Transportation Sector
Results Season Takeaways

Phillip Securities Research Pte Ltd

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Report type: Update

Sector Overview

The Transportation Sector under our coverage consists of Airlines (SIA, Tiger Airways), Shipping (NOL), Land Transport (SMRT, ComfortDelGro) & Aviation Services (SIA Engineering, ST Engineering, SATS).

- Government initiatives a negative for Land Transport
- Potential for collaboration between Tiger & Scoot
- Unattractive valuations for NOL
- Positive on Transport Services for yields
- SIAEC remains our top pick in the Transportation Sector

Earnings Surprise?

4th quarter results for the Transportation Sector surprised on the downside for ComfortDelGro, NOL & Tiger Airways and upside for SIA & ST Engineering. Results for the rest of the sector were in line with our expectations.

Land Transport

Government initiatives to expand bus and rail capacity would likely increase operating expenses for the sector. With no fare adjustments for 2012, we believe that Transport Operators would suffer from tightening of margins in the year ahead. We prefer ComfortDelGro (CDG) to SMRT for its global diversification and cheaper valuations.

Airlines

Progressive lifting of flight restrictions on Tiger Airways Australia could imply lower unit fixed cost for the company. We see potential for collaboration between Tiger Airways & Scoot (SIA's new long haul budget carrier) for traffic feed into each other network in Sydney. We prefer SIA over Tiger Airways on valuation grounds.

Shipping

Market seems to be very focused on expected improvement in freight rates in the container shipping industry. However, we remain skeptical over the sustainability of recent rate increase and maintain our Reduce rating on NOL with its unattractive valuations.

Transport Services

Favorable long term fleet growth in the region implies positive outlook for Aviation Service providers. Investors looking for stocks with a strong dividend track record could also favor the sector. We think that there is scope for SATS to pay out a special dividend at its full year results announcement, with the cash surplus on its balance sheet. ST Engineering continues to trade below its historical earnings multiples range. We rank SIAEC as our top pick in the Transportation Sector for its pure exposure to the Aviation growth story in the region.

Transportation Sector

Company	Rating	Price (S$)	TP (S$)	Upside (%)	M.Cap. (US$'mn)
Land Transport					
SMRT Corp	Sell	1.75	1.33	-24.0%	2,112
ComfortDelGro	Buy	1.50	1.65	10.0%	2,490
Airlines					
Singapore Airlines	Accumulate	10.93	11.30	3.4%	10,204
Tiger Airways	Reduce	0.79	0.58	-26.1%	511
Shipping					
Neptune Orient Lines	Reduce	1.40	1.24	-11.1%	2,861
Transport Services					
SATS	Buy	2.45	2.76	12.7%	2,155
ST Engineering	Accumulate	3.14	3.37	7.3%	7,626
SIA Engineering	Buy	4.09	4.84	18.3%	3,562

Source: Bloomberg, PSR

Analyst
Derrick Heng
derrickhengch@phillip.com.sg
+65 6531 1221

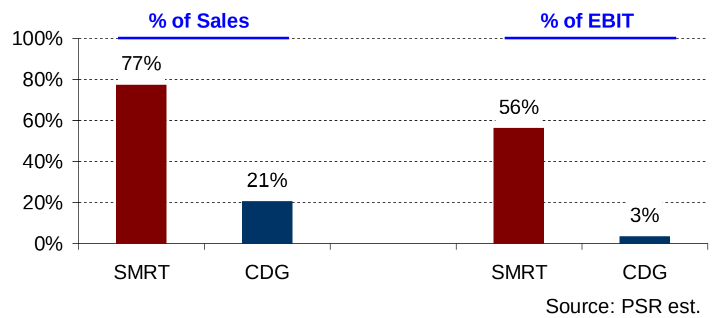
Land Transport

Results commentary. Operating losses of S$5mn for SBST's bus business, sequential decline in average fares & operating losses at its bus business in China resulted in the lower than expected earnings for CDG. While SMRT's profits declined significantly in the quarter, the margin pressure felt was inline with our expectations.

Capacity Expansion. Singapore's Transport Minister updated on plans for the public transport system during the Ministry's Committee of Supply (COS) debate (See: Transportation Sector Update, dated 8 March 2012). Initiatives to ease congestion and improve service quality for the public transport sector imply that more capacity would be injected into the Bus & Rail network over the next few years. For the Bus network, the government would setup a S$1.1bn Bus Service Enhancement Fund to fund the purchase of 550 buses. The Public Transport Operators (PTOs) would fund another 250 buses, representing total fleet growth of 800 buses (c.20% of current fleet) over the next 5 years. Congestion on the Rail network would also be eased with a 40-70% increase in train fleet across various parts of the network.

