

SATS Ltd

Stronger associates & JVs offset operating cost pressures



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SINGAPORE | TRANSPORT SERVICES | 2Q18 RESULTS

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- 2Q18 revenue in line with our forecast
- Underlying PATMI beat our forecast by 4.4%, due to associates/JVs contribution coming in 19% higher than we expected
- Better volumes was dragged down by cost pressures, resulting in lower EBIT margin
- 6 cents interim dividend declared, unchanged from previous year
- We upgrade to Accumulate with higher target price of \$5.23

Results at a glance

(SGD mn)	2Q18	2Q17	YoY	Comments
Revenue	435	439	-0.8%	3.1% lower Food Solutions, offset by 2.3% higher Gateway Services
EBIT	61.1	63.6	-3.9%	0.3% lower expenditure; lower margin of 14.1% from 14.5%
Associates & JVs	18.0	11.5	57%	75.9% higher Food Solutions, 50.0% higher Gateway Services
PATMI	72.2	62.1	16.3%	2Q18 includes disposal gain of \$7.0 mn comprising \$5.2 mn from SATS HK and \$1.8 mn from restructuring of Jilin JVCo
Underlying PATMI	65.2	62.1	5.0%	Excluding one-off above; higher margin of 15.0% from 14.2%

Source: Company, PSR

The positives

- + Robust 57% growth from associates/JVs: Overall volumes were up. Management shared that Indonesia and India markets had grown the most. Food Solutions growth came from Evergreen Sky Catering Corp.
- + Growth in underlying PATMI, despite lower operating profit: This was due to higher contribution from associates/JVs. This trend of increasing contribution from associates/JVs is to be expected going forwards, as it is a result of the strategy of forming partnerships – either horizontal integration in new geographies (see overleaf) or vertical integration with existing businesses (such as DAFSS SATS).

The negatives

- Lower Food Solutions revenue was due to weaker meal volumes at TFK Corp.: Some customers switched over to the ANA in-flight kitchen, and Delta Air Lines had cut some Tokyo flights. This resulted in 13.2% YoY lower revenue for TFK Corp.
- EBIT margin had compressed as the YoY decline in revenue outpaced the decline in OpEx: The lower OpEx was largely attributable to the deconsolidation of SATS HK which resulted in lower staff costs, company premise and utilities expense. However, licence fees was 24% YoY higher due to cessation of fee rebates at Changi Airport since 1 April.

Outlook

The outlook remains stable to positive. We see credible earnings growth as SATS continues to make investments in associates/JVs. In our [previous report](#), we mentioned the possibility of airlines divesting non-core businesses such as catering and ground handling. SATS has announced partnerships with AirAsia and Turkish Airlines (see overleaf). We view this positively, as they give SATS exposure to markets far larger than the domestic volumes at Changi Airport.

Upgrade to Accumulate (from Neutral); higher target price of \$5.23 (previously \$5.08)

We incorporate 1H18 results into our FY18e estimates and raise our outlook assumptions for associates/JVs by 12% to 17%. Our target price gives an implied FY18e forward P/E multiple of 23.2x, and forward P/E multiple of 21.7x FY19e earnings. We like the stock for its regional expansion story. SATS is building partnerships today outside of Singapore, that will bear fruit in later years.

Accumulate (Upgrade)

LAST CLOSE PRICE	SGD 4.71
FORECAST DIV	SGD 0.170
TARGET PRICE	SGD 5.23
TOTAL RETURN	14.6%

COMPANY DATA

BLOOMBERG CODE:	SATS SP
O/S SHARES (MN):	119
MARKET CAP (USD mn / SGD mn):	3877 / 5272
52 - WK HI/LO (SGD):	5.39 / 4.55
3M Average Daily T/O (mn):	198

MAJOR SHAREHOLDER (%)

TEMASEK HOLDINGS PTE LTD	39.9%
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PRICE PERFORMANCE (%)

	1M TH	3M TH	1YR
COMPANY	17	(19)	2.9
STI RETURN	4.1	3.8	25.4

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Mar	FY 16	FY 17	FY 18e	FY 19e
Revenue (SGD mn)	1,698	1,729	1,708	1,729
PATMI, adj. (SGD mn)	218	234	252	269
EPS, adj. (cents)	19.67	21.08	22.59	24.11
P/E, adj. (x)	20.6	23.3	20.9	19.5
BVPS (cents)	139.5	150.2	156.2	163.2
P/B (x)	2.9	3.3	3.0	2.9
DPS (cents)	15.0	17.0	17.0	18.0
Div. Yield (%)	3.7	3.5	3.6	3.8

Source: Company Data, PSR est.

