

Singapore Company Focus

SATS

Bloomberg: SATS SP | Reuters: SIAT.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

5 Nov 2015

HOLD

Last Traded Price: S\$3.80 (STI : 3,040.48)

Price Target : S\$3.65 (-4% downside) (Prev S\$3.43)

Reason for Report : Change in earnings/TP

Potential Catalyst: Recovery in regional aviation

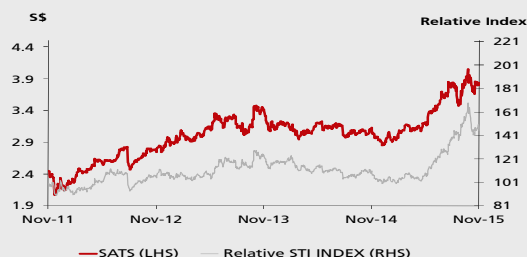
Where we differ: In line

Analyst

Alfie Yeo +65 6682 3717 alfieyeo@dbs.com

Andy Sim +65 6682 3718 andysim@dbs.com

Price Relative



Forecasts and Valuation

FY Mar (S\$ m)	2015A	2016F	2017F	2018F
Revenue	1,753	1,689	1,723	1,749
EBITDA	246	283	293	294
Pre-tax Profit	225	266	281	282
Net Profit	196	222	234	234
Net Pft (Pre Ex.)	197	219	234	234
EPS (S cts)	17.7	20.0	21.0	21.1
EPS Pre Ex. (S cts)	17.8	19.8	21.0	21.1
EPS Gth (%)	9	13	5	0
EPS Gth Pre Ex (%)	8	11	6	0
Diluted EPS (S cts)	17.7	20.0	21.0	21.1
Net DPS (S cts)	14.0	15.0	15.0	15.0
BV Per Share (S cts)	130.1	135.8	141.8	147.9
PE (X)	21.5	19.0	18.1	18.0
PE Pre Ex. (X)	21.4	19.2	18.1	18.0
P/Cash Flow (X)	17.8	17.3	17.1	17.1
EV/EBITDA (X)	16.2	14.1	13.5	13.4
Net Div Yield (%)	3.7	3.9	3.9	3.9
P/Book Value (X)	2.9	2.8	2.7	2.6
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	13.7	15.0	15.1	14.6

Earnings Rev (%)		4	6	-
Consensus EPS (S cts):		19.2	20.8	22.2
Other Broker Recs:		B: 3	S: 0	H: 8

ICB Industry : Industrials

ICB Sector: Industrial Transportation

Principal Business: SATS is a provider of integrated ground handling and infreight catering services at Singapore Changi Airport.

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

Lifted by BRF disposal

- 2Q16 above on lower opex, largely from BRF disposal
- Interim DPS of 5 Scts declared
- Raise FY16F/FY17F earnings by 4%/6%
- Maintain HOLD, TP raised to S\$3.65

BRF disposal led to lower costs and higher than expected earnings.

2Q16 (FYE Mar) earnings of S\$59.7m (+27% y-o-y) were ahead of our expectations as its food unit BRF S.A., which was spun off into a JV on 3 June, provided much relief to opex (S\$363.5m, -9% y-o-y). Along with prudent cost control measures, EBIT margins improved 4.4ppts to 14%. Loss of revenue contribution from BRF also led to some disappointment in revenue (S\$423m, -4% y-o-y) despite Changi showing an improvement in passenger/aircraft numbers. TFK turned in a sequentially stronger performance (S\$53.2m, +9% q-o-q), led by better Narita traffic and new accounts, but its revenue was below 2Q15 (-10% y-o-y). An interim DPS of 5 Scts was proposed for 1H16, in line with our expectations.

Anticipate better margins ahead; raise FY16-17F earnings by 4-6%.

We believe that BRF may not have been profitable since the disposal of BRF had shown an uptick in SATS' performance. The permanent absence of BRF's contribution to SATS hence suggests a sustainable improvement in margin structure. We have revised our FY16-17F earnings by 4-6% to reflect the better cost structure and margin outlook. Our revenue projection is also lower, given the absence of contribution from BRF, but is partly offset by a small improvement in passenger and aircraft traffic at Changi on the back of last year's low base.

