OCBC Bank

Issuer Profile:

Neutral (3)

Ticker:

SIASP

Ezien Hoo, CFA

+65 6722 2215

EzienHoo@ocbc.com

Singapore Airlines Ltd ("SIA")

Recommendation

- **Second quarter results for the financial year ended March 2020 ("2QFY2020") saw y/y revenue growth of 3.9% y/y to SGD4.2bn while reported operating profit was down 8.5% y/y to SGD213.1mn. Growth for the quarter was driven by passenger revenue, with cargo down y/y. 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 we view this as healthy with EBITDA/Interest coverage at 12.9x, including interest on lease liabilities. Net gearing (assuming lease liabilities as debt) had risen to 0.61x as at 30 September 2019 (0.51x as at 30 June 2019)**
- **For now we maintain SIA's issuer profile at Neutral (3) though monitoring for a downgrade within the next 12 months. We are likely to trigger this should profitability at SIA continue to lag its expansion plans. We expect SIA's net gearing to increase to ~85% by end-FY2020, based on SIA's capex alone, which will mean that SIA will no longer fall into our requirement of a Neutral (3) name, notwithstanding its commendable brand standing. While we have less clarity over timing of further investments into 49%-owned Vistara, directionally, in our view it is likely that SIA's net gearing (with lease liabilities) will go beyond ~0.85x.**
- **We are broadly neutral the SIASP curve though within the curve we like the SIASP 3.145% '21s (83bps spread). We are underweight the SIASP 3.03% '24s and the SIASP 3.13% '27s as these two trade tight against the bonds with a shorter maturity. For investors who are aiming to switch out of the Singapore Telecommunications ("STSP") curve though still wished to be invested in a high grade name with the same major shareholder, the SIASP short dated bonds provides a pick-up of ~20-35bps, which more than compensates for SIASP's weaker credit profile. We currently hold STSP's issuer profile at Positive (2), albeit precariously.**

Bond	Maturity date	Net gearing	Ask YTM	Spread
SIASP 3.22% '20	09/07/2020	61.2%	1.87%	44bps
SIASP 3.145% '21	08/04/2021	61.2%	2.23%	83bps
SIASP 3.16% '23	25/10/2023	61.2%	2.55%	111bps
SIASP 3.03% '24	28/03/2024	61.2%	2.42%	96bps
SIASP 3.035% '25	11/04/2025	61.2%	2.74%	123bps
SIASP 3.13% '26	17/11/2026	61.2%	2.84%	126bps
SIASP 3.13% '27	23/08/2027	61.2%	2.86%	125bps
STSP 3.4875% '20	08/04/2020	31.2%	1.57%	9bps
STSP 2.58% '20	24/09/2020	31.2%	1.97%	55bps
STSP 2.72% '21	03/09/2021	31.2%	2.02%	64bps

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

Background

- Singapore Airlines Ltd ("SIA"), listed on the SGX has a market cap of SGD10.9bn as at 18 November 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

- **Operating profit declined in 2QFY2020:** On a y/y basis, SIA's gross revenue increased 3.9% in the second quarter for the financial year ended 2020 ("2QFY2020") to SGD4.2bn on the back of passenger growth revenue (up 7.5% y/y) though partly offset by the fall in cargo revenue of 16.3% y/y. Symptomatic of the sector, the cargo business had been affected by decline in trade volumes. SIA's reported operating profit though declined by 8.5% y/y to SGD213.1mn as expenditure increased by 4.7% y/y, largely due to increase in capacity. SQ reported operating profit decline 2% y/y to SGD233mn while SilkAir reported y/y stable operating losses of SGD3.0mn, despite improvement in SilkAir traffic growth which led revenue higher as SilkAir needed to record costs on its grounded 737 MAX 8 planes. Scoot continued to drag overall results, with the segment reporting an operating loss of SGD39mn (operating loss of SGD11mn in 2QFY2019). Operating profit from 77.7%-owned SIA Engineering was SGD19mn for 2QFY2020 (2QFY2019: SGD11mn) driven by a 1.3% y/y increase in revenue from airframe and line maintenance while expenses declined 2.1% y/y.

