

# SIA Engineering Company Ltd

## Restructuring of Rolls-Royce Joint Ventures

SINGAPORE | TRANSPORT SERVICES | UPDATE

25 November 2015

- SIAEC divests its 10% stake in HAESL.
- No change to SIAEC's direct stake in SAESL.
- Termination of territory based rights leads to more open competition.

### What is the news?

SIA Engineering Company Ltd (SIAEC) announced the divestment of its 10% stake in Hong Kong Aero Engine Services (HAESL) for S\$163.8 mn. At the same time, HAESL will divest its 20% stake in Singapore Aero Engine Services Private Limited (SAESL). After the restructuring, SIAEC will own a 50% stake in SAESL, and no longer hold any stake in HAESL. Rolls-Royce and SIAEC intend to amalgamate the business and operations of SAESL and International Engine Component Overhaul Pte Ltd (IECO) into a single entity.

- **Termination of territory based rights of SAESL and HAESL.** SAESL and HAESL operate out of Singapore and Hong Kong, respectively. Restructuring of the SAESL and HAESL JVs with Rolls-Royce will result in the termination of territory based rights for both entities. Both entities will be free to compete beyond the current designated Asia-Pacific territory for the global Trent engine aftermarket business.
- **One-off divestment gain for SIAEC and dividend.** As of FY03/15 annual report, SIAEC's unquoted investment in HAESL stood at S\$14.6 mn. We estimate divestment of SIAEC's 10% stake in HAESL will result in a net gain of S\$149.2 mn. SIAEC will also receive a dividend of S\$38.1 mn from HAESL.
- **Open competition is a double-edged sword.** While the termination of territory based rights will allow SAESL to compete outside of its existing territory, but it also opens up competition from HAESL for SAESL's existing territory.
- **Special dividends possible, but unlikely.** We note that SIAEC had stated that "the proceeds from these transactions will provide additional resources for the Company's investments". As such, we do not assume any special dividends to be paid out.

### Investment Actions

We include the divestment gain into our financial model as an exceptional item and exclude all future dividends from SIAEC's stake in HAESL. As a result, core earnings are lower by about 3% to 4%.

We have a new lower target price of S\$3.35. (Previous: S\$3.46), but upgrade SIAEC to "Neutral" rating, as the share price has corrected 9% downwards since our last report three weeks ago.

### Neutral (Upgraded)

|                     |              |
|---------------------|--------------|
| LAST DONE PRICE     | SGD 3.62     |
| FORECAST DIV        | SGD 0.135    |
| TARGET PRICE        | SGD 3.35     |
| <b>TOTAL RETURN</b> | <b>-3.7%</b> |

#### COMPANY DATA

|                                |             |
|--------------------------------|-------------|
| O/S SHARES (MN) :              | 1,123       |
| MARKET CAP (USD mn / SGD mn) : | 2890 / 4066 |
| 52 - WK HI/LO (SGD) :          | 4.44 / 3.2  |
| 3M Average Daily T/O (mn) :    | 0.31        |

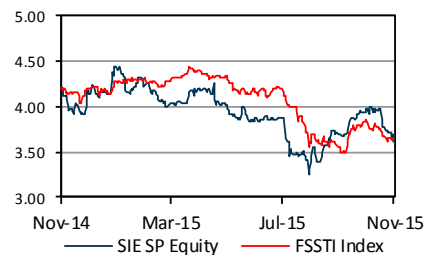
#### MAJOR SHAREHOLDERS (%)

|                                |       |
|--------------------------------|-------|
| SINGAPORE AIRLINES LTD         | 77.5% |
| MATTHEWS INTERNATIONAL CAPITAL | 19%   |
| BANK OF MONTREAL CANADA        | 0.6%  |

#### PRICE PERFORMANCE (%)

|           | 1M TH | 3M TH | 1Y R  |
|-----------|-------|-------|-------|
| COMPANY   | (4.9) | 14.9  | (8.7) |
| STIRETURN | (4.6) | 3.1   | (9.5) |