No Fare adjustment in 2012. There would be no fare adjustments in 2012. Singapore's public transport fares are reviewed annually with the maximum allowable fare increase set by a predetermined formula (0.5*ΔCPI+0.5*ΔWI-1.5%). With capacity expansion and rising operating costs, we believe that keeping transport fares unchanged would result in margin compression for the PTOs.

Fig.1. Exposure to Fare based business



We prefer CDG to SMRT. With Singapore's fare based business accounting for more than half of the Group's profits and 77% its sales, SMRT has a significant exposure to the new measures implemented. CDG would be less affected due to the diversity of its global operations. For CDG, exposure to Singapore's fare based business is much less material at only a fifth of its sales and 3% of profits. When comparing valuations on a Forward P/E basis, CDG's stock price is much more attractive at 13X as compared to SMRT's 20X. We maintain our Buy recommendation on CDG and Sell on SMRT.

Fig.2. SMRT pricey on a P/E basis

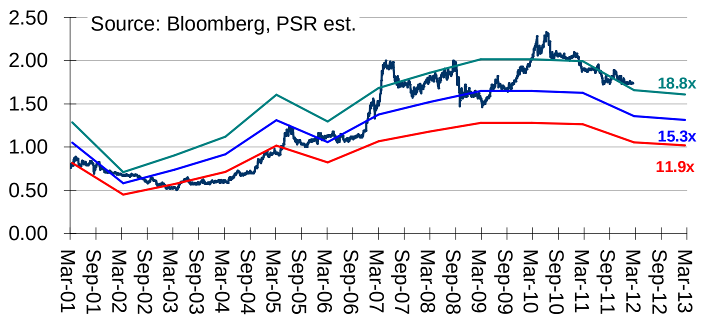
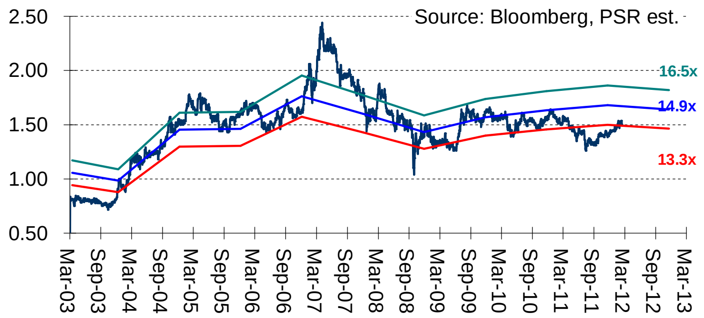


Fig.3. CDG undervalued on a P/E basis



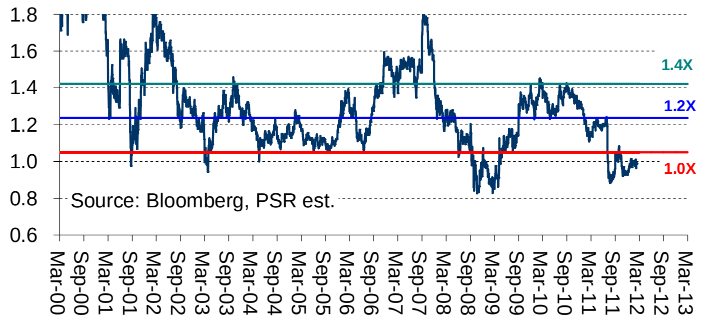
Airlines

Results commentary. With under utilization of its fleet in Australia, Tiger Airways was expected to post losses in the quarter. However, operating losses out of Singapore came as a surprise in the traditional peak travel season. While profits declined by 53% for SIA, the magnitude of profit decline was lower than expected, due to better than expected passenger yields for the quarter.

Lifting of sector limits, second Australian base in Sydney. Tiger Airways Australia announced that regulators would allow the company to operate to a max of 64 (current: 38) sectors per day from Oct 2012. We view this as a positive development for the company as unit fixed cost would be lowered with the gradual easing of flight restrictions. Tiger Airways also announced that the company would setup a second Australian base in Sydney. With this new base, we believe that there is potential for collaboration between Tiger Airways & Scoot (SIA's new long haul budget carrier) for traffic feed into each other network.

