

Singapore Company Guide

SIA Engineering

Version 11 | Bloomberg: SIE SP | Reuters: SIAE.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

5 Feb 2018

BUY (Upgrade from HOLD)

Last Traded Price (2 Feb 2018): S\$3.33 (STI : 3,529.82)

Price Target 12-mth: S\$3.86 (16% upside) (Prev S\$3.48)

Analyst

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What's New

- 3QFY18 earnings up 4% y-o-y on boost from JV profits
- Singapore Airshow starting this week (6 Feb); typically share price has positive correlation with newsflow on contracts/tie-ups
- Completion of sale of associate ACTS should result in S\$14.4m one-off gain in 4QFY18

Price Relative



Forecasts and Valuation

FY Mar (S\$ m)	2017A	2018F	2019F	2020F
Revenue	1,104	1,087	1,092	1,130
EBITDA	243	237	245	265
Pre-tax Profit	355	193	200	219
Net Profit	332	172	176	193
Net Pft (Pre Ex.)	174	172	176	193
Net Pft Gth (Pre-ex) (%)	(4.1)	(0.7)	2.3	9.7
EPS (S cts)	29.6	15.3	15.7	17.2
EPS Pre Ex. (S cts)	15.4	15.3	15.7	17.2
EPS Gth Pre Ex (%)	(4)	(1)	2	10
Diluted EPS (S cts)	29.3	15.2	15.5	17.1
Net DPS (S cts)	18.0	13.5	14.0	15.0
BV Per Share (S cts)	138	136	138	141
PE (X)	11.3	21.7	21.3	19.4
PE Pre Ex. (X)	21.6	21.7	21.3	19.4
P/Cash Flow (X)	28.4	30.2	31.6	28.2
EV/EBITDA (X)	13.2	13.8	13.5	12.6
Net Div Yield (%)	5.4	4.1	4.2	4.5
P/Book Value (X)	2.4	2.5	2.4	2.4
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	21.9	11.2	11.5	12.3
Earnings Rev (%)		10	10	N/A
Consensus EPS (S cts):		14.5	15.0	17.0
Other Broker Recs:		B: 2	S: 1	H: 5

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P

Singapore Airshow may bring some cheer

Opportunity to buy on share price weakness. Over the last 7 months, SIA Engineering (SIE)'s share price has declined c.20% from the previous peak, owing to a combination of weaker-than-expected 1HFY18 earnings, removal from the STI index since September 2017, and an alleged bulk sale of shares at a discount. We now see an opportunity to buy on weakness. SIE's forward P/E is now around the -1SD level relative to its 5-year average. Further, with the Singapore Airshow starting this week, we expect some announcements of contracts and/or partnerships, which could be a catalyst for an upward re-rating of the shares (share price has risen by 8% on average over the last 5 Singapore Airshows on such announcements).

Additionally, while revenues remained flat in 3QFY18, we saw a jump in JV earnings (primarily from SAESL, which is SIE's Rolls-Royce engine JV) which could hint at some upswing in the engine MRO cycle. Upgrade to BUY with TP of S\$3.86 (20% all-in return including c.4% dividend yield).

Not to forget the medium-term opportunities as they draw nearer.

SIE has a new GE engine facility which is likely to be operational in 2019; it is slated to perform cabin retrofitting work on SIA's legacy A380s (end of 2018 at the earliest); and there is the gradual ramp-up of its Japan line maintenance operations as well. We expect EPS growth to return to positive territory from FY19 onwards.

Tweaking earnings upward on higher JV profits. While we had slightly underestimated some operating costs (materials, staff cost), this is offset by raising estimated JV/associate profits. FY18/19F earnings are thus raised by c.10% each.

Valuation:

Our revised TP of S\$3.86 is based on a blended valuation framework (PE, EV/EBITDA, dividend yield and DCF), and includes a 20% M&A/privatisation premium.

Key Risks to Our View:

We cannot rule out a lengthy period of weak MRO demand amid structural changes in the industry. Increasing competition could also lead to renewed stress on the margin front. Upside risk exists in the form of potential privatisation/M&A.

