

# Transportation Sector

## Results season takeaways

### Report type: Update

#### Sector Overview

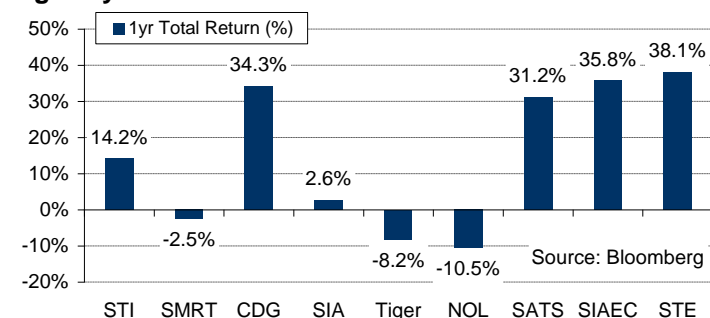
The Transportation Sector under our coverage consists of Airlines (SIA, Tiger Airways), Shipping (NOL), Land Transport (SMRT, ComfortDelGro) & Aviation Services (SIA Engineering, ST Engineering, SATS).

- Prefer Aviation Services sector despite outperformance
- Abnormally high level of uncertainty in the Land Transport sector
- Cyclical Airline & Shipping counters remain subdued

#### Still prefer the high yielding Aviation Services sector

Despite significant outperformance over the past year, the aviation services sector remains as our preferred exposure in the transportation space. Positive long term trends and stable dividend payouts underpins the attractiveness of these counters.

**Fig 1. 1yr total return for the sector**



#### Is the Land Transport sector still a safe haven?

While business stability had been the hallmark of the Land Transport sector, we believe that there is an abnormally high level of uncertainty facing investors in their stock. Inflationary pressures led to higher operating expenses, but revenue increases failed to keep pace. While network expansion would continue to drive ridership growth, we are skeptical that operators would benefit with the declining profitability of its business.

#### Cyclical Airline & Shipping counters remain subdued

The operating environment remains challenging for the cyclical Airline and Shipping companies. Weak demand outlook and competitive businesses environment continued to put pressure on profitability. While we believe that the worst is over for the three companies under our coverage, valuations for NOL and Tiger Airways remain unattractive. We believe that negatives are priced into the depressed stock price of SIA.

#### Transportation Sector

Company	Rating	Price (\$)	TP (\$)	Upside (%)	M.Cap. (US\$m)
<b>Land Transport</b>					
SMRT Corp	Sell	1.62	1.41	-12.7%	1,982
ComfortDelGro	Neutral	1.90	1.83	-3.7%	3,227
<b>Airlines</b>					
Singapore Airlines	Accumulate	10.92	13.00	19.0%	10,324
Tiger Airways	Sell	0.73	0.65	-10.3%	480
<b>Shipping</b>					
Neptune Orient Lines	Neutral	1.19	1.32	10.9%	2,484
<b>Aviation Services</b>					
SATS	Accumulate	2.92	3.33	14.0%	2,620
SIA Engineering	Buy	4.87	6.10	25.3%	4,343
ST Engineering	Accumulate	4.13	4.50	9.0%	10,288

Source: Bloomberg, PSR

#### Analyst

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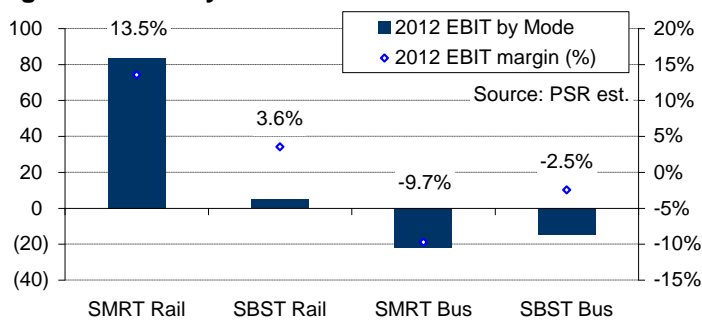
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**Land Transport**

**Results Commentary:** Cost pressure remain a recurring theme based on results of the transport operators. SMRT reported a sharp decline in profits to S\$25.5mn (-31%y-y) with staff cost reaching a record high in the quarter. SMRT's management continued to guide for further cost pressure over the next 15 months. A similar trend is observed at the fare based business of ComfortDelGro. Given the persistent losses, we opine that the bus business model in Singapore is not sustainable for the operators. Rail profitability would continue to be impacted by higher maintenance and staff related expenses. We believe that a substantial increase in bus and rail fare is necessary for these businesses to be viable in the long run.