Maintain HOLD, with higher S\$3.65 TP. The better 2Q16 earnings were mainly driven by productivity improvements and the disposal of BRF. We envisage higher earnings ahead from potential recovery in Changi's numbers and cost controls. However, valuations are steep at +1.5SD of its four year mean PE and -1.5SD of its three year historical dividend yield. We will turn more positive on the stock when 1) valuations correct to more palatable levels; and/or 2) Changi continues to recover on a more sustained basis. Our TP based on average of DCF and PE valuations is nudged up to S\$3.65, backed by higher earnings estimate and rolling over earnings base to FY17F. Maintain HOLD.

At A Glance

Issued Capital (m shrs)	1,111
Mkt. Cap (S\$m/US\$m)	4,221 / 3,022
Major Shareholders	
Temasek Holdings (%)	43.1
Free Float (%)	56.9
3m Avg. Daily Val (US\$m)	5.0

INVESTMENT THESIS

Profile	Rationale
<p>SATS is a leading provider of gateway services and food solutions in the region with a leading market share in inflight catering and ground handling services at Singapore's Changi Airport. The company also provides aviation security, airline laundry, airport cargo delivery management services. Additionally, it also offers catering services and food solutions to non-aviation sector and manages a cruise centre.</p>	<p>Better earnings traction priced in. We believe that earnings upside is capped. 2Q16 turned in a stronger than expected performance, led by spin-off of food arm BRF S.A. We hence expect margin improvement to sustain going forward. Besides, Changi's passenger and aircraft numbers have also shown an initial improvement. These improving matrices led us to raise our FY16-17F earnings forecast by 4-6%. However despite the earnings uplift, the stock which is valued at +1.5SD of its four year mean PE valuation and -1.5SD of three year historical dividend yield, suggests that the better earnings prospects have already been reflected in the current price.</p> <p>4% dividend yield lends support to the share price. We also believe that downside to the stock price is limited since the stock is supported by dividend yield of 4%. SATS generates strong cashflows and has a net cash balance sheet capable of supporting current DPS of 14-15 Scts going forward. There is little risk of DPS cuts.</p> <p>Valuation at +1.5 SD above historical average. We believe current valuations are lofty. Even after raising earnings, the stock is trading at valuations of +1.5 SD above its 4-year historical average PE.</p>
Valuation	Risks
<p>We raised our FY16F/17F forecasts by 4%/6% on the back of lower costs assumptions, on expectations that the trend seen in 2Q16 should continue. As a result, our TP is raised to S\$3.65. We derive our TP based on the average of discounted cash flow (DCF) valuation and price-earnings valuation methodologies. We adopt a DCF model as the business provides stable and predictable cashflows, while the PER methodology takes into account near-term earnings growth. We peg our PER valuation at 17x FY17F earnings. Our DCF methodology is based on a weighted average cost of capital of 7.7% and a terminal growth assumption of 2%.</p>	<p>Downturn in aviation volumes. A downturn in passenger travel and airline yields will impact passengers handled and inflight meals served. This could have an adverse impact on revenue growth.</p> <p>Cost pressure. Management has managed to reap cost savings through productivity. Spikes in raw material prices and/or energy could impinge in margins, as there could be a lag effect in passing on costs to customers.</p>

Source: DBS Bank

2Q16 results above expectations on lower opex

Lower than expected operating costs were a surprise. 2Q16 earnings of S\$59.7m (+27% y-o-y) were ahead of our expectations. Revenue was below our expectations (S\$423m, -4% y-o-y) as stronger Changi numbers were offset by weak TFK performance and revenue loss from the spin-off of BRF S.A. into a JV on 3 June. The surprise however came in the form of lower opex and higher EBIT margins (14%, +4.4ppts). The better margins were largely from operational cost savings after the BRF spin-off. An interim DPS of 5 Scts was proposed for 1H16, in line with our expectations.