Accumulate on SIA, Reduce on Tiger Airways. Under the current high fuel price environment, ticket price differential between full service carriers and budget carriers would narrow. With the challenging operating environment for airlines, we have little conviction in a near term re-rating of SIA's stock price. However, SIA already trade at valuations close to past crisis levels implying little downside, in our view. On a forward basis, Tiger Airways' trades at a premium to Air Asia's (its closest peer) 5yr historical P/B of 1.9X, which we feel is not justified under current market conditions. We prefer SIA to Tiger Airways.

Fig.4. SIA P/B valuation near crisis levels

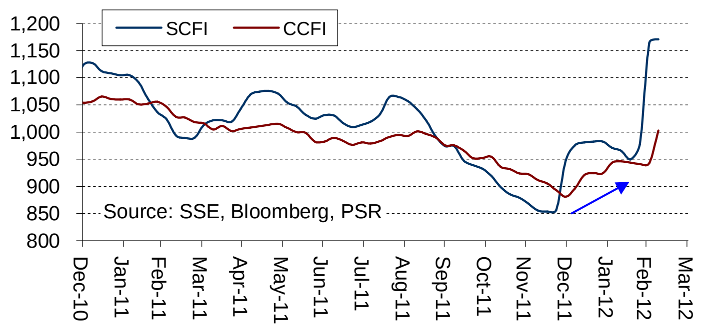


Container Shipping

Results commentary. NOL surprised the market with huge losses of US$478mn for FY11, reflecting the tough operating environment for Liners suffering from chronic oversupply. Management highlighted during the results briefing that the Group aims to achieve cost savings of US$500mn for FY12E to enhance the competitiveness of its Liner business. While the results were disappointing, we believe that losses for NOL would narrow with progressive delivery of newer vessels to its fleet, which would lower unit slot cost for the Liner.

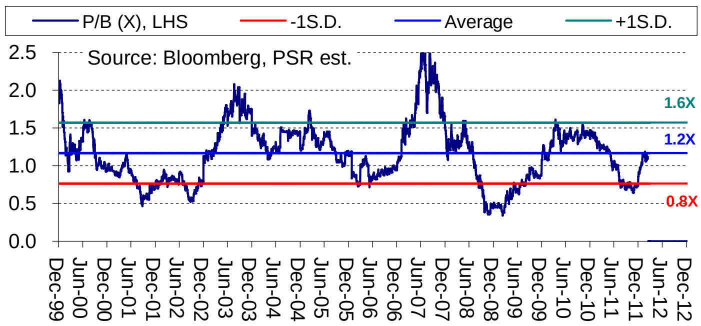
Freight rates rallied, but will it last? Since the start of the year, NOL's stock price rallied by 33% to a peak of S$1.50 in response to expected improvement in freight rates. Industry players had highlighted intentions to cut capacity and lift freight rates to combat the ongoing crisis facing the industry. However, industry growth in capacity remains high relative to demand, making the sustainability in the recent freight rate recovery questionable. Taking reference to indices disclosed by Shanghai Shipping Exchange (SSE), freight rates have rallied significantly in recent weeks, suggesting a successful push through of rates in the industry. However, we opine that investors should not merely look at improvements to the top line, but should also focus on the increase in operating expenses. Bunker prices continued to trend up in line with rising crude oil prices, suggesting that any freight rate increase would likely be eroded by a corresponding increase in fuel costs.

Fig.5. Freight rates



Unattractive valuations. NOL's current valuation is in line with past recovery cycles (Jan 2003 & Jan 2010), when we cross check against its historical valuations. However, we currently do not expect NOL to be profitable this year as compared to the past recovery cycles. Hence, we maintain our view that valuations had gone ahead of fundamentals and rate NOL as Reduce.

Fig.6. NOL P/B valuation at historical average



Aviation Services

Results commentary. Profits declined for SATS due to the loss on disposal of Daniels Group & cost pressures suffered at its core business. SIAEC recorded the higest level of sales in recent history and had strong contributions from its Joint Ventures. Despite the reversal of sales due to the terminated ROPAX contract, ST Engineering performed better than expected with significant margin improvements.

Maintain Overweight. Our Strategist kept his Overweight rating on the Aviation Services sector. Record fleet delivery into the region suggests favorable long term outlook. The current low interest rates in the market could also favor these high yielding stocks under our coverage.

Valuations. Surplus cash post divestment of Daniels Group supports our non-consensus view that SATS could pay out a special dividend at its full year results announcement. While SATS currently trades at the top end of its historical P/E trading range, we believe that this ignores the cash surplus in the company and expected earnings recovery in FY13E. At 16X Forward P/E, SIAEC's valuation is in line with historical averages. STE currently trades below its historical average P/E multiples.