At A Glance

Issued Capital (m shrs)	1,118
Mkt. Cap (S\$m/US\$m)	3,724 / 2,821
Major Shareholders (%)	
Temasek Holdings	77.7
Free Float (%)	22.3
3m Avg. Daily Val (US\$m)	1.3

ICB Industry : Industrials / Industrial Transportation

WHAT'S NEW

Bumper quarter for JV profits

Net earnings up 4% y-o-y on boost from JV profits. This quarter's earnings saw an upside surprise from JV income, which boosted earnings to S\$54.8m, representing 4% y-o-y increase and a 44% q-o-q jump (as 1Q/2QFY18 were weaker quarters). Excluding the boost from associate/JVs, operating profits remained below historical trend levels at S\$18.2m for the quarter. EBIT margins were flattish compared to previous quarters.

Revenues flat q-o-q. Topline was comparable to previous quarters (down 0.5% y-o-y and 1% q-o-q) at S\$271m as the decrease in fleet management revenue continued to take its toll, partially offset by stronger line maintenance revenues.

Strong showing from SAESL – a hint at Trent engine MRO upcycle? As mentioned, profit from JVs spiked upward sharply this quarter to S\$22.9m (vs. S\$4.7m in 2QFY18 and S\$14.3m in 3QFY17 –profits tend to be lumpy), which was

unexpected, and provided a boost to the bottomline. JV profits are mainly derived from SAESL, which is the engine JV with Rolls Royce. There was no mention of extraordinary items at the JV level, so this could point to an upswing in work, albeit it could be too early to call for a secular recovery from one quarter of strong earnings. Meanwhile associate profit contribution was S\$17.9m this quarter was comparable to the previous few quarters.

Completion of sale of ACTS. SIE completed the sale of its stake in former associate Asian Compressor Technology Services Company Limited (ACTS) on 22 Jan 2018, which should result in a one-off gain of S\$14.4m and cash proceeds of S\$14.7m in 4QFY18. Given the relatively small size of the sale, we don't think this points to any sort of special dividend at financial year-end (March 2018).

Quarterly / Interim Income Statement (S\$m)

FY Mar	3Q2017	2Q2018	3Q2018	% chg yoy	% chg qoq
Revenue	272	275	271	(0.5)	(1.3)
Cost of Goods Sold	(247)	(255)	(252)	2.1	(1.1)
Gross Profit	25.2	19.5	18.6	(26.2)	(4.6)
Other Oper. (Exp)/Inc	0.0	0.0	0.0	-	-
Operating Profit	25.2	19.5	18.2	(27.8)	(6.7)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Associates & JV Inc	31.6	22.9	40.8	29.1	78.2
Net Interest (Exp)/Inc	0.80	1.00	0.90	12.5	(10.0)
Exceptional Gain/(Loss)	2.30	0.50	0.40	(82.6)	(20.0)
Pre-tax Profit	59.9	43.9	60.3	0.7	37.4
Tax	(6.3)	(5.5)	(5.2)	(17.5)	(5.5)
Minority Interest	(1.0)	(0.3)	(0.3)	70.0	0.0
Net Profit	52.6	38.1	54.8	4.2	43.8
Net profit bef Except.	50.3	37.6	54.4	8.2	44.7
EBITDA	70.2	56.1	73.1	4.1	30.3
Margins (%)					
Gross Margins	9.3	7.1	6.9		
Opg Profit Margins	9.3	7.1	6.7		
Net Profit Margins	19.3	13.9	20.2		

Source of all data: Company, DBS Bank

SINGAPORE AIRSHOW TENDS TO GIVE SIE'S STOCK A BOOST

Good chance of contract/tie-up announcements in this year's Singapore Airshow. SIE has a history of inking deals at the Singapore Airshow since the biennial event began in 2008. Some years have seen more significant deals than others, with 2016's Airshow one of the better years in our view, in light of the Airbus JV and Trent work secured. Nonetheless every year's Airshow thus far has brought with it some good news, and we are hopeful for more at this year's event, being held this week from 6-11 February.

The market likes deal related newsflow. The market has rewarded SIE for its announcements of contracts/partnerships

that have come in tandem with the Singapore Airshow. SIE's share price was up an average of 4% in the 30 days after the last five Airshows and 8% 90 days after. Notably, 2016's bumper year saw its share price up almost 10% during the 90 days after the event, and in 2008 its share price was up 15% 90 days after, despite the broader STI being flattish in that same time period (amid a challenging time for markets during the GFC period). The 2008 performance hints at our thesis that post-airshow positive newsflow provides support for SIE's share price as a safe haven stock amid any market volatility. The current lofty valuations in the broader market could also lead to investor interest in laggard stocks.