#### PRICE VS. STI



Source: Bloomberg, PSR

#### KEY FINANCIALS

| Y/E Mar              | FY 14 | FY 15 | FY 16 e | FY 17 e |
|----------------------|-------|-------|---------|---------|
| Revenue (SGD mn)     | 1,178 | 1,121 | 1,085   | 1,118   |
| PATM I, adj (SGD mn) | 266   | 183   | 173     | 192     |
| EPS, adj. (Cents)    | 23.88 | 16.36 | 28.72   | 17.17   |
| P/E, adj. (x)        | 20.5  | 25.2  | 23.5    | 211     |
| BVPS (Cents)         | 128.3 | 124.8 | 139.1   | 142.7   |
| P/B (x)              | 3.8   | 3.3   | 2.6     | 2.5     |
| DPS (Cents)          | 25.00 | 14.50 | 13.50   | 15.50   |
| Div. Yield (%)       | 5.1   | 3.5   | 3.7     | 4.3     |

Source: Company Data, PSR est.

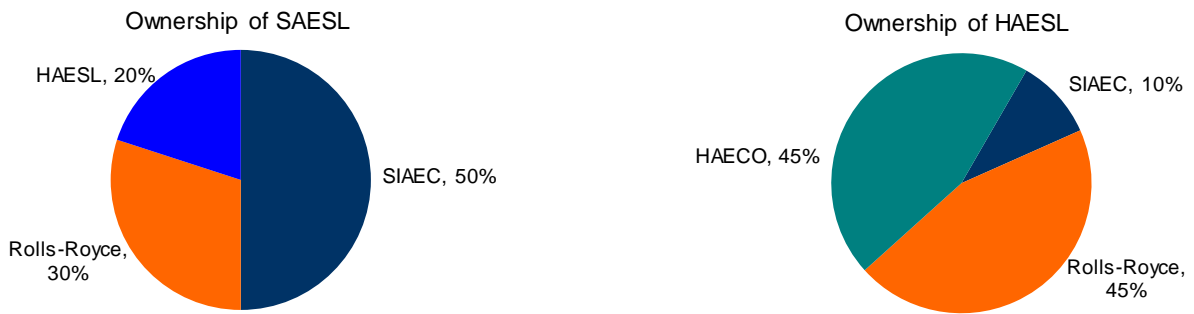
#### VALUATION METHOD

DCF (WACC: 7.3%; Terminal g: 15%)

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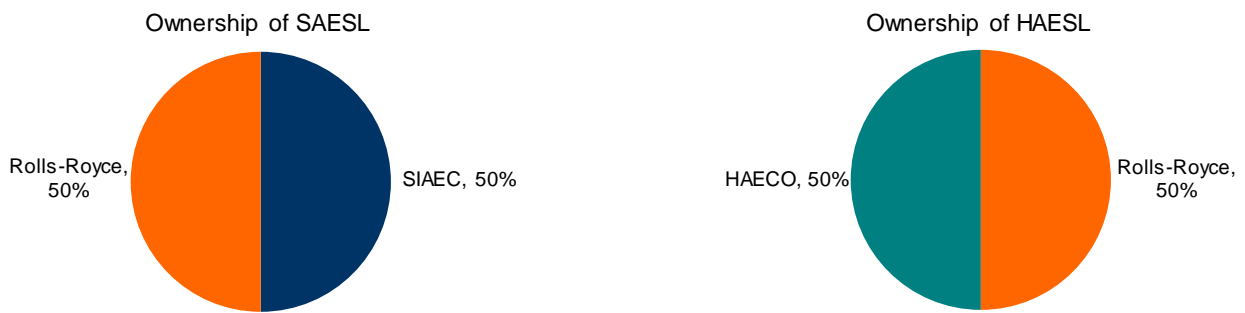
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Figure 1. Before restructuring