VALUATION METHOD

DCF (WACC: 7.0%, Terminal g: 2.0%)

Richard Leow, CFA, CFTe, FRM (+65 6212 1848)

richardleowwt@phillip.com.sg

Key Takeaways

Management shared some insights to the recent two announcements of overseas ventures with airlines.

Formation of Gateway Services JV with AirAsia

- SATS will take a 50% stake in AirAsia's Ground Team Red Holdings (GTRH). Following a series of equity swaps and through that 50% stake in GTRH, SATS will have an effective 60% stake in SATS Ground Services Singapore (SGSS) and effective 49% stake in Ground Team Red (GTR) Malaysia.
- SGSS is a newly formed ground handling entity to serve customers at Changi Airport's Terminal 4 (T4). GTR Malaysia is AirAsia's ground handling unit and it currently only serves the AirAsia group at 15 airports across Malaysia. The four busiest airports in Malaysia are Kuala Lumpur, Penang, Kuching and Kota Kinabalu.
- With this new access to Malaysia, SATS has an opportunity to serve 88 million passengers in Malaysia, in contrast to the 16 million passengers handling capacity at T4. SATS will grow the business by marketing the ground handling services to other third-party airlines.
- GTRH is likely to begin contributing by the end of 2017 after the transfer is completed.

Memorandum of agreement (MOA) with Turkish Airlines (THY) for Food Solutions JV at Istanbul New Airport

- Istanbul New Airport is slated to become the biggest airport in the world. The First Stage will be able to handle 90 million passengers, and eventually 150 million passengers when completed.
- SATS will share the cost with THY and invest 50% of the CapEx to fit-out the interior of the in-flight kitchen. SATS does not have to incur CapEx for the in-flight kitchen building and will likely pay a lease to the airport authorities.
- THY has 70% share of the base market, Istanbul. Consequently, SATS should have sufficient economies of scale through partnering with the base airline, and can then reach out to other airlines for catering.
- MOA is subject to due diligence and further announcements on the details of the partnership should be made within the next six months.

Financials

Income Statement

Y/E Mar, SGD mn	FY15	FY16	FY17	FY18e	FY19e
Revenue	1,753	1,698	1,729	1,708	1,729
EBITDA	246	285	304	306	315
Depreciation & Amortisation	(68)	(70)	(74)	(76)	(79)
EBIT	178	215	231	229	236
Net Finance (Expense)/Inc	0.4	2.4	3.4	3.2	2.8
Other items	(1.6)	2.2	9.9	-	-
Associates & JVs	48	48	65	70	81
Exceptional items	(0.1)	(2.1)	-	7.0	-
Profit Before Tax	225	265	309	310	320
Taxation	(34)	(47)	(48)	(53)	(52)
Profit After Tax	191	218	261	257	268
- Non-controlling interest	(5.0)	(2.2)	2.9	(2.2)	(0.7)
PATMI, reported	196	221	258	259	269
Underlying PATMI	196	218	234	252	269

Per share data (cents)

Y/E Mar	FY15	FY16	FY17	FY18e	FY19e
EPS, reported	17.5	19.9	23.2	23.2	24.1
EPS, adj.	17.5	19.7	21.1	22.6	24.1
DPS	14.0	15.0	17.0	17.0	18.0
BVPS	135.8	139.5	150.2	156.2	163.2

Cash Flow

Y/E Mar, SGD mn	FY15	FY16	FY17	FY18e	FY19e
CFO					
PBT	225	265	309	310	320
Adjustments	27	28	70	3	(5)
WC changes	21	17	38	(17)	8
Cash generated from ops	273	310	417	296	323
Others	(36)	(37)	(43)	(54)	(53)
Cashflow from ops	236	273	374	242	270
CFI					
CAPEX, net	(61)	(49)	(86)	(85)	(85)
Divd from associates & JVs	89	34	42	46	53
Others	30	(41)	(75)	(76)	(76)
Cashflow from investments	58	(56)	(120)	(115)	(108)
CFF					
Share issuance, net	(49.1)	(1.7)	4.3	-	-
Loans, net of repayments	(0.5)	0.4	(6.7)	(10.4)	(20.0)
Dividends	(146)	(156)	(179)	(189)	(189)
Others	(4.4)	0.5	8.7	-	-
Cashflow from financing	(200)	(157)	(173)	(200)	(209)
Net change in cash	95	60	82	(73)	(48)
Effects of exchange rates	(4.8)	0.6	2.0	-	-
CCE, end	430	490	574	500	452

Source: Company, Phillip Securities Research (Singapore) Estimates

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.