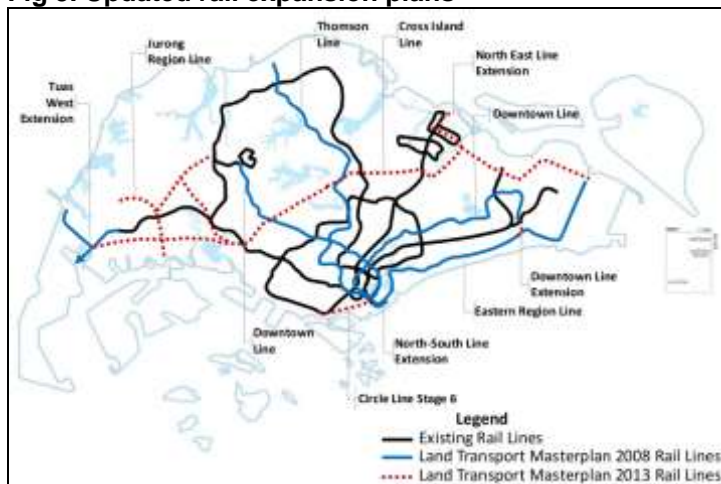
**Fig 2. Profitability of Fare based business**



**Rail network will expand, so what?**

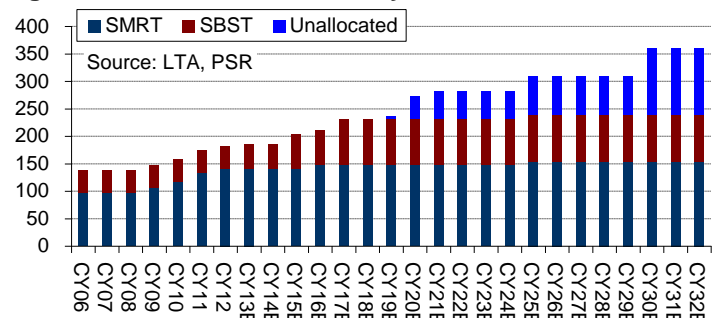
The Land Transport Authority (LTA) recently announced an update to double the existing rail network by 2030. While improved connectivity would lead to an increase in rail ridership, we remain skeptical that operators would benefit from this expansion. Over the past years, strong ridership growth had led to significantly higher rail revenue for the operators. However, increases in average operating expense had eroded profits for the operators. In 2012, we estimate that EBIT per rail km across the entire rail network is less than half the peak level reached in 2008. Hence, we believe that in order to incentivize operators, a structural shift in the business model is necessary.

**Fig 3. Updated rail expansion plans**

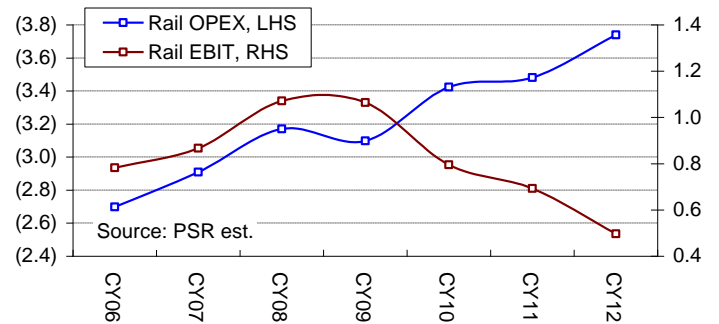


Source: LTA

**Fig 4. Rail network to double by 2030**



**Fig 5. Rising rail OPEX (CY06-12: +39%), led to falling rail EBIT (CY06-12: -37%) (S\$m/m/km)**



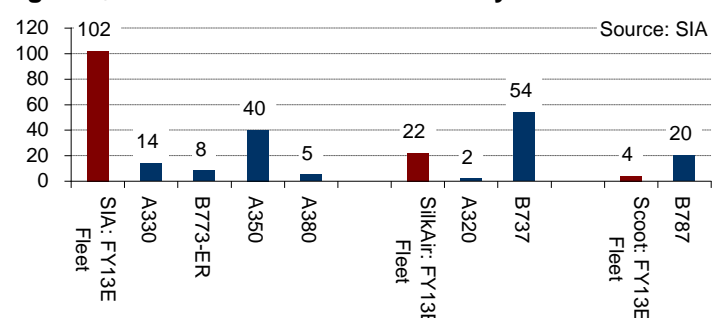
**Limited stock upside**

Until there are clear signs of sustainable profits, we see limited upside to the stock of the transport operators. Company specific restructuring and stricter maintenance regime is likely to weigh on the profits of SMRT (Sell, TP: S\$1.41). While CDG (Neutral, TP: S\$1.83) is much less dependent on the fare based business in Singapore, we believe that start up costs associated with Downtown line could impact near term profits of the group. Furthermore, the stock's valuation is no longer attractive at current levels.