Source: Company, PSR

Figure 2. After restructuring



Source: Company, PSR

## Financials

### Income Statement

| Y/E Mar, SGD mn             | FY13         | FY14         | FY15         | FY16e        | FY17e        |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|
| <b>Revenue</b>              | <b>1,147</b> | <b>1,178</b> | <b>1,121</b> | <b>1,085</b> | <b>1,118</b> |
| <b>EBITDA</b>               | <b>163</b>   | <b>153</b>   | <b>127</b>   | <b>155</b>   | <b>151</b>   |
| Depreciation & Amortisation | 35           | 37           | 43           | 43           | 44           |
| <b>EBIT</b>                 | <b>128</b>   | <b>116</b>   | <b>84</b>    | <b>112</b>   | <b>108</b>   |
| Net Finance (Expense)/Inc   | 1.3          | 1.3          | 1.1          | 1.0          | 1.5          |
| Other items                 | 18           | 15           | 14           | 41           | -            |
| Associates & JVs            | 159          | 163          | 106          | 84           | 107          |
| Exceptional items           | -            | -            | -            | 149          | -            |
| <b>Profit Before Tax</b>    | <b>306</b>   | <b>294</b>   | <b>205</b>   | <b>387</b>   | <b>216</b>   |
| Taxation                    | (32)         | (23)         | (20)         | (60)         | (21)         |
| <b>Profit After Tax</b>     | <b>274</b>   | <b>271</b>   | <b>185</b>   | <b>327</b>   | <b>195</b>   |
| - Non-controlling interest  | 4.1          | 5.3          | 2.1          | 5.0          | 3.0          |
| <b>Net profit, reported</b> | <b>270</b>   | <b>266</b>   | <b>183</b>   | <b>322</b>   | <b>192</b>   |
| <b>Net profit, adj.</b>     | <b>270</b>   | <b>266</b>   | <b>183</b>   | <b>173</b>   | <b>192</b>   |

### Per share data (Cents)

| Y/E Mar       | FY13  | FY14  | FY15  | FY16e | FY17e |
|---------------|-------|-------|-------|-------|-------|
| EPS, reported | 24.51 | 23.88 | 16.36 | 28.72 | 17.17 |
| EPS, adj.     | 24.51 | 23.88 | 16.36 | 15.40 | 17.17 |
| DPS           | 22.00 | 25.00 | 14.50 | 13.50 | 15.50 |
| BVPS          | 122.4 | 128.3 | 124.8 | 139.1 | 142.7 |

### Cash Flow

| Y/E Mar, SGD mn                  | FY13         | FY14         | FY15         | FY16e        | FY17e        |
|----------------------------------|--------------|--------------|--------------|--------------|--------------|
| <b>CFO</b>                       |              |              |              |              |              |
| PBT                              | 306          | 294          | 205          | 387          | 216          |
| Adjustments                      | (142)        | (137)        | (81)         | (232)        | (65)         |
| WC changes                       | (4.0)        | (20.6)       | (5.1)        | 2.5          | (2.3)        |
| Cash generated from ops          | 160          | 137          | 119          | 157          | 149          |
| Others                           | (27)         | (24)         | (23)         | (60)         | (21)         |
| <b>Cashflow from ops</b>         | <b>134</b>   | <b>113</b>   | <b>96</b>    | <b>98</b>    | <b>128</b>   |
| <b>CFI</b>                       |              |              |              |              |              |
| CAPEX, net                       | (32)         | (67)         | (49)         | (43)         | (43)         |
| Divd from associates & JVs       | 138          | 157          | 112          | 71           | 90           |
| Others                           | 4.6          | 11.0         | 14.6         | 205.9        | 1.8          |
| <b>Cashflow from investments</b> | <b>111</b>   | <b>101</b>   | <b>78</b>    | <b>234</b>   | <b>49</b>    |
| <b>CFF</b>                       |              |              |              |              |              |
| Share issuance, net              | 22.6         | 30.3         | 17.2         | -            | -            |
| Loans, net of repayments         | 3.2          | 16.1         | 8.8          | -            | -            |
| Dividends                        | (245)        | (248)        | (273)        | (167)        | (155)        |
| Others                           | (0.1)        | (0.2)        | (0.3)        | (0.3)        | (0.3)        |
| <b>Cashflow from financing</b>   | <b>(219)</b> | <b>(202)</b> | <b>(248)</b> | <b>(167)</b> | <b>(155)</b> |
| <b>Net change in cash</b>        | <b>25</b>    | <b>13</b>    | <b>(74)</b>  | <b>164</b>   | <b>22</b>    |
| Effects of exchange rates        | (0.1)        | -            | 5.1          | -            | -            |
| <b>CCE, end</b>                  | <b>523</b>   | <b>536</b>   | <b>464</b>   | <b>628</b>   | <b>650</b>   |

