Issuer Profile:
Neutral (3)

Ticker:
SIASP

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Singapore Airlines Ltd ("SIA")

Recommendation

- **First quarter results for the financial year ended March 2020 ("1QFY2020") saw y/y revenue growth of 6.7% y/y to SGD4.1bn while reported operating profit grew 3.6% y/y to SGD200mn. Growth for the quarter was driven by parent airline SQ, with SilkAir and Scoot both reporting operating losses.**
- **SIA's interest coverage ratio is not comparable y/y given impact from adoption of IFRS 16 – Leases though with EBITDA/Interest coverage at 12.2x, including interest on lease liabilities, we see this as still healthy. Net gearing (assuming lease liabilities as debt) was 0.51x as at 30 June 2019, even taking out lease liabilities impact, this is now far removed from its cash surplus position in 2017. While overall liquidity is acceptable for now, we are looking out for the weakening internal liquidity at SIA, with cash received in advanced and deferred revenue used to fund capex in 1QFY2020.**
- **We are broadly neutral the SIASP curve though we are underweight the SIASP 3.03% '24s, which is trading 6bps tighter compared to the SIASP 3.16% '23s from its own curve (this bond also matures five months earlier).**
- **For now we maintain SIA's issuer profile at Neutral (3) though may lower this should cash balance continue to dwindle amidst operating performance which has not improved decisively.**

Relative Value:

Bond	Maturity date	Net gearing	Ask YTM	Spread
SIASP 3.22% '20	09/07/2020	51.1%	2.19%	50bps
SIASP 3.145% '21	08/04/2021	51.1%	2.36%	71bps
SIASP 3.16% '23	25/10/2023	51.1%	2.65%	102bps
SIASP 3.03% '24	28/03/2024	51.1%	2.59%	96bps
SIASP 3.035% '25	11/04/2025	51.1%	2.88%	121bps
SIASP 3.13% '26	17/11/2026	51.1%	2.95%	122bps
SIASP 3.13% '27	23/08/2027	51.1%	2.98%	122bps

Indicative prices as at 2 August 2019 Source: Bloomberg
Net gearing based on latest available quarter

Background

- Singapore Airlines Ltd ("SIA"), listed on the SGX has a market cap of SGD10.8bn as at 2 August 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 is ~55%-owned by Temasek while the remaining shareholding is dispersed.

Key Considerations

- **SQ operating profit boosted overall growth:** Revenue for the first quarter results for the financial year ended 2020 ("1QFY2020") was up 6.7% y/y to SGD4.1bn. Revenue growth was driven by higher passenger flown revenue, led by overall higher traffic growth (up 8.1% y/y) and 6.6% y/y growth in capacity. As a result, overall passenger load factor was higher by +1.1 ppt at 83.4%. While SIA does not provide cargo flown revenue number, the company indicated that this had declined by 8.4% y/y (down SGD45mn on absolute terms). Reported operating profit though grew by a narrower 3.6% y/y to SGD200mn driven by higher fuel, staff and depreciation costs (though we think depreciation was higher from IFRS 16 impact, so not an apple-to-apple comparison). The parent airline, SQ continue being the main driver of operating profit, generating SGD232mn in operating profit for 1QFY2020 and increasing by 28.2% y/y, although this quarter both SilkAir and Scoot saw large operating losses. ~78%-owned SIA Engineering reported operating profit of SGD18mn (1QFY2019: SGD10mn), despite flattish revenue. SilkAir will be fully merged into SQ (we think within the next 18 months) though preparation matters including transfer of routes have happened and are ongoing. In June 2019, SIA and Malaysian Airlines signed a memorandum of understanding ("MOU") to increase their cooperation (eg: more code-share flights and involve cargo, maintenance, repair and overhaul services), with a formal agreement to be finalised later.

- **Business disruption:** Per company, SilkAir was negatively impacted by the grounding of six 737 MAX 8 aircraft which had reduced capacity by 1.6% y/y. As yet, the company has not provided an update as to whether Boeing will be compensating SIA for the business disruption and the delay in delivery in aircraft. While SIA no longer provides breakeven load factors for its various operations, we think the negative spread between passenger break-even load factor and actual achieved load factor had more than double at SilkAir. In 1QFY2020, operating loss at SilkAir was negative SGD16mn against a small profit of SGD0.2mn in 1QFY2019.

- **Scoot reported operating losses:** Scoot's operating losses were astounding this quarter at SGD37mn (FY2019 operating loss of SGD15mn). While Scoot's traffic growth and capacity growth was both at +6.5% y/y, costs had increased faster while Scoot also did not earn as much in other revenue (eg: fees). With the SilkAir brand ceasing to exist in the short term, associates aside, SIA would be a dual-brand airline and appears to be lifting a playbook out of Qantas Airways Ltd ("QANAU"), albeit without a hinterland. QANAU operates two main brands of "Qantas" and "Jetstar", with the launch of low cost carrier Jetstar in 2004 seen as a big strategic risk back then. We expect Scoot to continue reporting losses in the short term on the back of the intense competition among low cost carriers and Scoot's continuous capacity expansion though it is too early for us to opine on Scoot's longer term prospects.

- **Interest coverage ratio still healthy:** On 1 April 2019, SIA adopted IFRS16 – Leases which had resulted in higher depreciation while finance charges would have also included interest on lease liabilities. As such we think interest coverage ratio on an EBITDA/Interest basis is not comparable y/y. 1QFY2020 EBITDA (based on our calculation) was SGD704mn, with resultant EBITDA/Interest coverage ratio at 12.2x, still healthy. In 1QFY2019 (before IFRS16 was adopted), EBITDA/Interest coverage was 18.0x.

- **Looking out for weakening internal liquidity:** As at 30 June 2019, unadjusted net gearing (lease liabilities included) was 0.51x, which optically is still manageable. Unadjusted gross gearing was 0.68x as at 30 June 2019. While SIA's key credit metrics appear weaker post adoption of IFRS 16, this was a known factor and as such the adoption of IFRS 16 in and of itself does not change our view on SIA's credit profile. Common across the airline industry, SIA receives cash ahead of providing services and for its frequent flyer programme. We have observed that since end-2017, sale in advance of carriage and deferred revenue (both current liabilities) have progressively expanded and as at 30 June 2019, exceeded cash balance by SGD1.3bn. As at 30 June 2019, these liabilities were collectively SGD3.4bn against SGD2.1bn in cash. We think this is indicative of a progressively weakening of internal liquidity. While SIA is free to use the cash on its balance sheet (including for capex and debt repayment) there is no guarantee that customers will not seek refunds and/or higher than expected operating cost to fulfil promised services down the road.

- **Though overall liquidity boosted by access to debt markets:** SIA enjoys significant external liquidity from debt capital and bank loan markets, leading us to view that while weakened, SIA's overall liquidity is acceptable for now. SIA reported cash flow from operations (after tax but before interest) of SGD841.9mn in 1QFY2020, though investing outflow (mainly for aircraft) was SGD1.5bn, with funding from operating cash flow and existing cash balance during the quarter versus previous quarters where debt funding was significant.

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

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

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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