- **Highly manageable interest coverage:** In our view y/y EBITDA comparison is less useful given the adoption of IFRS16 Leases from 1 April 2019. In 2QFY2020, we find SIA's EBITDA at SGD736mn, while interest expense (including finance charges on lease liabilities) was SGD57.2mn, resulting in an EBITDA/Interest coverage of 12.9x (1QFY2020: 12.2x), still highly manageable. Reported profit to owners was stronger at SGD94.5mn (2QFY2019: SGD56.4mn) mainly due to much narrower share of losses at associated companies (mainly from Virgin Australia) of SGD49.7mn against prior year share of losses of associated companies of SGD117.1mn. Additionally, SIA recorded a SGD9.9mn share of profit from joint venture companies (ie: Vistara, NokScoot and Singapore CAE Flight Training) versus a loss from joint venture companies of SGD0.5mn in 2QFY2019.

- **Net gearing expected to rise:** As at 30 September 2019, net gearing (with lease liabilities) was 61.2% (30 June 2019: 51.5%), increasing since 2018 as debt was taken to help fund SIA's large capex spent though the q/q net gearing change was driven by drawing down of existing cash balance to fund capex. As at 30 September 2019, SIA is projecting that it will spend SGD5.7bn in capex for FY2020 and SGD6.0bn for FY2021. Capex is predominantly for aircraft (for fleet renewal and capacity addition to boost network and fuel efficiencies). In 1HFY2020, SIA had spent SGD1.2bn in capex (excluding investments to associates and joint ventures), indicating that the remainder targeted for the financial year will be back-loaded.

- **Serious about India for SIA's multi-hub strategy:** We continue to expect SIA to fund expansion at its joint venture, especially 49%-owned Vistara which is not yet profitable and in a huge expansion phase including commencing international operations since August 2019, ordered new aircraft and took over assets and employees of a competitor who had ceased operations. Beyond base case, the media has reported that Tata Group, SIA's India joint venture partner) is interested in Air India which the Indian government is now a highly motivated seller. We think there is now a higher likelihood for a sale to happen given that the Indian government is a highly motivated seller (considering a 100%-stake sale) while debt levels at Air India had been pared down. In our view, should Tata Group be serious about bidding for Air India, this would likely involve SIA as well (eg: taking a minority stake).

<u>Explanation of Issuer Profile Rating / Issuer Profile Score</u>

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.

Treasury Research & Strategy

Macro Research

Selena Ling
Head of Research & Strategy
LingSSSelena@ocbc.com

Tommy Xie Dongming
Head of Greater China Research
XieD@ocbc.com

Wellian Wiranto
Malaysia & Indonesia
WellianWiranto@ocbc.com

Terence Wu
FX Strategist
TerenceWu@ocbc.com

Howie Lee
Thailand, Korea & Commodities
HowieLee@ocbc.com

Carie Li
Hong Kong & Macau
carierli@ocbcwh.com

Dick Yu
Hong Kong & Macau
dicksnyu@ocbcwh.com

Credit Research

Andrew Wong
Credit Research Analyst
WongVKAM@ocbc.com

Ezien Hoo
Credit Research Analyst
EzienHoo@ocbc.com

Wong Hong Wei
Credit Research Analyst
WongHongWei@ocbc.com

Seow Zhi Qi
Credit Research Analyst
ZhiQiSeow@ocbc.com

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

Disclaimer for research report
This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC and/or its related and affiliated corporations may at any time make markets in the securities/instruments mentioned in this publication and together with their respective directors and officers, may have or take positions in the securities/instruments mentioned in this publication and may be engaged in purchasing or selling the same for themselves or their clients, and may also perform or seek to perform broking and other investment or securities-related services for the corporations whose securities are mentioned in this publication as well as other parties generally.

This report is intended for your sole use and information. By accepting this report, you agree that you shall not share, communicate, distribute, deliver a copy of or otherwise disclose in any way all or any part of this report or any information contained herein (such report, part thereof and information, "**Relevant Materials**") to any person or entity (including, without limitation, any overseas office, affiliate, parent entity, subsidiary entity or related entity) (any such person or entity, a "**Relevant Entity**") in breach of any law, rule, regulation, guidance or similar. In particular, you agree not to share, communicate, distribute, deliver or otherwise disclose any Relevant Materials to any Relevant Entity that is subject to the Markets in Financial Instruments Directive (2014/65/EU) ("**MiFID**") and the EU's Markets in Financial Instruments Regulation (600/2014) ("**MiFIR**") (together referred to as "**MiFID II**"), or any part thereof, as implemented in any jurisdiction. No member of the OCBC Group shall be liable or responsible for the compliance by you or any Relevant Entity with any law, rule, regulation, guidance or similar (including, without limitation, MiFID II, as implemented in any jurisdiction).

Co.Reg.no.:193200032W