### Balance Sheet

| Y/E Mar, SGD mn                      | FY13         | FY14         | FY15         | FY16e        | FY17e        |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|
| <b>ASSETS</b>                        |              |              |              |              |              |
| PPE                                  | 306          | 337          | 344          | 346          | 346          |
| Intangibles                          | 49           | 54           | 62           | 60           | 59           |
| Associates & JVs                     | 427          | 436          | 464          | 476          | 493          |
| Investments                          | 15           | 15           | 15           | -            | -            |
| Others                               | -            | -            | -            | -            | -            |
| <b>Total non-current assets</b>      | <b>796</b>   | <b>842</b>   | <b>884</b>   | <b>882</b>   | <b>898</b>   |
| Inventories                          | 51           | 44           | 38           | 36           | 37           |
| Accounts Receivables                 | 71           | 97           | 83           | 80           | 83           |
| Prepayments                          | 16           | 19           | 13           | 12           | 13           |
| Investments                          | -            | -            | -            | -            | -            |
| Cash                                 | 523          | 536          | 464          | 628          | 650          |
| Others                               | 176          | 169          | 176          | 170          | 175          |
| <b>Total current assets</b>          | <b>837</b>   | <b>865</b>   | <b>773</b>   | <b>927</b>   | <b>958</b>   |
| <b>Total Assets</b>                  | <b>1,633</b> | <b>1,707</b> | <b>1,657</b> | <b>1,809</b> | <b>1,857</b> |
| <b>LIABILITIES</b>                   |              |              |              |              |              |
| Short term loans                     | 5.7          | 8.2          | 9.3          | 9.3          | 9.3          |
| Accounts Payables                    | 249          | 246          | 230          | 222          | 229          |
| Others                               | 24           | 22           | 17           | 17           | 17           |
| <b>Total current liabilities</b>     | <b>278</b>   | <b>276</b>   | <b>257</b>   | <b>249</b>   | <b>256</b>   |
| Long term loans                      | -            | 14           | 24           | 24           | 24           |
| Others                               | 25           | 27           | 27           | 27           | 27           |
| <b>Total non-current liabilities</b> | <b>25</b>    | <b>40</b>    | <b>51</b>    | <b>51</b>    | <b>51</b>    |
| <b>Total Liabilities</b>             | <b>304</b>   | <b>317</b>   | <b>307</b>   | <b>300</b>   | <b>306</b>   |
| <b>EQUITY</b>                        |              |              |              |              |              |
| Non-controlling interests            | 27           | 30           | 25           | 25           | 25           |
| <b>Shareholder Equity</b>            | <b>1,302</b> | <b>1,361</b> | <b>1,325</b> | <b>1,484</b> | <b>1,525</b> |