Balance Sheet

Y/E Mar, SGD mn	FY15	FY16	FY17	FY18e	FY19e
ASSETS					
PPE	552	517	539	551	560
Intangibles	166	164	158	155	152
Associates & JVs	465	546	671	775	884
Others	45	50	56	56	56
Total non-current assets	1,227	1,276	1,423	1,536	1,651
Inventories	19	22	22	22	22
Accounts Receivables	283	277	271	273	274
Cash	411	490	506	432	385
Others	63	22	40	42	41
Total current assets	776	811	839	770	722
Total Assets	2,003	2,087	2,262	2,306	2,373
LIABILITIES					
Short term loans	16	110	10	20	20
Accounts Payables	287	309	331	319	327
Others	43	51	69	69	69
Total current liabilities	346	470	410	407	415
Long term loans	90	1	98	78	58
Others	67	70	80	80	80
Total non-current liabilities	156	70	178	158	138
Total Liabilities	502	541	588	566	554
EQUITY					
Non-controlling interest	77	74	88	86	85
Shareholder Equity	1,424	1,472	1,586	1,655	1,734

Valuation Ratios

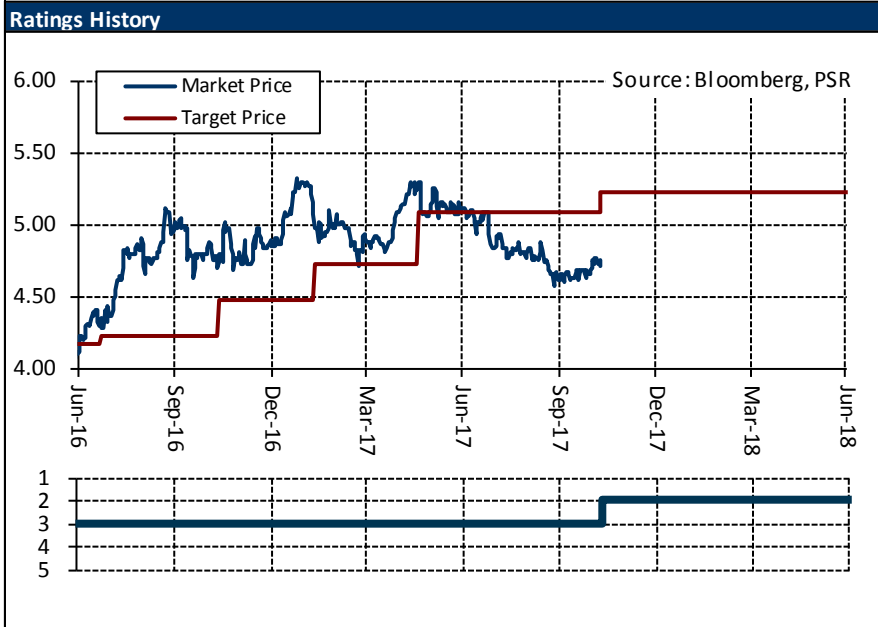
Y/E Mar	FY15	FY16	FY17	FY18e	FY19e
P/E (x), adj.	17.8	20.6	23.3	20.9	19.5
P/B (x)	2.3	2.9	3.3	3.0	2.9
EV/EBITDA (x), adj.	12.8	14.4	16.7	16.1	15.7
Dividend Yield (%)	4.5%	3.7%	3.5%	3.6%	3.8%

Growth & Margins (%)

Growth					
Revenue	-1.9%	-3.1%	1.8%	-1.2%	1.2%
EBITDA	-0.8%	15.8%	6.7%	0.5%	3.1%
EBIT	4.1%	20.6%	7.4%	-0.6%	3.0%
Net Income, adj.	7.0%	11.4%	7.4%	7.4%	6.7%
Margins					
EBITDA margin	14.0%	16.8%	17.6%	17.9%	18.2%
EBIT margin	10.2%	12.6%	13.3%	13.4%	13.7%
Net Profit Margin	11.2%	12.8%	13.5%	14.7%	15.5%

Key Ratios

ROE (%)	13.9%	15.1%	15.3%	15.5%	15.9%
ROA (%)	9.8%	10.7%	10.8%	11.0%	11.5%
Net Debt or (Net Cash)	(306)	(379)	(397)	(334)	(306)
Net Gearing (x)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

