Asia Credit Research

Earnings Review: Singapore Airlines Ltd (“SIA”)

Recommendation

- SIA’s operating metrics were stronger on the back of overall passenger carriage growth though operating profit was hit from higher y/y net fuel costs. We believe SIA’s KrisFlyer business is increasing as a contributor to the business, which is positive as we think this business tends to be less volatile. Nonetheless, there is insufficient breakdown over this income stream which makes it difficult for us to track the growth trajectory.
- While SIA’s credit metrics still look healthy, the company continues to be on a leverage trend, not only at the SIA level but in our view it will also need to support aircraft expansion plans of its 49%-owned associate Vistara.
- The SIASP curve in general trades 10-22bps tighter than other Neutral (3) names. Within the curve, we are underweight the SIASP 3.035% ‘25s where its YTW is 3.28% against the SIASP 3.75% ‘24s which matures one year earlier though trading at similar levels. We prefer the SIASP 3.75% ‘24s which is paying 11bps more for only a five month longer tenor versus the SIASP 3.16% ‘23s.

Relative Value:

Bond	Maturity/Call date	Net gearing	Ask YTW	Spread (bps)
SIASP 3.22% ‘20	09/07/2020	0.17x	2.71%	66
SIASP 3.145% ‘21	08/04/2021	0.17x	2.84%	74
SIASP 3.16% ‘23	25/10/2023	0.17x	3.14%	88
SIASP 3.75% ‘24	08/04/2024	0.17x	3.28%	99
SIASP 3.035% ‘25	11/04/2025	0.17x	3.28%	93
SIASP 3.13% ‘26	17/11/2026	0.17x	3.45%	101
SIASP 3.13% ‘27	23/08/2027	0.17x	3.49%	101

Indicative prices as at 23 November 2018 Source: Bloomberg
Net gearing based on latest available quarter

Issuer Profile: Neutral (3)

Ticker: **SIASP**

Background

Singapore Airlines Ltd (“SIA Group”), listed on the SGX has a market cap of SGD11.1bn as at 22 November 2018. Apart from its flagship carrier, Singapore Airlines (“SQ”), the company also operates other airline and businesses via subsidiaries: 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 ~55% owned by Temasek while the remaining shareholding is dispersed.

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Key Considerations

- **Operating metrics stronger though offset by higher fuel cost:** SIA reported its second quarter results for the financial year ended 2019 (“2QFY2019”). Revenue was up 5.6% y/y to SGD4.1bn on the back of overall passenger carriage growth (8.4% y/y increase). Encouragingly, growth in passengers carried had outpaced capacity growth, with available seat-km growing only by 5.3% y/y. Passenger load factor (a measure of capacity utilization) was higher at 84.9% in 2QFY2019 against 81.8% in 2QFY2018. Reported operating profit though was down 34.8% y/y to SGD232.9mn. This was mainly due to the 24% y/y rise in net fuel costs, higher depreciation and higher other operating costs. Net fuel cost made up 30% of total costs in 2QFY2019 (27% in 2QFY2018). SIA is hedged at 58% for 2HFY2019 at an average price of jet fuel of USD71/bbl. EBITDA (based on our calculation) was down 12.5% y/y to SGD574mn. With interest expense rising to SGD28mn (2QFY2018: SGD22mn), driven by higher average debt balance in 2QFY2019 of SGD4.0bn versus SGD2.6bn in 2QFY2018, we find EBITDA/Interest coverage lower at 20.6x (2QFY2018: 29.7x), though still very healthy.

- **Associates dragged net income:** SIA had reported a net income of only SGD65.7mn in 3Q2018 against SGD303.2mn in 3Q2017 though it is worth noting that 3Q2018 net income was dragged by a SGD117mn in share of losses of associated companies. This was due to a one-off accounting adjustment at Virgin Australia (“VHA”). This accounting adjustment is non-cash and due to de-recognisation of deferred tax assets (“DTA”) and impairment of assets at Virgin Australia International. Typically DTA, a balance sheet item, is only recognised if it is probable that taxable profit will be available for the DTA to be utilised. With a de-recognisation, we infer that VHA is still not confident that it will turn profitable to utilise these DTA. VHA reported loss before net finance costs and tax of

AUD48.8mn for the financial year ended 30 June 2018 ("FY2018") against AUD120mn in FY2017.

- **Getting more levered though still healthy:** As at 30 September 2018, unadjusted net gearing at SIA was 0.17x, higher than the 0.12x as at 30 June 2018. Common across airlines, SIA part funds its operations using customer prepayments. Cash balance was SGD2.0bn though sales in advanced of carriage (a current liability item where cash had been received ahead of provision of services) was higher at SGD2.6bn. With SIA ramping up its KrisFlyer frequent flyer miles business, we expect sales in advance of carriage to increase in significance going forward. SIA's gross gearing was 0.31x against 0.25x.

- **Capex commitments higher:** In 2QFY2019, SIA had spent SGD1.0bn in investing outflows (largely on purchase of planes) and paid SGD380mn in dividends. These were funded by operating cash flows of SGD612.5mn and additional borrowings of SGD883.1mn (net of debt repaid). Post quarter-end, SIA had raised a further SGD600mn in SGD bonds. We estimate that on a pro-forma basis, SIA's net gearing would have reached 0.2x. SIA had spent SGD3.1bn in capex in 1HFY2019, against SGD6.2bn expected in FY2019. This though excludes amounts that Vistara (49%-owned joint venture) is intending to spend on capex. In July 2018, Vistara had placed orders for 19 aircrafts with Airbus and Boeing, the combined order is valued at USD3.1bn (~SGD4.2bn), though this excludes discounts. Our base case assumes that Vistara will need to pay USD1.9bn (~SGD2.5bn) for the aircraft. Given SIA is a major customer of aircraft, we assume Vistara also benefits from a 40% discount from the sticker price. We expect this funding will need to come from Vistara's owners (or at the very least corporate guarantees). Assuming a proportionate contribution based on their shareholdings, we estimate that SIA would need to fund USD911mn (~SGD1.2bn) of the cost. SIA is on a leveraging trend, though for now we are comfortable maintaining SIA's issuer profile at Neutral (3).

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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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