Fig.7. SATS P/E range

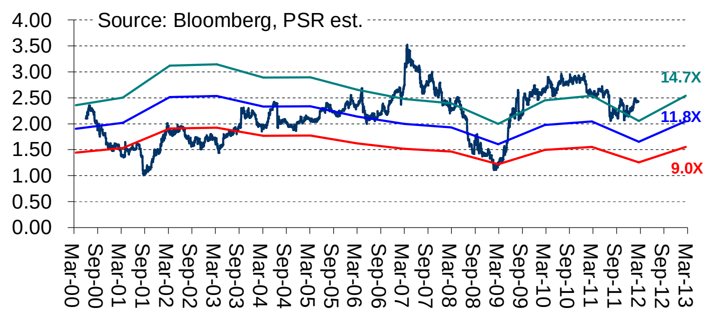


Fig.8. SIAEC P/E range

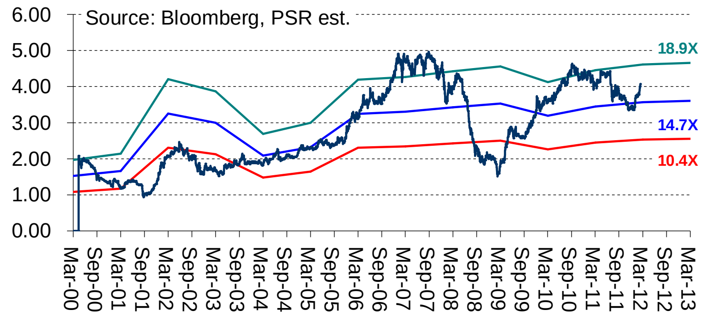
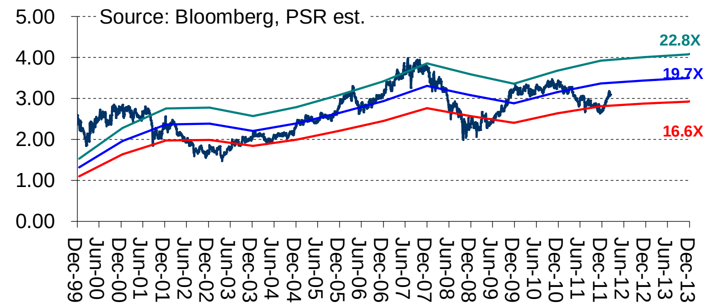


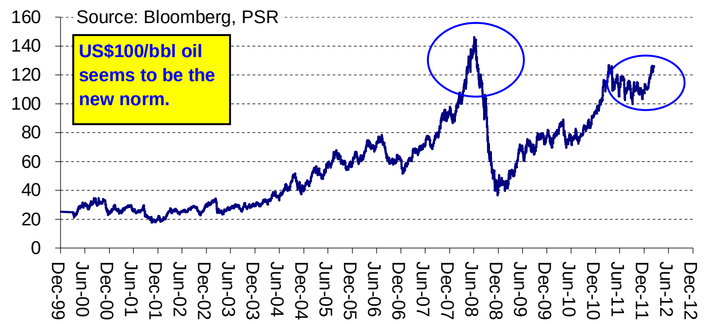
Fig.9. STE P/E range



Exposure to Oil price

Investors into stocks of Transport Operators are often concerned over the companies' exposure to volatile oil price movements. To be clear, high oil prices are not an issue if Operators are able to pass on the cost increase. For example, SIA recorded very strong profits in the run up to peak oil in mid 2008. However, the current weak economic conditions do not allow Transport Operators to pass on the cost increase to their customers.

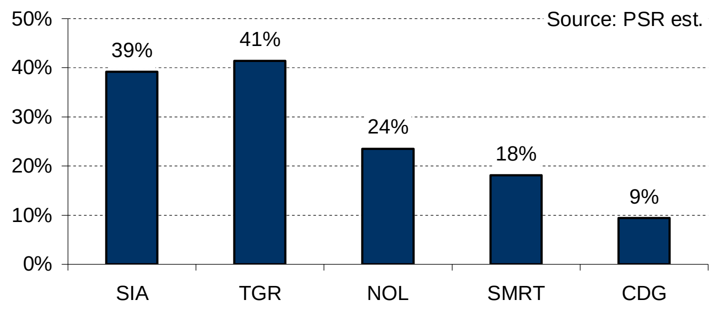
Fig.10. Brent Crude (US$/bbl)



Airlines has the highest exposure to oil price

Among the Transport Operators under our coverage, Airlines have the highest exposure to energy expenses. SIA recovers part of the increase in energy cost through the use of fuel surcharges, but is exposed to sharp increase in oil prices due to light fuel hedging till the end of the year. Tiger Airways does not impose fuel surcharges, but prices its tickets according to profitability of routes. Apart from hedging its exposure, NOL could recover part of its fuel expense through Bunker Adjustment Factors (BAF), dependent on the type of contracts that is signed with shippers. SMRT and ComfortDelGro periodically engage in fuel hedging when prices are favorable.