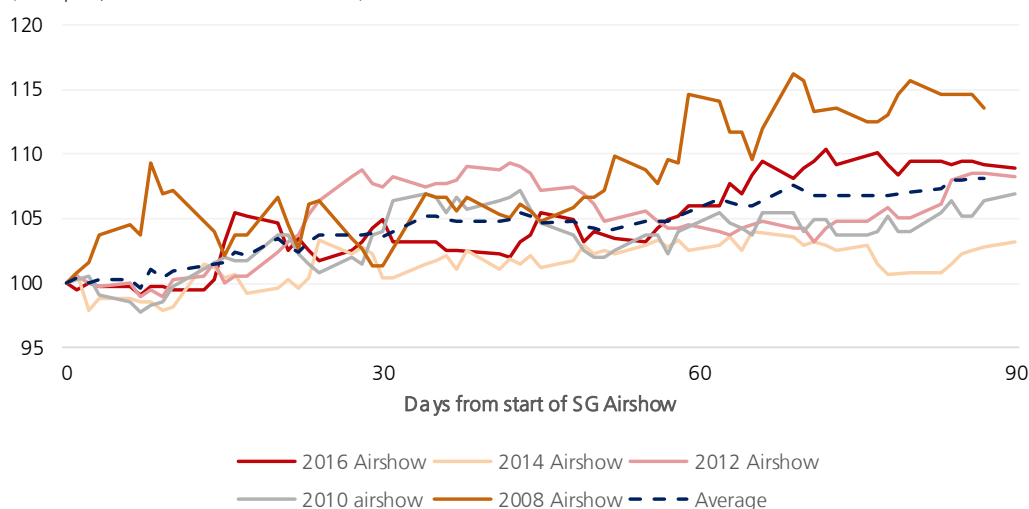
Past contract announcements from the biennial Singapore Airshow (which started in 2008)

Year	SG airshow dates	Announcement Date	Details of announcement
2018	6-11 Feb		Potential new contracts/JVs?
2016	16 - 21 Feb	18-Feb-16 17-Feb-16 17-Feb-16 16-Feb-16	Renewal of FMP agreement with Tigerair Taiwan for 5 years JV for MRO services relating to Moog products on Boeing 787, Airbus A350 and other aircraft SIAEC forms JV with Airbus for airframe maintenance, cabin upgrade and modification services for A380, A350 and A330 planes SIAEC appointed as on-wing service provider for Trent engines
2014	11 to 16 Feb	12-Feb-14	S\$350m services agreement with SilkAir
2012	14 to 19 Feb	6-Feb-12 15-Feb-12 14-Feb-12	Signing of Inventory Technical Management services agreement with VietJet Air SIAEC secures MRO contract for Scoot B777 fleet SIAEC appointed as Authorised Repair Centre for wheels and brakes by Messier-Bugatti-Dowty
2010	2 to 7 Feb	3-Feb-10	MoU signed with Panasonic Avionics Corp to explore JV relating to MRO of in-flight entertainment systems and components
2008	19 to 24 Feb	19-Feb-08	SIAEC signs 3-year contract with Gulf Air for heavy maintenance work on 17 Airbus planes

Source: Company

SIE's share price typically sees a post-airshow upswing

(Share price, indexed: start of airshow = 100)



Source: Bloomberg Finance L.P., DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

Close to 70% of top line is driven by parent SIA. This is mainly due to legacy reasons, as SIE was born as the in-house MRO operations centre of SIA before it was independently listed in 2000. The growth and maintenance cycle of SIA's fleet therefore strongly impacts SIE's core businesses of line maintenance, heavy maintenance and fleet management.

Line maintenance division largely driven by Changi Airport traffic. SIE already captures around 80% of the line maintenance market at Changi Airport, thus market share gains are unlikely. We estimate flights handled by SIE to grow by c.3% annually in FY18 and FY19. In the longer term, continued growth of Singapore as a tourism hub to the region and the addition of capacity via the upcoming Terminals 4 and 5, as well as expansion into other regions (e.g. recent moves into Japan) should help drive line maintenance revenues and earnings.

Heavy maintenance headwinds prevail in near term. The heavy maintenance segment saw revenues decline by 8% and 2% in FY16 and FY17 respectively, which was largely attributed to the phasing in of newer aircraft with longer maintenance cycles and less need for maintenance by virtue of just being new.

