SIA Group"), listed on the SGX has a market cap of SGD11.7bn as at 18 February 2019. Apart from its flagship carrier, Singapore Airlines ("SQ"), the company also operates other airlines and businesses: SIA Engineering Company, SilkAir and Scoot. SIA owns a 20%-stake in Virgin Australia Holdings Limited and a 49%-stake in TATA SIA Airlines Limited (operates Vistara Airlines). SIA Group is ~56% owned by Temasek while the remaining shareholding is dispersed.

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Recommendation

- SIA showed an overall 6.5% y/y revenue improvement though operating profit was down 14.6% y/y to SGD387.6mn due to higher fuel cost, staff cost and depreciation. While operating results from SQ looks defensible, low cost carrier success is still elusive.
- At the short end, the SIASP 3.22% '20s provides a ~20bps pick-up over Singapore Telecommunication Ltd ("Singtel")'s STSP 3.4875% '20s which more than compensates for SIASP 3.22% '20s three month longer maturity. At the longer-end, we prefer the SIASP 3.035% '25s over the SIASP 3.13% '26s. We do not think the SIASP 3.13% '26s sufficiently compensates its 19 month longer maturity. We hold SIASP's issuer profile at Neutral (3) and Singtel at Positive (2), albeit we see Singtel's credit profile as deteriorating.

Relative Value:

Bond	Maturity/Call date	Net gearing	Ask Yield to Maturity	Spread
SIASP 3.22% '20s	09/07/2020	0.31x	2.41%	44bps
SIASP 3.035% '25s	11/04/2025	0.31x	3.22%	115bps
SIASP 3.13% '26s	17/11/2026	0.31x	3.31%	116bps
STSP 3.4875% '20s	08/04/2020	0.25x	2.19%	22bps

Indicative prices as at 18 February 2019 Source: Bloomberg
Net gearing based on latest available quarter

Key Considerations

- **Lower but still decent interest coverage ratio:** SIA announced its third quarter results for the financial year ended March 2019 ("3QFY2019") with revenue up 6.5% y/y to SGD4.3bn, on the back of stronger passenger growth, stable cargo revenue and higher revenue contribution from 77.7%-owned SIA Engineering. EBITDA (based on our calculation) was down 1.8% y/y to SGD742mn against SGD31mn in interest expense, representing lower though still decent EBITDA/Interest coverage of 23.6x (3QFY2018: 29.7x). 80% of its fuel requirements for this quarter have been hedged at USD74 so we do not expect SIA to benefit much in 4QFY2019 from the current lower oil price environment. As SIA has ramped up its KrisFlyer Miles business and lately entered into digital payments via KrisPay, we believe this income stream is a less volatile though full year financials should give a better (albeit imperfect) indication of contribution.

- **Flat operating profits at SQ and down at SilkAir y/y:** Overall reported operating profit was down 14.6% y/y to SGD387.6mn due to higher fuel cost, staff cost and depreciation. By segment, SQ (including the re-integrated SIA Cargo) saw operating profit remain relatively flat at SGD369mn. While SQ's overall top line saw good growth of 6.6% y/y with decent load factors for passenger and cargo, profitability was mainly dragged by higher fuel cost. SIA Engineering was the second largest operating profit contributor at SGD16mn. This was down SGD3.0mn, primarily from lower airframe maintenance and fleet management revenue which was insufficiently offset by increases in higher line maintenance revenue. SilkAir reported operating profit of SGD7.0mn, down from SGD19mn in 3QFY2018, also dragged by higher fuel cost. SilkAir will cease to operate as a separate brand post-2020 when it merges with SQ. Certain of SilkAir routes would be progressively transferred to Scoot in April 2019 to 2020.

- **Still figuring out Scoot:** Low cost carrier Scoot reported a measly SGD1.0mn in operating profit (down SGD42mn y/y). Scoot's capacity had been ramped up (+17% y/y) though passenger traffic growth as measured by revenue passengers-km (million) was only up 12.1% y/y, indicating lower fleet utilisation amidst increase in operating cost. While we are in full support of airlines managing technical issues promptly and thoroughly, recent lengthy delays have been observed. For example, in January 2019, passengers on a Taipei flight bound for Singapore were delayed by 28 hours. While break-even load factors were not provided this quarter, we think Scoot would have shown negative spreads from its actual load factor of 77.1%.

- **Made additional investments in associate:** SIA had in March and September 2018 flagged its projected capex plan, with amounts largely to be spent for aircraft renewal and expansion. As at 9MFY2019, SIA had spent ~SGD4.6bn, out of SGD6.2bn projected for FY2019. Of these, SGD1.5bn was spent in 3QFY2019. Outside of the projected capex plan, SIA also made a large SGD184mn investment in associated companies in 3QFY2019, in contrast only SGD19.6mn of additional investment was made in associated companies in the previous quarter. We think this was for its Indian associate Vistara, to help Vistara fund its own plane purchase plans. As highlighted in July 2018, we think that SIA will need to help fund up to ~SGD1.2bn of the cost, reflecting its proportionate 49%-stake in Vistara.

- **Much higher net gearing:** The cash gap at SIA in 3QFY2019 was funded by additional borrowings (bulk from the bond market) and draw down of existing cash, including those received upfront prior to providing service. Net gearing as at 31 Dec 2018 was now much higher at 0.31x versus 0.18x in the previous quarter. Apart from higher debt which was more or less expected, SIA took a SGD2.0bn loss in jet fuel derivatives contracts which hit book value of equity. This though is a non-cash item and could be used to offset fuel costs down the road when incurred. We continue to expect SIA to leverage up for capex funding, including those of Vistara (albeit indirectly via additional investments into associates).

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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.