Aviation numbers recovering but still below expectations.

Aviation revenue excluding TFK grew 3.4% y-o-y on the back of stronger passenger and aircraft numbers at Changi. TFK continued to post weaker revenue versus last year (S\$53.2m, -10% y-o-y) but nonetheless recovered sequentially (+9.5% q-o-q) as a result of improving visitor arrivals particularly from China and to a lesser extent, contribution of new accounts. Non-aviation food revenue declined by 27% to S\$62.6m, largely due to the spin-off of BRF S.A. Despite recovery in aviation numbers, revenue was still below our expectations.

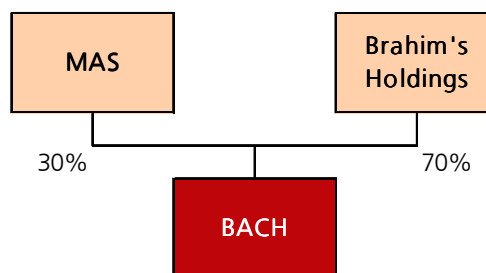
Better productivity led to lower cost and higher margins.

Continued productivity initiatives led to lower opex (S\$363.5m, -9.1% y-o-y) across all expense categories except depreciation and amortisation charges. Labour costs remained steady at S\$201m thanks to automation and productivity initiatives. Raw material costs dropped to S\$73m, largely due to spin off of BRF and in part due to better sourcing. Other cost reductions came from more stringent cost management and improved operational efficiencies, which resulted in lower licence fees, company premise and utilities expenses, fuel and gas costs, transportation and distribution charges, sales and marketing expenses, rental of ground support equipment, maintenance expenses and professional fees.

Gaining entry into Malaysia's aviation market through acquiring 34% of Brahim's flight kitchen

SATS buying 34% in Brahim's Airlines Catering Holdings Sdn Bhd. SATS announced two weeks ago that it is proposing to buy 49% of Brahim's Holdings' stake (of 70%) in Brahim's Airlines Catering Holdings Sdn Bhd (BACH), which was subsequently accepted. The offer is worth RM110m with additional earn-outs of up to RM108m. We view this transaction more as a strategic acquisition rather than a financial one based on the following: 1) SATS has no presence in Malaysia and this transaction allows it to gain access into the Malaysia market; 2) valuation multiples are not low (we estimate >42x PE); 3) scope for growing BACH at airport level is limited as kitchen utilisation is 80% and Brahim's Holdings already has 90% share of KLIA.

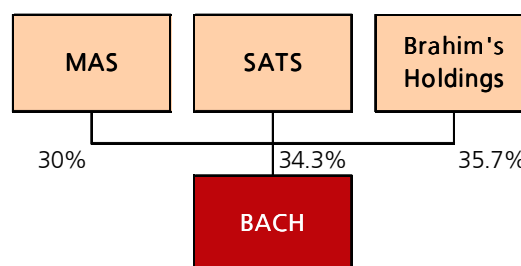
Shareholding before acquisition



Source: Company, DBS Bank

Insignificant impact on earnings. SATS has S\$400m cash and can well afford to pay up the total consideration including earn outs of RM218m (RM110m or c.S\$71m, <20% of cash balances excluding earn outs). But, we work out that earnings contribution from its 34% stake in BACH is <S\$1m, which is very insignificant compared to its S\$200m annual earnings. However, leveraging on its network of flight kitchens across Asia, we believe SATS will be able to realise its synergies with BACH over the longer term.

Shareholding after acquisition



Source: Company, DBS Bank

Raise FY16F/FY17F earnings by 4-6%

Lower revenue estimate but factor in better margins. We revise our numbers to mainly reflect the impact of the spin-off of BRF, since detailed BRF financials have not been previously disclosed. We impute a better cost structure and margin outlook, but lower our revenue forecast in view that BRF is no longer contributing. The lower revenue forecast is also offset by a small improvement of passenger and aircraft situation at Changi on the back of last year's low base. These changes in assumptions have led us to raise our FY16-17F's earnings by 4-6%.