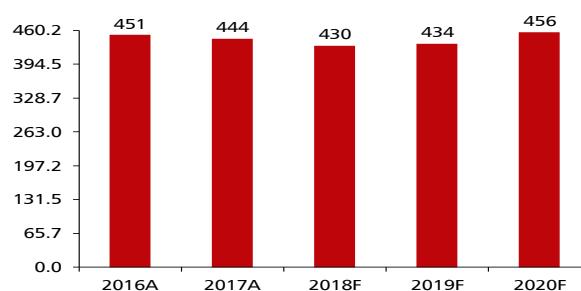
SIE's partnerships with airframe OEMs provide a first-mover advantage. SIE incorporated a fleet management JV with Boeing in 2015, and in 2016 inked another airframe MRO JV with Airbus. These deals will give SIE a strong foothold in securing fleet management and MRO work in Asia Pacific derived from the airframe OEM's total care programmes, which have been gaining traction with airlines. While MRO providers now have to carve out some of the pie to airframe OEMs, SIE's JV agreements are a bet that the volumes allocated to the JVs will more than offset the sharing of profits. By positioning itself as an OEM partner early in the game, SIE should benefit in the long term from the territorial exclusivity granted to it.

JVs/associates contribute roughly 50-60% to the bottom line.

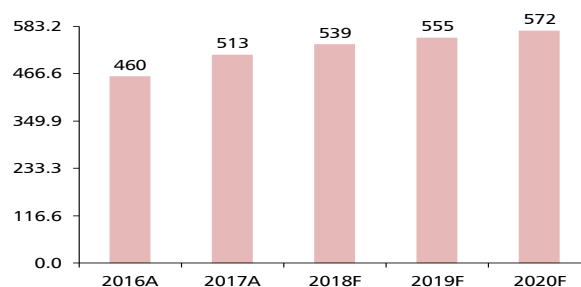
SIE has 24 associates and JVs in nine countries, with engine overhaul centres comprising the bulk of JV/associate revenues. However, the phasing out of older generation engine models and extended maintenance intervals for their successors continue to dampen contributions from the company's key engine MRO centres Eagle Services Asia and SAESL.

Low oil prices have not fed through to MRO players significantly. The slump in fuel prices means that some airlines have delayed the retirement of older aircraft but it is unclear if these older aircraft will be put through the next round of heavy checks or be sent to the scrapyards, given the substantial backlog of new aircraft under construction.

