Land Transport Sector

Improving operating landscape from regulatory reviews and changes

SINGAPORE | TRANSPORT SERVICES | UPDATE

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- Areas under review are: fare formula and licencing of private-hire car companies
- Operating regime change: NEL and SPLRT move to NRFF on Apr 1
- Regulatory reviews and changes addressing *profitability* and *sustainability*
- Fare formula under review by the PTC: any revenue impact is limited to Rail business
- Private-hire car companies possibly facing a licencing regime
- Rental car population YoY growth has moderated, and population has contracted YTD
- Uncertainty of takeover of Uber by Grab for Southeast Asia remains
- Maintain Overweight on the Land Transport Sector, and "Buy" rating on ComfortDelGro Corp with a target price of $2.50.

Outlook

The Positives

+ **Next fare adjustment could be an increase, as the Public Transport Council (PTC) is currently reviewing the existing fare formula.** Fare adjustments in recent years have not tracked the increase in operating costs under the existing fare formula. Any impact from a change in fare formula will be limited to the Rail segment only, and not extend to Bus segment. The Rail segment is still on a fare-revenue model, while the Bus segment has transitioned to the government bus contracting model since Sep 1, 2016.
+ **Worst could be over for Taxi, as Rental cars YoY population growth has not only moderated, but even contracted year-to-date (YTD).** Rental cars population grew +23% YoY for February 2018, but contracted -0.2% since December 2017.
+ **Operating losses for Downtown Line (DTL) to narrow in 2018.** This follows the commencement of revenue service for Downtown Line Stage 3 (DTL3) on Oct 21, 2017. However, there will be a delay in the breakeven due to -2.2% fare reduction that was effective Dec 29, 2017.
+ **North East Line (NEL), Sengkang LRT and Punggol LRT (SPLRT) transit to asset-light model.** The transit to the New Rail Financing Framework (NRFF) alleviates SBS Transit from heavy capital expenditures, thus improving cash flow. The NRFF also mitigates large fare-revenue risks through a limited risk-sharing revenue collar with the Land Transport Authority (LTA).

The Negatives

– **NRFF EBIT margin cap and collar structure limits upside for NEL and SPLRT.** EBIT margin for the lines will be capped at ~5%, with limited risk-sharing from the LTA if EBIT margin falls below 3.5%.

– **Economic moat for Rail segment is eroded as it becomes more contestable.** The NRFF is for a shorter licence period of 15 years with a possible 5-year extension, compared to 30-40 years under the previous regime.

Investment Action

We maintain Overweight on the Land Transport sector, on the basis of regulatory reviews and changes that address *profitability* and *sustainability*.

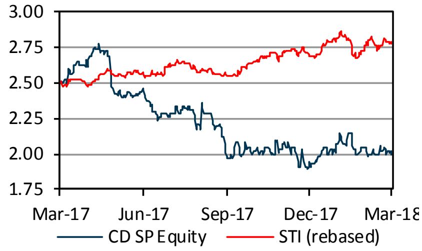
We have a "Buy" rating on ComfortDelGro Corp with a target price of $2.50. We forecast earnings to have bottomed in FY17, with the Public Transport Services segment largely driving earnings going forward. Regulatory changes on fare formula and licencing of private-hire car companies could be catalysts for a re-rating of the stock.

Overweight

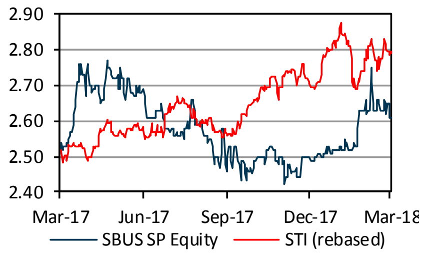
STOCK & INDEX PERFORMANCE (%)

	1MTH	3MTH	1YR
COMFORTDELGRO	(1.0)	4.1	(16.1)
SBS TRANSIT	(1.9)	4.4	6.1
STI RETURN	1.1	3.7	14.3

COMFORTDELGRO VS. STI



SBS TRANSIT VS. STI



Source: Bloomberg, PSR

Richard Leow, CFA, CFTe, FRM (+65 6212 1848)
Investment Analyst
richardleowwt@phillip.com.sg

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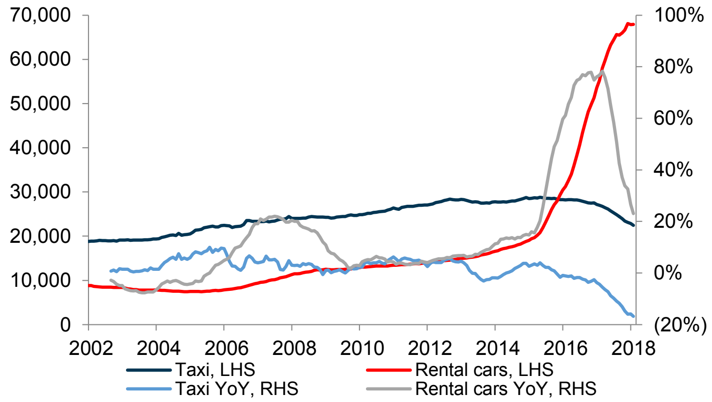
Taxi outlook

- **Rental car population YoY growth has moderated and population has stagnated**

  We had first highlighted in our 2018 Strategy piece (Dec 18, 2017) that Rental cars population growth was moderating and the equilibrium between Taxi and Rental cars populations could be near.