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Valuation

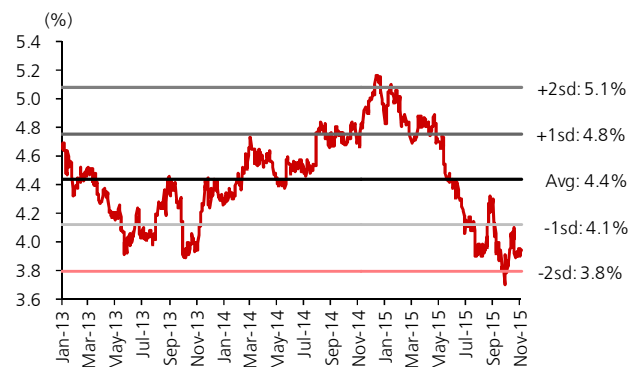
Maintain HOLD, TP raised to S\$3.65. The better 2Q16 earnings were mainly driven by productivity measures and the disposal of BRF. Initial recovery for Changi's numbers and cost controls will no doubt help to drive higher earnings. However, we find valuations lofty even after raising our earnings estimates, at close to +1.5SD of its four year mean PE and close to -1.5SD of its three year historical dividend yield. We will turn more positive on the stock when 1) valuations correct to more palatable levels; and/or 2) Changi continues to recover on a more sustained basis. Our TP is nudged up to S\$3.65 on the back of higher earnings estimate and rolling over earnings base to FY17F. We maintain our HOLD rating for now.

Stock trades at +1.5SD of its four year historical PE



Source: DBS Bank

Stock trades at -1.5SD of its three year historical dividend yield



Source: DBS Bank

Valuation methodology

Valuation methodology	Market Value (S\$m)	S\$/share	Remarks
PER	3,970	3.57	17x on FY17F earnings
DCF	4,126	3.72	WACC 7.7%, terminal growth 2%
Average of PER and DCF	4,048	3.65	S\$/share derived from average of DCF and PER

No. of shares 1,111

Source: Company, DBS Bank

Results Summary and comments

FY Mar (\$m)	2Q15	1Q16	2Q16	y-o-y chg %	q-o-q chg %	Comments
Sales	442.2	416.9	422.7	-4%	1%	Loss of BRF contribution
<i>Staff Costs</i>	(202.2)	(200.1)	(200.8)	-1%	0%	
<i>Cost of raw materials</i>	(90.0)	(75.9)	(72.7)	-19%	-4%	BRF no longer contributing
<i>Licensing fees</i>	(19.4)	(17.0)	(16.3)	-16%	-4%	Lower licensing revenue and rebates
<i>Depreciation & amortisation charges</i>	(16.9)	(17.3)	(17.0)	1%	-2%	
<i>Company accommodation & utilities</i>	(32.2)	(29.4)	(28.5)	-11%	-3%	Lower rates and more efficient usage
<i>Other costs</i>	(39.0)	(33.2)	(28.2)	-28%	-15%	Lower fuel, transport, distribution, marketing costs
Operating Expenses	(399.7)	(372.9)	(363.5)	-9.1%	-3%	Above expectations
EBIT	42.5	44.0	59.2	39%	35%	Above expectations
Interest Income	0.3	0.8	0.8	n/m	n/m	
Interest Expense	(0.2)	(0.2)	(0.4)	n/m	n/m	
Share of Associates' or JV Income	10.8	12.8	11.9	10%	-7%	
Exceptional Gains/(Losses)	0.2	2.5	0.0	n/m	n/m	
Pretax Profit	53.6	59.9	71.5	33%	19%	
Tax	(7.9)	(11.3)	(12.1)	53%	7%	
Minority Interests	1.4	1.0	0.3	-79%	-70%	
Net Profit	47.1	49.6	59.7	27%	20%	Above expectations
Margins (%)						
EBITDA Margin	13.4	14.7	18.0			
EBIT Margin	9.6	10.6	14.0			
Pre-tax Margin	12.1	14.4	16.9			
Net Margin	10.7	11.9	14.1			
Revenue (\$m)						
Food solutions	267.7	241.1	243.0	-9%	+1%	
- Non-aviation	86.3	73.0	62.6	-27%	-14%	Loss of BRF contribution
- Aviation	122.3	119.5	127.2	+4%	+6%	Improved passenger/meal numbers at Changi
- TFK	59.1	48.6	53.2	-10%	+9%	Better passenger numbers at Narita
Gateway services	173.4	174.7	178.5	+3%	+2%	Improved passenger/aircraft numbers at Changi
Corporate	1.1	1.1	1.2	+9%	+9%	
Total Revenue	442.2	416.9	422.7	-4%	+1%	Below expectations