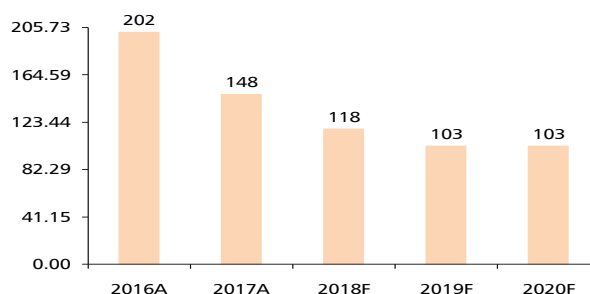
Base maintenance revenue



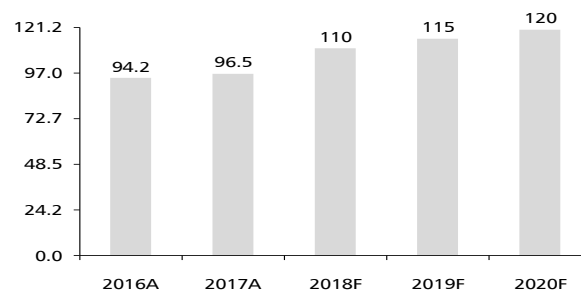
Line maintenance revenue



Fleet management revenue



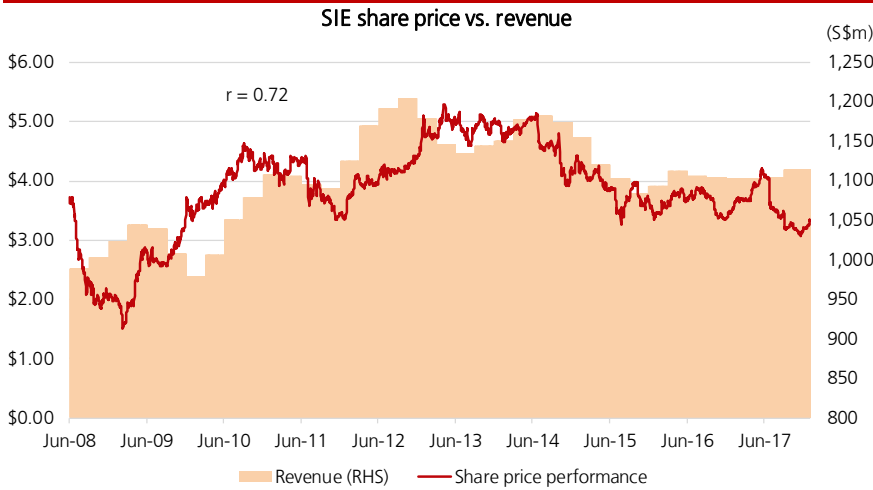
Profit from associates & JVs



Source: Company, DBS Bank

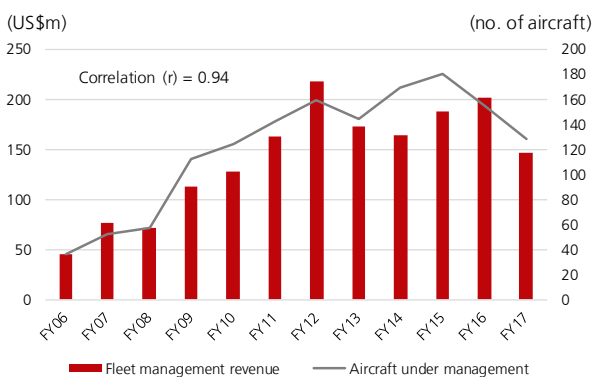
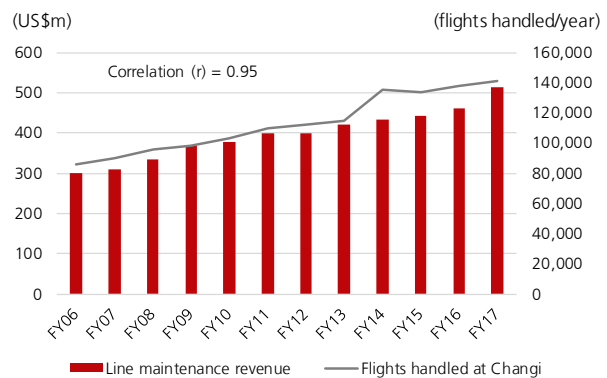
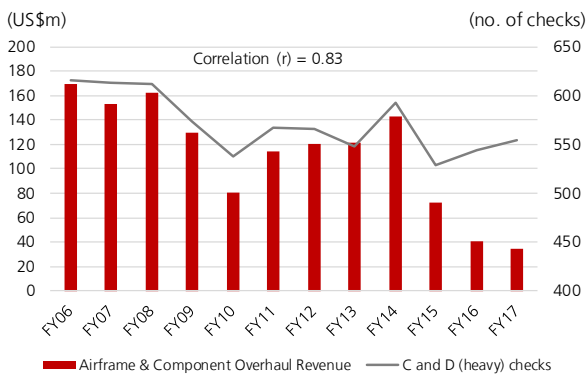
Appendix 1: A look at SIE's listed history – what drives its share price?

SIA Engineering's share price has shown the highest correlation to its revenues (not earnings)



Source: Bloomberg Finance L.P., DBS Bank

Revenue is mainly dependent on: i) heavy checks; ii) flights handled at Changi; and iii) aircraft under fleet management



Source: Company, DBS Bank

SIA Engineering

Balance Sheet:

Strong balance sheet provides headroom for expansion. SIE has very low leverage, with gross debt-to-equity ratio at only 0.02x. It is also in a net cash position with ~S\$450m of cash reserves on its balance sheet at 3QFY18. Thus, should attractive opportunities arise, SIE could still utilise its cash reserves, and/or also fund such projects with additional debt, which could help drive long-term growth.

Share Price Drivers:

M&A and other corporate activity are catalysts. In order to tackle some of the structural issues, SIE may consider merging with or partnering third-party MROs with complementary business models. A combination of SIE and ST Aerospace is also possible, and would consolidate Singapore’s credentials as an aviation hub, as synergies are realised in the form of bigger scale, cost efficiencies and breadth of offerings. Under such a scenario, the target company – in this case, SIE – usually sees a positive reaction in share price, as other parties may need to pay a premium over market prices. Finally, we would not rule out potential privatisation by parent Singapore Airlines.