  Rental car population YoY growth had peaked at high-70% in 4Q 2016 and tapered down during 2017. Rental car population had accordingly started to stagnate in 2H 2017. YoY growth for February 2018 has further moderated to 23%.

  Figure 1: Monthly Taxi and Rental cars population



  Source: Bloomberg, LTA, PSR

- **Worst could be over for Taxi, as Rental car population contracted YTD**

  Not only has Rental cars YoY population growth tapered, but the population has contracted -0.2% YTD. For context, Taxi population had a larger contraction of -3.0% YTD. This could be an early indication of an oversupply of Rental cars and an impending rationalisation of its population, thus supporting our view that the equilibrium could be near. We would like to see the monthly YoY contraction in Taxi population start to moderate as well, to serve as an additional indicator that the worst could be over for the Taxi segment.

  Singapore Taxi and Rental cars population

Y/E Dec	Feb-18	Feb-17	YoY	Dec-17	2M18-YTD
Taxi	22,440	26,986	-16.8%	23,140	-3.0%
Rental cars	67,931	55,224	23.0%	68,083	-0.2%

  Source: Bloomberg, LTA, PSR

- **Uber reiterates that it is not exiting Southeast Asia, launches Uber Commute**

  CNBC first reported on Feb 16 that Uber was in the process of selling its Southeast Asian business to Grab. Both firms have denied such reports as "speculation". Uber's Asia Pacific chief business officer subsequently said that was no plans to sell its Southeast Asian business to Grab.

  Amid media reports again in early-March that a deal was being finalised, Uber on Mar 14 launched its carpooling app, Uber Commute. Uber Commute is conceptually similar to GrabHitch, though with some differences. Uber Commute is widely believed to not have a material impact on profits for Uber.

- **Takeover of Uber by Grab in Singapore could face regulatory resistance**

  During the recent Singapore Budget debate, Second Minister for Transport Ng Chee Meng had expressed the government's desire for the transport market to remain "open and contestable". Thus signalling a monopoly is not ideal – having a dominant transport operator may not be in the best interest of commuters.

  We do not speculate on whether a takeover of Uber by Grab in Southeast Asia would materialise. However, we offer two cases on how it could be beneficial or detrimental to the Taxi segment. **Bull case:** more rational pricing of commuter fares and driver incentives for private-hire cars, would shift some demand back to Taxis. **Bear case:** monopoly by Grab over the private-hire car business in Singapore, would put it in a better position to compete against Taxis.

Link to Second Minister's speech.
Source: Ministry of Transport

- **Regulating and licencing of private-hire car companies a possibility**
  Mr Ng had also commented that regulating and licencing of such companies could be possible in the future, as the population of Rental cars has grown unabated. Licencing would require private-hire car companies Grab and Uber to pay for a licence to operate in Singapore. At present, the regulatory regime extends only to drivers and their vehicles. The concern is congestion caused by the private-hire cars, and the government's intent is to have the ability to exercise control over the private-hire car population. This could be beneficial to the Taxi segment, should the government decide to curb private-hire car numbers.

Bus outlook

- **Seletar package to contribute positively to SBS Transit in 2018**
  Bus revenue for SBS Transit is expected to be higher YoY in 2018, mainly due to contribution from the Seletar package after taking over operations since Mar 11 this year. The contract was awarded in April 2017 through a competitive bidding process. The contract value of the package is $480mn over the five-year contract period, with an option for LTA to extend the contract term for an additional two years. Prior to this, the package was a combination of services operated by both SBS Transit and SMRT Buses under the negotiated price agreement.
- **Continuation of Bukit Merah package for SBS Transit**
  SBS Transit was also awarded the Bukit Merah package in February 2018 through a competitive tender process. The contract value is $472mn over the five-year contract period, with an option for LTA to extend the contract term for an additional two years. The package will commence in 4Q 2018. Any upside from the package will be limited, as SBS Transit is the incumbent operator of the package under the negotiated price agreement.
- **Sembawang – Yishun package will be next to be put up for competitive tender**
  The package is currently operated by SMRT Buses for four-years under the negotiated price agreement. It should conclude in 3Q 2020.