**Airlines**

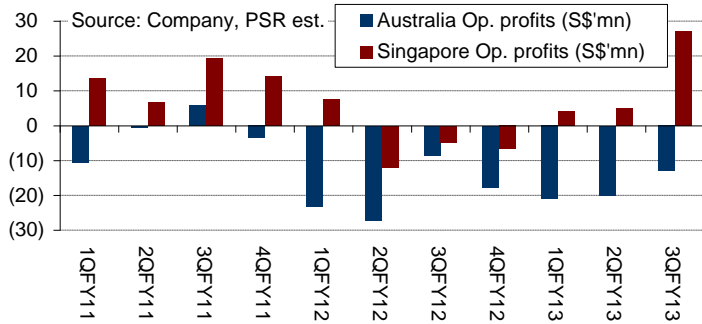
**Results Commentary:** SIA's result disappointed as passenger yields at the parent company was significantly below our expectations. Using segmental disclosures of other business units, we estimate that Scoot might have been marginally profitable in the quarter. While CAPEX is likely to increase over the next few years due to the new orders placed, we believe that SIA's cash holdings and operating cashflows is more than sufficient to fund them. Furthermore, we expect part of these orders to be on leases and will not require upfront cash outlay from the group.

**Fig 6. S\$14bn of orders over the next 5yrs**



Driven by very strong performance out of Singapore, Tiger Airways reported its first profitable quarter in six. Despite significantly better aircraft utilization, Tiger Australia's losses widened to S\$13mn (3QFY12: -S\$8.6mn). The JVs in Indonesia and Philippines continue to suffer start up losses and required more loans and cash injection from the holding company. Given the funding needs of the startups, we do not rule out a cash call from investors.

**Fig 7. Strong profits in Singapore, offset by losses in Australia**



**Container Shipping**

**Results Commentary:** NOL reported a negative earnings surprise with losses of US\$98mn due to lower than expected freight rates in the quarter. Over the course of the year, management managed to improve operating costs for its liner business by US\$138/FEU and achieved its targeted cost savings of US\$504mn for the group. We believe that near term risk-reward trade off for the stock is unattractive. However, we expect NOL to turn profitable in FY13E on 1) improved cost structure, 2) rationale competitive environment, and 3) gains on disposal of NOL building.

**Fig 8. Vessel deliveries to improve competitiveness**



Source: NOL

**Aviation Services**

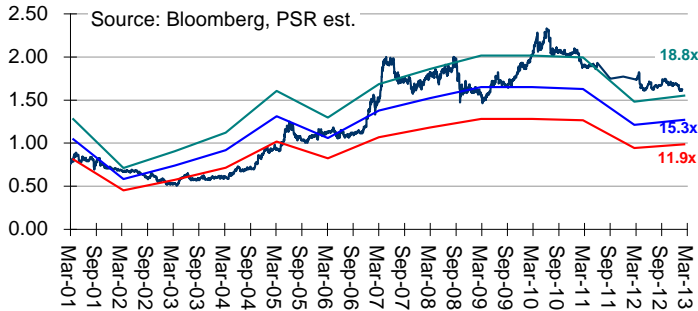
**Results Commentary:** The results season was largely a non-event for the companies in this sector. Driven by seasonal strength, SATS reported a 7.6% growth in underlying profits for the quarter. While SATS's inflight catering business in Japan, TFK Corp, is likely to be negatively impacted by the weaker JPY, we believe that its contribution to the group is not material at the moment (c.7% of Group EBIT). SIAEC's results were in line with our expectations and it continues to be one of our top picks for the Singapore Market. We advise that clients accumulate this stock on the recent correction as there is no change to the fundamentals of the company. STE's earnings beat our expectations with guidance for stronger sales and profits in FY13E. During the quarter, STE won a major shipbuilding contract from the Singapore Navy for an undisclosed value (PSR est: S\$2bn). We expect the stock to trend towards the top end of its historical valuation range on expectations of a record high order book in the next quarter.