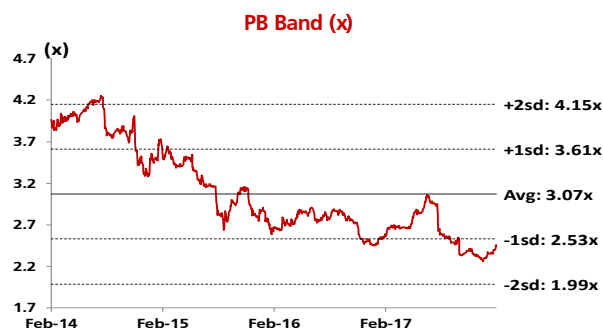
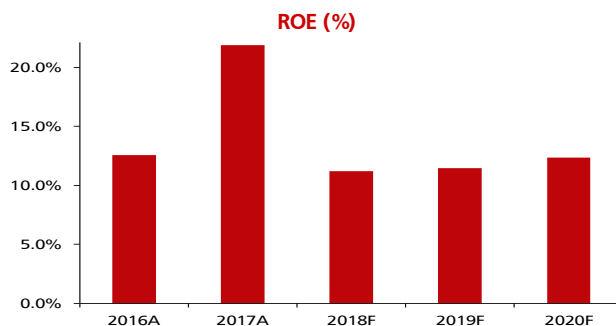
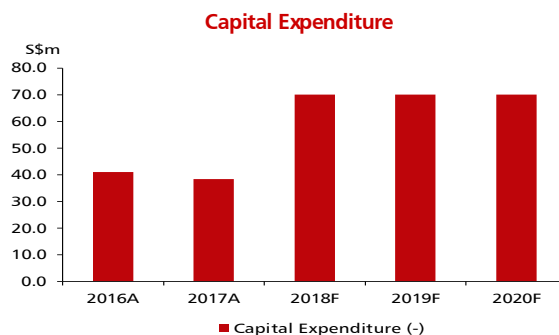
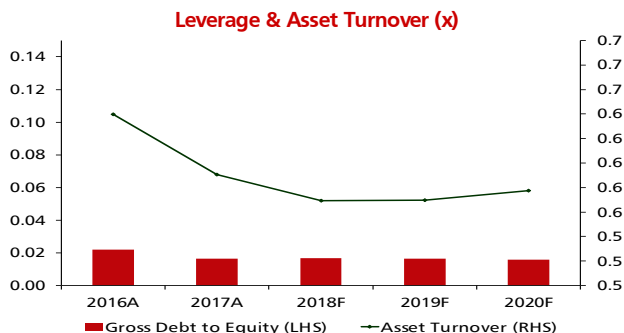
Key Risks:

Continued erosion of heavy maintenance revenues. As newer aircraft – with longer check intervals and lower man-hours required overall, owing to harder aluminium/composite materials used in airframes and interiors – continue to account for a larger proportion of the global fleet, there is a risk that SIE does not capture a large enough share of the growing Asia Pacific fleet, which would ideally serve to offset the declining MRO revenue from these newer aircraft.

Competition risk: Garuda’s MRO subsidiary GMF AeroAsia, which has lower costs than SIE, is setting up a new hangar in Batam, targeted at international airlines. Also, new JVs and associates, such as the Boeing fleet management JV, carry the risk of cannibalising some of the group's existing revenue lines, which could slow growth.

Company Background

SIA Engineering (SIE) is a leading regional aircraft maintenance, repair and overhaul (MRO) company with bases in Singapore and Philippines. A comprehensive cluster of JVs with renowned OEMs allows it to provide a full suite of MRO services.



Source: Company, DBS Bank

Key Assumptions

FY Mar	2016A	2017A	2018F	2019F	2020F
Base maintenance revenue	451	444	430	434	456
Line maintenance revenue	460	513	539	555	572
Fleet management revenue	202	148	118	103	103
Profit from associates & JVs	94.2	96.5	110	115	120

Income Statement (\$m)