Rail outlook

- **Losses for DTL to narrow, with the commencement of DTL3**
  DTL has been loss-making since the commencement of Downtown Line Stage 1 (DTL1) in December 2013. We estimate accumulated losses for DTL came up to ~$150mn as at end of December 2017, with highest ever quarterly loss of ~$16mn in 4Q 2017. Losses over the years were due to start-up costs, as the DTL was progressively opened in three stages.
  However, with the commencement of revenue service for DTL3 in October 2017, the full DTL is now operational and losses are expected to narrow as ridership ramps up to the normalised level.
  The Land Transport Authority stated in a News Release on Feb 10, 2018 that daily weekday ridership on DTL has grown from 300k to 470k since DTL3 opened. This resulted in an average ridership of 279k for DTL in 2017. The normalised ridership level that is being projected for DTL is 500k.
- **Fare reduction in December 2017 to delay DTL breakeven to 2019**
  With the fare reduction of -2.2% that was effective Dec 29, 2017, ComfortDelGro management expects DTL to only turn profitable in 2019. This is contingent on achieving 500k average daily ridership and pending the outcome of the fare adjustment at the end of 2018. A fare reduction at the end of 2018 would further delay DTL turning profitable. (Fare adjustments have historically come into effect at end-December.)
- **Fare formula review: Setting expectation of fare increase at next adjustment**
  The PTC had announced on Apr 5, 2017 that it had commenced a review of the current fare formula. The current fare formula was adopted in late-2013 and it incorporates core Consumer Price Index, Wage Index, Energy Index and Productivity Extraction to derive the fare adjustment. The fare reduction experienced in the last few years was largely due to lower energy costs.
  Transport Minister Khaw Boon Wan commented during the recent Singapore Budget

Fare adjustments under current fare formula

Effective date	Fare adjustment
Apr 6, 2014	+3.2%
Dec 27, 2015	-1.9%
Dec 30, 2016	-4.2%
Dec 29, 2017	-2.2%

Source: PTC, PSR

debate that the current formula is "inadequate" and cheap fares are "not sustainable". Costs have been rising, but fares have reduced – and he said that the current fare formula "can be improved to better track total costs".

Link to Minister's speech.
Source: Ministry of Transport

- **Fare adjustment will only affect Rail segment, with no impact on Bus segment**
  We highlight that only the Rail segment remains on a fare-revenue model, while the Bus segment has transitioned on Sep 1, 2016 to the government bus contracting model where a service fee is awarded through a competitive bidding process.
- **Transit of NEL and SPLRT to asset-light NRFF: Relieving SBS Transit of heavy capital expenditure, but trimming margin**
  The LTA announced on Feb 14 that the NEL and SPLRT will transit to the NRFFF on Apr 1. SBS Transit will pay a Licence Charge to operate the rail lines, and that will go into the Railway Sinking Fund for the renewal of operating assets.
  The Licence Charge Structure for SBS Transit's NEL and SPLRT is identical to that of SMRT Trains. Recall that SMRT Trains' North-South and East-West Lines (NSEWL), Circle Line (CCL) and Bukit Panjang LRT (BPLRT) had transitioned to the NRFF in 2016.
  The transit to the NRFF will relieve SBS Transit from heavy capital expenditure and large fare-revenue risks. Large fare-revenue risk will be mitigated through a risk-sharing revenue collar. However, margin for NEL is expected to be lower going forward, due to the profit-sharing cap and collar structure of the NRFF. EBIT margin will be capped at 5%, with substantial profit-sharing to the LTA above the 5% cap. The current NEL EBIT margin is not disclosed, but we believe it to be in the mid- to high-teens. The LTA's sharing of risk is limited to the amount of Licence Charge payable.

Link to SBS Transit's Press Release on the move to the NRFF.

Structure of Revenue Collar

Shortfall	LTA risk-sharing
2% to 6%	LTA shares 50% of the shortfall
> 6%	LTA shares 75% of the incremental shortfall beyond 6%

Source: SBS Transit, PSR

Structure of Profit Cap and Collar

EBIT margin	LTA risk- and profit-sharing
< 3.5%	LTA shares 50% of the shortfall
> 5%	LTA takes 85% to 95% of the excess above the 5% cap

Source: SBS Transit, PSR

- **No windfall of special dividend for SBS Transit from sale of NEL and SPLRT assets**
  SBS Transit will sell the relevant operating assets of NEL and SPLRT it currently owns to the LTA at net book value. The assets are worth $28.8mn, which is 6.4% of the net asset value of SBS Transit as at Dec 31, 2017. SBS Transit intends to use the sale proceeds to repay borrowings which stand at $181mn as at Dec 31, 2017.

Link to SBS Transit's announcement of sale of operating assets.

Contact Information (Singapore Research Team)

Head of Research
Paul Chew – paulchewkl@phillip.com.sg

Research Associate
Alvin Chia - alvinchiawy@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 - richardleowwt@phillip.com.sg

REITs (Commercial, Retail, Healthcare) | Property
Dehong Tan - tandh@phillip.com.sg

Technical Analysis
Jeremy Ng - jeremyngch@phillip.com.sg

REITs (Commercial, Retail, Healthcare) | Property
Tara Wong - tarawongsj@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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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