Source: Company, DBS Bank

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Key Assumptions

FY Mar	2014A	2015A	2016F	2017F	2018F
Passengers Handled (m)	43.5	41.6	41.7	42.3	42.3
Unit Services ('000)	111	110	108	108	108
Cargo ('000 tonnes)	1,500	1,570	1,555	1,555	1,555
Unit Meals Produced (m)	20.6	20.8	21.2	21.2	21.2
Average no of employees	14,708	14,550	14,114	14,114	14,114

Segmental Breakdown

FY Mar	2014A	2015A	2016F	2017F	2018F
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Revenues (\$\$ m)

Food solutions	1,104	1,052	974	998	1,017
Gateway services	678	697	711	720	728
Corporate	5	5	5	5	5

Total

	1,787	1,753	1,689	1,723	1,749
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Operating profit (\$\$ m)

Food solutions	142	127	160	167	164
Gateway services	14	40	41	42	42
Corporate	15	11	12	12	12

Total

	171	178	213	221	219
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Operating profit Margins

Food solutions	12.9	12.1	16.4	16.7	16.1
Gateway services	2.0	5.7	5.8	5.8	5.8
Corporate	306.0	234.0	259.3	251.9	244.7

Total

	9.6	10.2	12.6	12.8	12.5
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Income Statement (\$\$ m)

FY Mar	2014A	2015A	2016F	2017F	2018F
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Revenue	1,787	1,753	1,689	1,723	1,749
Other Opg (Exp)/Inc	(1,616)	(1,575)	(1,476)	(1,502)	(1,531)
Operating Profit	171	178	213	221	219
Other Non Opg (Exp)/Inc	2	0	0	0	0
Associates & JV Inc	47	48	49	59	61
Net Interest (Exp)/Inc	(2)	0	2	2	2
Exceptional Gain/(Loss)	(3)	(1)	3	0	0
Pre-tax Profit	216	225	266	281	282
Tax	(33)	(34)	(46)	(48)	(48)
Minority Interest	0	5	2	0	0
Preference Dividend	0	0	0	0	0
Net Profit	182	196	222	234	234
Net Profit before Except.	185	197	219	234	234
EBITDA	250	246	283	293	294

Growth

Revenue Gth (%)	(1.8)	(1.9)	(3.7)	2.0	1.5
EBITDA Gth (%)	(11.7)	(1.7)	15.1	3.6	0.3
Opg Profit Gth (%)	(11.1)	4.1	19.8	3.6	(1.0)
Net Profit Pre-Ex Gth (%)	(8.4)	6.7	11.4	6.4	0.2

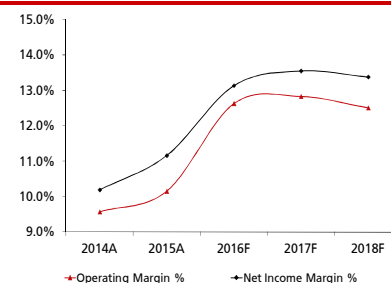
Margins & Ratio

Gross Margins (%)	100.0	100.0	100.0	100.0	100.0
Opg Profit Margin (%)	9.6	10.2	12.6	12.8	12.5
Net Profit Margin (%)	10.2	11.2	13.1	13.6	13.4
ROAE (%)	12.9	13.7	15.0	15.1	14.6
ROA (%)	9.0	9.7	11.0	11.3	10.9
ROCE (%)	8.4	8.9	10.4	10.5	10.0
Div Payout Ratio (%)	80.1	79.2	75.1	71.3	71.2
Net Interest Cover (x)	95.0	NM	NM	NM	NM