FY Mar	2016A	2017A	2018F	2019F	2020F
Revenue	1,113	1,104	1,087	1,092	1,130
Cost of Goods Sold	(1,008)	(1,011)	(1,013)	(1,015)	(1,038)
Gross Profit	104	93.3	74.4	77.1	91.9
Other Opng (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Operating Profit	104	93.3	74.4	77.1	91.9
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	94.2	96.5	110	115	120
Net Interest (Exp)/Inc	7.80	6.40	8.98	7.82	7.39
Exceptional Gain/(Loss)	(4.4)	159	0.0	0.0	0.0
Pre-tax Profit	202	355	193	200	219
Tax	(20.8)	(17.9)	(19.3)	(20.0)	(21.9)
Minority Interest	(4.6)	(4.8)	(1.9)	(3.8)	(4.2)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	177	332	172	176	193
Net Profit before Except.	181	174	172	176	193
EBITDA	243	243	237	245	265
Growth					
Revenue Gth (%)	(0.7)	(0.8)	(1.5)	0.4	3.5
EBITDA Gth (%)	4.0	0.0	(2.2)	3.2	8.1
Opg Profit Gth (%)	24.3	(10.6)	(20.2)	3.6	19.1
Net Profit Gth (Pre-ex) (%)	2.0	(4.1)	(0.7)	2.3	9.7
Margins & Ratio					
Gross Margins (%)	9.4	8.5	6.8	7.1	8.1
Opg Profit Margin (%)	9.4	8.5	6.8	7.1	8.1
Net Profit Margin (%)	15.9	30.1	15.8	16.1	17.1
ROAE (%)	12.6	21.9	11.2	11.5	12.3
ROA (%)	10.2	17.8	9.0	9.2	9.9
ROCE (%)	6.3	5.5	4.1	4.3	5.0
Div Payout Ratio (%)	89.1	60.9	88.1	89.4	87.3
Net Interest Cover (x)	NM	NM	NM	NM	NM

Gains and dividend related to sale of 10% stake in HAESL, less additional staff provision costs. We have yet to factor in the gains on disposal of stake in associate ACTS.

Source: Company, DBS Bank

Quarterly / Interim Income Statement (\$\$m)

FY Mar	3Q2017	4Q2017	1Q2018	2Q2018	3Q2018
Revenue	272	295	273	275	271
Cost of Goods Sold	(247)	(272)	(255)	(255)	(252)
Gross Profit	25.2	23.9	18.1	19.5	18.6
Other Oper. (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Operating Profit	25.2	23.9	18.1	19.5	18.2
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	31.6	27.0	21.1	22.9	40.8
Net Interest (Exp)/Inc	0.80	0.90	1.10	1.00	0.90
Exceptional Gain/(Loss)	2.30	0.0	0.0	0.50	0.40
Pre-tax Profit	59.9	51.8	40.3	43.9	60.3
Tax	(6.3)	(4.8)	(4.1)	(5.5)	(5.2)
Minority Interest	(1.0)	(1.1)	0.0	(0.3)	(0.3)
Net Profit	52.6	45.9	36.2	38.1	54.8
Net profit bef Except.	50.3	45.9	36.2	37.6	54.4
EBITDA	70.2	64.9	53.0	56.1	73.1

Growth

Revenue Gth (%)	2.8	8.5	(7.7)	0.7	(1.3)
EBITDA Gth (%)	27.9	(7.5)	(18.3)	5.8	30.3
Opg Profit Gth (%)	2.9	(5.2)	(24.3)	7.7	(6.7)
Net Profit Gth (Pre-ex) (%)	40.9	(8.7)	(21.1)	3.9	44.7

Margins

Gross Margins (%)	9.3	8.1	6.6	7.1	6.9
Opg Profit Margins (%)	9.3	8.1	6.6	7.1	6.7
Net Profit Margins (%)	19.3	15.5	13.3	13.9	20.2

Balance Sheet (\$\$m)