**Links to our latest results update**

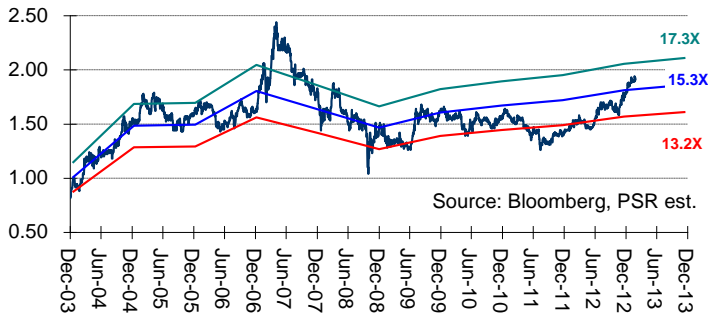
- [SMRT Corp. Ltd, 30 January 2013](#)
- [ComfortDelGro Ltd, 13 February 2013](#)
- [Singapore Airlines Ltd, 13 February 2013](#)
- [Tiger Airways Holdings Ltd, 25 January 2013](#)
- [Neptune Orient Lines Ltd, 25 February 2013](#)
- [SATS Ltd, 31 January 2013](#)
- [ST Engineering Ltd, 18 February 2013](#)
- [SIA Engineering Co. Ltd, 6 February 2013](#)

Historical Valuation charts

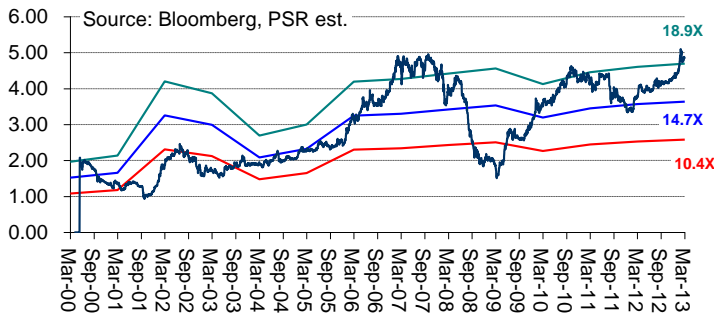
**Fig 9. SMRT P/E price range**



**Fig 10. CDG P/E price range**



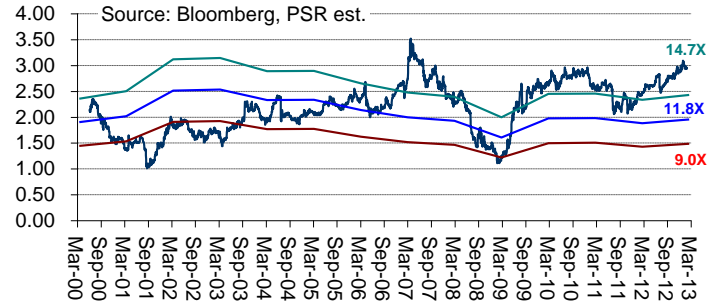
**Fig 11. SIAEC P/E price range**



**Fig 12. STE P/E price range**



**Fig 13. SATS P/E price range**



**Fig 14. SIA P/B (X)**



**Fig 15. NOL P/B (X)**



\* Chart for Tiger Airways omitted, as its short trading history makes historical analysis less meaningful.

**Transportation Sector Comparables**

Company	Rating	FYE	Price	TP	Upside (%)	Market Cap. (US\$m)	Ent. Value (US\$m)	Equity Multiple (X)						Dividend Yield (%)		
								Net Income			Book Value			11	12E	13E
Market price as of: 27-Feb-13																
<b>Land Transport</b>																
SMRT Corp	Sell	Mar	1.62	1.41	-12.7%	1,982	2,035	20.5	19.5	20.0	3.1	3.0	3.0	4.6%	4.3%	4.6%
ComfortDelGro	Neutral	Dec	1.90	1.83	-3.7%	3,227	3,749	17.0	16.1	15.6	2.1	2.0	1.9	3.2%	3.4%	3.5%
<b>Airlines</b>																
Singapore Airlines	Accumulate	Mar	10.92	13.00	19.0%	10,324	7,220	37.5	30.6	15.0	1.0	1.0	0.9	1.8%	1.5%	2.7%
Tiger Airways	Sell	Mar	0.73	0.65	-10.3%	480	798	(6.0)	(16.4)	22.7	2.4	2.8	2.5	0.0%	0.0%	0.0%
<b>Shipping</b>																
Neptune Orient Lines	Neutral	Dec	1.19	1.32	10.9%	2,484	5,616	(5.2)	(6.4)	9.9	1.0	1.1	1.0	0.0%	0.0%	3.4%
<b>Aviation Services</b>																
SATS	Accumulate	Mar	2.92	3.33	14.0%	2,620	2,595	18.3	17.6	16.4	2.2	2.3	2.3	8.9%	5.1%	5.5%
SIA Engineering	Buy	Mar	4.87	6.10	25.3%	4,343	4,015	20.0	19.5	18.5	4.3	4.1	3.9	4.3%	4.5%	4.5%
ST Engineering	Accumulate	Dec	4.13	4.50	9.0%	10,288	10,009	24.2	22.1	20.7	7.2	6.7	6.4	3.8%	4.1%	4.3%

Source: PSR est.

\*12E refers to FYE Dec 2012, FYE Mar 2013, FYE Jun 2013



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