Source: Company, DBS Bank

Loss of BRF revenue

Margins Trend



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

FY Mar	2Q2015	3Q2015	4Q2015	1Q2016	2Q2016
Revenue	442	451	425	417	423
Other Oper. (Exp)/Inc	(400)	(400)	(380)	(373)	(364)
Operating Profit	43	51	45	44	59
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	11	14	13	13	12
Net Interest (Exp)/Inc	0	0	0	1	0
Exceptional Gain/(Loss)	0	(1)	0	3	0
Pre-tax Profit	54	64	58	60	72
Tax	(8)	(11)	(9)	(11)	(12)
Minority Interest	1	0	3	1	0
Net Profit	47	54	52	50	60
Net Profit before Except	47	54	52	47	60
EBITDA	70	82	75	74	88

Growth

Revenue Gth (%)	1.6	1.9	(5.7)	(1.9)	1.4
EBITDA Gth (%)	4.8	16.7	(8.7)	(0.9)	18.9
Opg Profit Gth (%)	7.1	20.2	(12.5)	(1.6)	34.5
Net Profit Pre-Ex Gth (%)	6.1	15.8	(5.0)	(8.7)	26.8

Margins

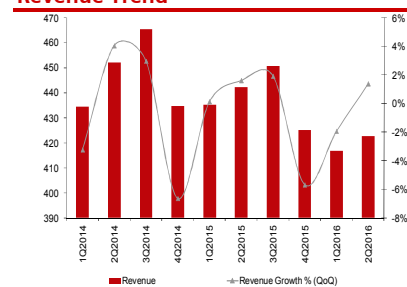
Gross Margins (%)	100.0	100.0	100.0	100.0	100.0
Opg Profit Margins (%)	9.6	11.3	10.5	10.6	14.0
Net Profit Margins (%)	10.7	11.9	12.1	11.9	14.1

Balance Sheet (\$\$ m)

FY Mar	2014A	2015A	2016F	2017F	2018F
Net Fixed Assets	568	552	543	531	518
Invts in Associates & JVs	495	465	550	609	670
Other LT Assets	233	211	200	189	180
Cash & ST Invts	341	411	369	400	429
Inventory	46	19	18	18	19
Debtors	288	283	272	278	282
Other Current Assets	50	81	81	81	81
Total Assets	2,020	2,020	2,032	2,106	2,178
ST Debt	17	15	10	10	10
Creditor	267	287	277	282	287
Other Current Liab	45	43	47	48	48
LT Debt	97	90	50	50	50
Other LT Liabilities	79	67	67	67	67
Shareholder's Equity	1,417	1,441	1,508	1,575	1,642
Minority Interests	98	77	75	75	75
Total Cap. & Liab.	2,020	2,020	2,032	2,106	2,178
Non-Cash Wkg. Capital	71	51	47	46	46
Net Cash/(Debt)	227	306	309	340	369
Debtors Turn (avg days)	60.1	59.3	59.9	58.3	58.4
Creditors Turn (avg days)	59.8	67.2	73.2	71.4	71.4
Inventory Turn (avg days)	11.8	7.9	4.8	4.6	4.6
Asset Turnover (x)	0.9	0.9	0.8	0.8	0.8
Current Ratio (x)	2.2	2.3	2.2	2.3	2.4
Quick Ratio (x)	1.9	2.0	1.9	2.0	2.1
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	49.7	57.8	83.3	83.3	87.5
Z-Score (X)	7.2	7.2	7.8	7.7	7.7

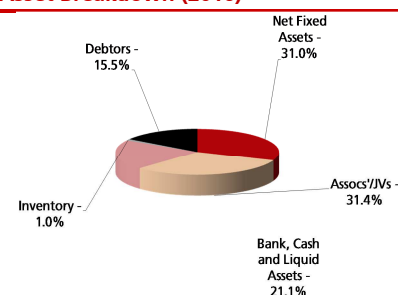
Source: Company, DBS Bank

Revenue Trend



Includes S\$2.5m net gain from transfer of 49% stake in SBRF to BRG GmbH JV.