FY Mar	2016A	2017A	2018F	2019F	2020F
Net Fixed Assets	341	332	349	366	383
Invts in Associates & JVs	492	542	581	622	664
Other LT Assets	63.4	65.3	65.3	65.3	65.3
Cash & ST Invts	394	602	524	495	478
Inventory	155	148	152	152	158
Debtors	91.0	87.5	88.9	89.3	92.4
Other Current Assets	286	142	142	142	142
Total Assets	1,822	1,918	1,902	1,932	1,983
ST Debt	8.80	4.00	4.00	4.00	4.00
Creditor	228	250	259	260	269
Other Current Liab	19.8	24.9	28.5	29.2	31.1
LT Debt	24.5	21.9	21.9	21.9	21.9
Other LT Liabilities	29.5	29.1	29.1	29.1	29.1
Shareholder's Equity	1,486	1,554	1,524	1,548	1,584
Minority Interests	26.4	34.0	35.9	39.7	43.9
Total Cap. & Liab.	1,822	1,918	1,902	1,932	1,983
Non-Cash Wkg. Capital	285	102	95.5	94.7	92.2
Net Cash/(Debt)	361	576	498	469	452
Debtors Turn (avg days)	30.6	29.5	29.6	29.8	29.3
Creditors Turn (avg days)	86.1	91.1	96.8	98.4	98.0
Inventory Turn (avg days)	52.9	57.7	56.9	57.6	57.4
Asset Turnover (x)	0.6	0.6	0.6	0.6	0.6
Current Ratio (x)	3.6	3.5	3.1	3.0	2.9
Quick Ratio (x)	1.9	2.5	2.1	2.0	1.9
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	123.1	147.9	270.3	270.3	270.3
Z-Score (X)	9.1	8.7	8.4	8.4	8.2

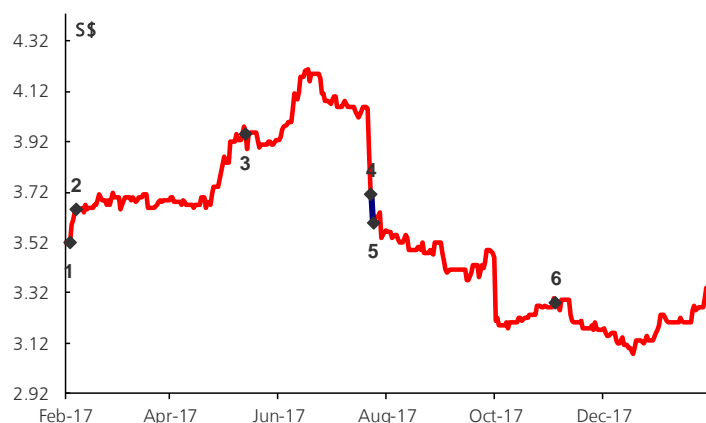
Source: Company, DBS Bank

Cash Flow Statement (S\$m)

FY Mar	2016A	2017A	2018F	2019F	2020F
Pre-Tax Profit	202	355	193	200	219
Dep. & Amort.	43.9	52.8	52.8	52.8	52.8
Tax Paid	(18.6)	(20.4)	(15.7)	(19.3)	(20.0)
Assoc. & JV Inc/(loss)	(94.2)	(96.5)	(110)	(115)	(120)
Chg in Wkg.Cap.	(65.9)	29.7	3.30	0.07	0.65
Other Operating CF	9.90	(189)	0.0	0.0	0.0
Net Operating CF	77.1	132	124	118	133
Capital Exp.(net)	(41.0)	(38.3)	(70.0)	(70.0)	(70.0)
Other Invts.(net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	(19.4)	3.80	0.0	0.0	0.0
Div from Assoc & JV	78.5	62.4	71.1	74.4	77.6
Other Investing CF	3.60	196	0.0	0.0	0.0
Net Investing CF	21.7	224	1.13	4.36	7.60
Div Paid	(163)	(135)	(202)	(152)	(157)
Chg in Gross Debt	0.80	(8.7)	0.0	0.0	0.0
Capital Issues	(1.1)	0.0	0.0	0.0	0.0
Other Financing CF	(4.3)	(6.1)	0.0	0.0	0.0
Net Financing CF	(168)	(150)	(202)	(152)	(157)
Currency Adjustments	(1.1)	2.30	0.0	0.0	0.0
Chg in Cash	(69.8)	208	(77.4)	(28.9)	(17.1)
Opg CFPS (S cts)	12.7	9.08	10.7	10.5	11.7
Free CFPS (S cts)	3.21	8.32	4.79	4.31	5.58

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	06 Feb 17	3.52	3.58	HOLD
2:	10 Feb 17	3.65	3.58	HOLD
3:	16 May 17	3.95	3.84	HOLD
4:	26 Jul 17	3.71	3.84	HOLD
5:	27 Jul 17	3.60	3.84	HOLD
6:	07 Nov 17	3.28	3.48	HOLD

Note: Share price and Target price are adjusted for corporate actions.

Source: DBS Bank

Analyst: Suvro Sarkar
Glenn Ng

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 5 Feb 2018 09:38:06 (SGT)

Dissemination Date: 5 Feb 2018 10:30:01 (SGT)

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