Fig.11. Energy Expenses as % of Op Cost



Transportation Sector Valuation Comparables

Company	Rating	FYE	Price	TP	Upside	Market	Ent.	Equity Multiple (X)						Dividend Yield (%)		
Market price as of:						Cap.	Value	Net Income			Book Value					
13-Mar-12					(%)	(US$'mn)	(US$'mn)	FY10/11	FY11/12E	FY12/13E	FY10/11	FY11/12E	FY12/13E	FY10/11	FY11/12E	FY12/13E
Land Transport																
SMRT Corp	**Sell**	**Mar**	1.75	**1.33**	-24.0%	2,112	2,087	16.5	19.8	20.5	3.3	3.3	3.3	4.9%	4.9%	4.7%
ComfortDelGro	**Buy**	**Dec**	1.50	**1.65**	10.0%	2,490	2,982	13.7	13.3	13.6	1.7	1.7	1.6	3.7%	4.0%	3.7%
Airlines																
Singapore Airlines	**Accumulate**	**Mar**	10.93	**11.30**	3.4%	10,204	7,174	9.9	24.5	33.2	0.9	1.0	1.0	12.8%	2.7%	2.7%
Tiger Airways	**Reduce**	**Mar**	0.79	**0.58**	-26.1%	511	810	16.1	(7.9)	36.5	3.3	2.5	2.3	0.0%	0.0%	0.0%
Shipping																
Neptune Orient Lines	**Reduce**	**Dec**	1.40	**1.24**	-11.1%	2,861	5,039	6.3	(6.0)	(45.9)	0.9	1.1	1.1	3.3%	0.0%	0.0%
Transport Services																
SATS	**Buy**	**Mar**	2.45	**2.76**	12.7%	2,155	2,048	14.2	17.4	14.1	1.8	1.8	2.0	6.9%	12.7%	5.3%
ST Engineering	**Accumulate**	**Dec**	3.14	**3.37**	7.3%	7,626	7,542	19.6	18.2	17.7	5.9	5.4	5.2	4.6%	4.9%	5.0%
SIA Engineering	**Buy**	**Mar**	4.09	**4.84**	18.3%	3,562	3,284	17.4	16.6	16.3	3.4	3.6	3.6	7.3%	6.4%	5.1%

Source: PSR est.
*FY10/11 refers to: FY10 for FYE Dec & FY11 for FYE Mar

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Contact Information (Singapore Research Team)

Chan Wai Chee
CEO, Research
Special Opportunities
+65 6531 1231
yebo@phillip.com.sg

Lee Kok Joo, CFA
Head of Research
S-Chips, Strategy
+65 6531 1685
leekj@phillip.com.sg

Joshua Tan
Strategist
+65 6531 1249
joshuatan@phillip.com.sg

Magdalene Choong
Investment Analyst
SG & US Financials, Gaming
+65 6531 1791
magdalenechoongss@phillip.com.sg

Go Choon Koay, Bryan
Investment Analyst
Property
+65 6531 1792
gock@phillip.com.sg

Derrick Heng
Investment Analyst
Transportation, Telecom.
+65 6531 1221
derrickhengch@phillip.com.sg

Nicholas Low, CFA
Investment Analyst
Commodities, Offshore & Marine
+65 6531 1535
nicholaslowkc@phillip.com.sg

Travis Seah
Investment Analyst
REITS
+65 6531 1229
travisseahhk@phillip.com.sg

Peter Lee
Research Assistant
General Enquiries
+65 6531 1240 (Phone)
+65 6336 7607 (Fax)
research@phillip.com.sg

Ken Ang
Investment Analyst
Financials
+65 6531 1793
kenangwy@phillip.com.sg

PhillipCapital
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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) 21628841
Fax (603) 21665099
Website: www.poems.com.my

HONG KONG
Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites**:** www.phillip.com.hk

JAPAN
PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
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) 57900800
Fax (62-21) 57900809
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) 51699200
Fax (86-21) 63512940
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 Futures 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

AUSTRALIA
PhillipCapital Australia
Level 37, 530 Collins Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96298380
Fax (613) 96148309
Website: www.phillipcapital.com.au