Asset Breakdown (2016)

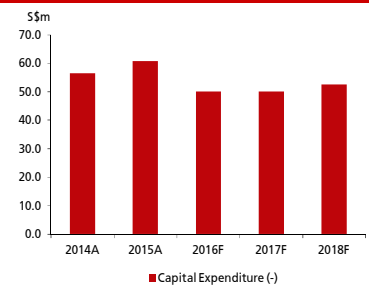


SATS

Cash Flow Statement (\$\$ m)

FY Mar	2014A	2015A	2016F	2017F	2018F
Pre-Tax Profit	216	225	266	281	282
Dep. & Amort.	77	68	70	72	75
Tax Paid	(39)	(35)	(43)	(46)	(48)
Assoc. & JV Inc/(loss)	(47)	(48)	(49)	(59)	(61)
Chg in Wkg.Cap.	22	19	1	0	0
Other Operating CF	18	7	(1)	(1)	(1)
Net Operating CF	247	236	243	247	247
Capital Exp.(net)	(57)	(61)	(50)	(50)	(53)
Other Invts.(net)	0	3	0	0	0
Invts in Assoc. & JV	(118)	25	(37)	0	0
Div from Assoc & JV	27	89	0	0	0
Other Investing CF	2	3	0	0	0
Net Investing CF	(146)	58	(87)	(50)	(53)
Div Paid	(168)	(146)	(155)	(167)	(167)
Chg in Gross Debt	(5)	(1)	(45)	0	0
Capital Issues	23	6	0	0	0
Other Financing CF	(12)	(59)	1	1	1
Net Financing CF	(163)	(200)	(199)	(166)	(166)
Currency Adjustments	(3)	(5)	0	0	0
Chg in Cash	(65)	90	(42)	32	29
Opg CFPS (\$ cts)	20.0	19.6	21.9	22.3	22.3
Free CFPS (\$ cts)	17.0	15.9	17.4	17.8	17.5

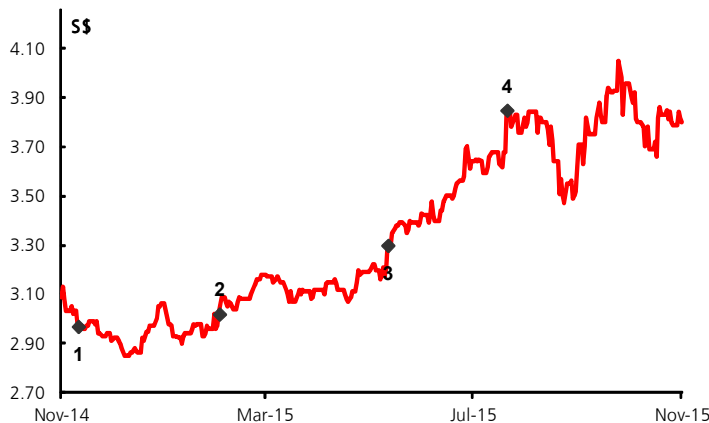
Capital Expenditure



34% stake in BACH for RM110m (before earn outs). Assume completion before end of FY16F

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date	Closing Price	Target Price	Rating
1:	14 Nov 14	2.97	2.70	FULLY VALUED
2:	05 Feb 15	3.02	2.84	HOLD
3:	15 May 15	3.30	3.06	HOLD
4:	24 Jul 15	3.85	3.43	HOLD

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

Source: DBS Bank

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:

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

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DBS Bank Ltd.

12 Marina Boulevard, Marina Bay Financial Centre Tower 3

Singapore 018982

Tel. 65-6878 8888

Company Regn. No. 196800306E