### Valuation Ratios

| Y/E Mar             | FY13 | FY14 | FY15 | FY16e | FY17e |
|---------------------|------|------|------|-------|-------|
| P/E (X), adj.       | 20.0 | 20.5 | 25.2 | 23.5  | 21.1  |
| P/B (X)             | 4.0  | 3.8  | 3.3  | 2.6   | 2.5   |
| EV/EBITDA (X), adj. | 30.3 | 32.6 | 33.2 | 22.5  | 22.9  |
| Dividend Yield (%)  | 4.5% | 5.1% | 3.5% | 3.7%  | 4.3%  |

### Growth & Margins (%)

|                   | FY13  | FY14  | FY15   | FY16e | FY17e |
|-------------------|-------|-------|--------|-------|-------|
| <b>Growth</b>     |       |       |        |       |       |
| Revenue           | -2.0% | 2.7%  | -4.9%  | -3.2% | 3.1%  |
| EBITDA            | -3.6% | -6.4% | -16.9% | 22.2% | -2.3% |
| EBIT              | -1.2% | -9.8% | -27.3% | 33.3% | -3.8% |
| Net Income, adj.  | 0.4%  | -1.6% | -31.0% | -5.9% | 11.5% |
| <b>Margins</b>    |       |       |        |       |       |
| EBITDA margin     | 14.2% | 13.0% | 11.3%  | 14.3% | 13.5% |
| EBIT margin       | 11.2% | 9.8%  | 7.5%   | 10.3% | 9.6%  |
| Net Profit Margin | 23.9% | 23.0% | 16.5%  | 30.1% | 17.5% |

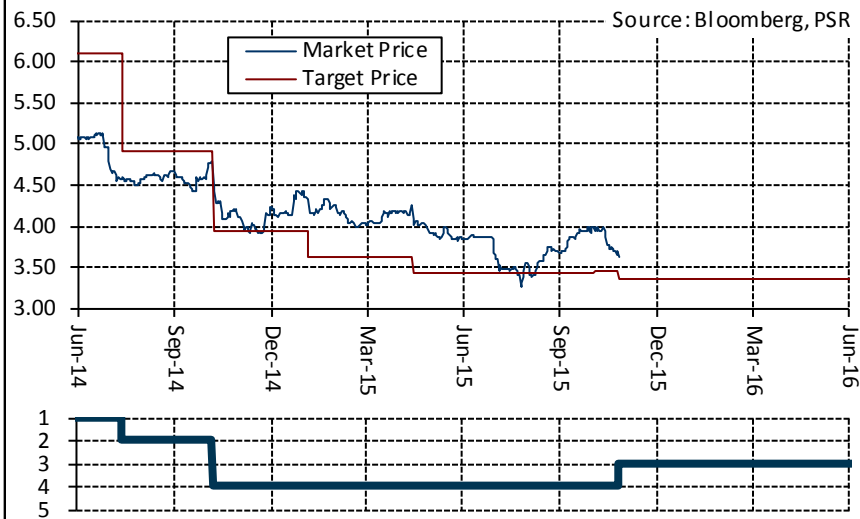
### Key Ratios

|                        | FY13     | FY14     | FY15     | FY16e    | FY17e    |
|------------------------|----------|----------|----------|----------|----------|
| ROE (%)                | 21.1%    | 20.0%    | 13.6%    | 12.3%    | 12.8%    |
| ROA (%)                | 16.7%    | 15.9%    | 10.9%    | 10.0%    | 10.5%    |
| Net Debt or (Net Cash) | (517)    | (514)    | (431)    | (595)    | (617)    |
| Net Gearing (X)        | Net Cash | Net Cash | Net Cash | Net Cash | Net Cash |

Source: Company, Phillip Securities Research (Singapore) Estimates

\*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.

**Ratings History**



**PSR Rating System**

| Total Returns | Recommendation | Rating |
|---------------|----------------|--------|
| > +20%        | Buy            | 1      |
| +5% to +20%   | Accumulate     | 2      |
| -5% to +5%    | Neutral        | 3      |
| -5% to -20%   | Reduce         | 4      |
| < -20%        | Sell           | 5      |

**Remarks**

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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