Contact Information (Singapore Research Team)
Head of ResearchPaul Chew – paulchewkl@phillip.com.sg**Research Operations Officer**Mohamed Amiruddin - amiruddin@phillip.com.sg**Consumer | Healthcare**Soh Lin Sin - sohls@phillip.com.sg**Oil & Gas | Energy**Chen Guangzhi - chengz@phillip.com.sg**Macro**Pei Sai Teng - peist@phillip.com.sg**Transport | REITs (Industrial)**Richard Leow, CFTe, FRM -
richardleowwt@phillip.com.sg**REITs (Commercial, Retail, Healthcare) | Property**Dehong Tan - tandh@phillip.com.sg**Technical Analysis**Jeremy Ng - jeremyngch@phillip.com.sg**Banking and Finance**Jeremy Teong - jeremyteongfh@phillip.com.sg**US Equity**Ho Kang Wei - hokw@phillip.com.sg

Contact Information (Regional Member Companies)
SINGAPORE**Phillip Securities Pte Ltd**Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel +65 6533 6001
Fax +65 6535 6631
Website: www.poems.com.sg**JAPAN****Phillip Securities Japan, Ltd.**4-2 Nihonbashi Kabuto-cho Chuo-ku,
Tokyo 103-0026
Tel +81-3 3666 2101
Fax +81-3 3666 6090
Website: www.phillip.co.jp**THAILAND****Phillip Securities (Thailand) Public Co. Ltd**15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel +66-2 6351700 / 22680999
Fax +66-2 22680921
Website www.phillip.co.th**UNITED STATES****Phillip Capital Inc**141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1-312 356 9000
Fax +1-312 356 9005
Website: www.phillipusa.com**INDIA****PhillipCapital (India) Private Limited**No.1, 18th Floor, Urmi Estate
95, Ganpatrao Kadam Marg
Lower Parel West, Mumbai 400-013
Maharashtra, India
Tel: +91-22-2300 2999 / Fax: +91-22-2300 2969
Website: www.phillipcapital.in**CAMBODIA****Phillip Bank Plc**Ground Floor of B-Office Centre,#61-64,
Norodom Blvd Corner Street 306,Sangkat
Boeung Keng Kang 1, Khan Chamkamorn,
Phnom Penh, Cambodia
Tel: 855 (0) 7796 6151/855 (0) 1620 0769
Website: www.phillipbank.com.kh**MALAYSIA****Phillip Capital Management Sdn Bhd**B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel +603 2162 8841
Fax +603 2166 5099
Website: www.poems.com.my**INDONESIA****PT Phillip Securities Indonesia**ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel +62-21 5790 0800
Fax +62-21 5790 0809
Website: www.phillip.co.id**FRANCE****King & Shaxson Capital Limited**3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel +33-1 45633100
Fax +33-1 45636017
Website: www.kingandshaxson.com**AUSTRALIA****Phillip Capital Limited**Level 10, 330 Collins Street
Melbourne, Victoria 3000, Australia
Tel +61-03 9629 8288
Fax +61-03 9629 8882
Website: www.phillipcapital.com.au**TURKEY****PhillipCapital Menkul Degerler**Dr. Cemil Bengü Cad. Hak Is Merkezi
No. 2 Kat. 6A Caglayan
34403 Istanbul, Turkey
Tel: 0212 296 84 84
Fax: 0212 233 69 29
Website: www.phillipcapital.com.tr**HONG KONG****Phillip Securities (HK) Ltd**11/F United Centre 95 Queensway
Hong Kong
Tel +852 2277 6600
Fax +852 2868 5307
Websites: www.phillip.com.hk**CHINA****Phillip Financial Advisory (Shanghai) Co Ltd**No 550 Yan An East Road,
Ocean Tower Unit 2318,
Postal code 200001
Tel +86-21 5169 9200
Fax +86-21 6351 2940
Website: www.phillip.com.cn**UNITED KINGDOM****King & Shaxson Capital Limited**6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel +44-20 7426 5950
Fax +44-20 7626 1757
Website: www.kingandshaxson.com**SRI LANKA****Asha Phillip Securities Limited**2nd Floor, Lakshmans Building,
No. 321, Galle Road,
Colombo 03, Sri Lanka
Tel: (94) 11 2429 100
Fax: (94) 11 2429 199
Website: www.ashaphillip.net**DUBAI****Phillip Futures DMCC**Member of the Dubai Gold and
Commodities Exchange (DGCX)
Unit No 601, Plot No 58, White Crown Bldg,
Sheikh Zayed Road, P.O.Box 212291
Dubai-UAE
Tel: +971-4-3325052 / Fax: + 971-4-3328895

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