

SIA Engineering (SIE SP)

Decent quarter but outlook remains challenging

Maintain HOLD: 3Q18 profit driven by associates/JVs

3Q18 profit of SGD54.8m, up c4% YoY, was in line with our expectations. Revenues slid marginally and the bottom-line growth was driven principally by associate & JV contributions, up 29% YoY. The anticipated double-digit growth in core operations is still 1-2 years away we believe. Maintain HOLD with SGD3.50 price target based on 5 year forward PER mean of 21x FY3/19E EPS (unchanged).

Core operations remain sluggish; guidance muted

Revenues slid marginally by 0.5% in 3Q, while for 9M18 it was up just 1.2%. Line maintenance revenues posted modest growth for the quarter, which was offset by the decline in fleet management revenues (from loss of a major customer in the prior quarter). Meanwhile, cost pressures exist as evidenced by the 2.1% and 2.9% YoY increases in operating costs for the 3Q18 and 9M19 periods, respectively. While 9M18 accounted for 79% of our FY18 forecast, our est.'s are unchanged as 3Q has seasonally been the strongest quarter in recent years (at c27-31% of full year profit). Management cite the operating environment to be challenging with intense competition and pricing pressure in the region, along with lighter maintenance requirements and longer maintenance cycles arising from technological advancements of new generation aircraft.

Associates & JVs delivered

Associate & JV profit grew a solid 29.1% YoY for the quarter with almost all of the growth coming from contributions from repair and overhaul (R&O) while the line maintenance contributions remained flat YoY. We expect the recent expansion in Japan (Osaka airport) should start contributing to growth over the coming 2-3 quarters.

New partnerships positive but will take time

We remain positive on the long term growth potential of a number of the new partnerships/JVs announced earlier this year, more specifically ones with Air India for line maintenance, with MOOG for maintenance of flight control systems and with General Electric for engine overhaul. That said, in the near term, these ventures will entail start-up costs and any material contributions will likely take 6-8 quarters.

FYE Mar (SGD m)	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue	1,113	1,104	1,128	1,172	1,237
EBITDA	148	125	135	150	161
Core net profit	184	172	164	188	205
Core EPS (cts)	16.3	15.3	14.6	16.7	18.2
Core EPS growth (%)	0.4	(6.4)	(4.7)	14.5	9.1
Net DPS (cts)	14.0	18.0	17.0	17.0	17.0
Core P/E (x)	20.4	21.8	22.8	20.0	18.3
P/BV (x)	2.5	2.4	2.5	2.5	2.5
Net dividend yield (%)	4.2	5.4	5.1	5.1	5.1
ROAE (%)	12.6	21.9	10.7	12.4	13.5
ROAA (%)	10.6	9.2	8.6	10.0	10.8
EV/EBITDA (x)	25.0	28.9	23.6	21.3	19.9
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	157	160	201
MKE vs. Consensus (%)	-	-	4.8	17.4	1.9

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HOLD

Share Price	SGD 3.33
12m Price Target	SGD 3.50 (+5%)
Previous Price Target	SGD 3.50

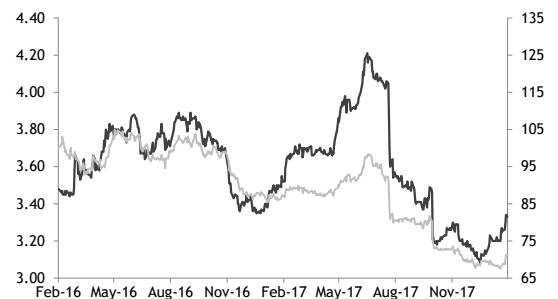
Statistics

52w high/low (SGD)	4.21/3.08
3m avg turnover (USDm)	1.3
Free float (%)	21.8
Issued shares (m)	1,124
Market capitalisation	SGD3.7B
	USD2.8B

Major shareholders:

Singapore Airlines Ltd.	77.4%
Matthews International Capital Managemen	1.9%
Seafarer Capital Partners LLC	1.1%

Price Performance



— SIA Engineering - (LHS, SGD) — SIA Engineering / Straits Times Index - (RHS, %)

	-1M	-3M	-12M
Absolute (%)	5	2	(6)
Relative to index (%)	2	(2)	(19)

Source: FactSet

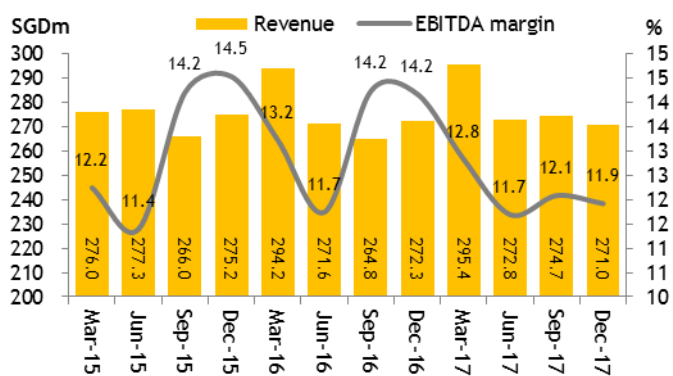
3Q FY18 results takeaways

Fig 1: 3Q FY18 P&L summary

FYE 31 Mar	3Q18	2Q18	3Q17	3Q18	3Q18	9M18	9M17	9M18	9M18
	(SGD m)	(SGD m)	(SGD m)	(QoQ %)	(YoY %)	(SGD m)	(SGD m)	(YoY %)	% of FY18
Revenue	271.0	274.7	272.3	(1.3)	(0.5)	818.5	808.7	1.2	72.5
Operating expenses	(238.7)	(241.5)	(233.7)	(1.2)	2.1	(721.1)	(700.5)	2.9	72.6
EBITDA	32.3	33.2	38.6	(2.7)	(16.3)	97.4	108.2	(10.0)	72.1
Depreciation & Amortisation	(14.1)	(13.7)	(13.4)	2.9	5.2	(41.6)	(38.8)	7.2	76.1
EBIT	18.2	19.5	25.2	(6.7)	(27.8)	55.8	69.4	(19.6)	69.4
Net interest	0.9	1.0	0.8	(10.0)	12.5	3.0	5.5	(45.5)	101.3
Others	0.4	0.5	2.3	(20.0)	(82.6)	0.9	158.9	(99.4)	nm
Associates & JVs	40.8	22.9	31.6	78.2	29.1	84.8	69.5	22.0	84.8
Pretax profit	60.3	43.9	59.9	37.4	0.7	144.5	303.3	(52.4)	78.8
Tax	(5.2)	(5.5)	(6.3)	(5.5)	(17.5)	(14.8)	(13.1)	13.0	104.5
Net profit	55.1	38.4	53.6	43.5	2.8	129.7	290.2	(55.3)	76.7
Minority interest	(0.3)	(0.3)	(1.0)	0.0	(70.0)	(0.6)	(3.7)	(83.8)	12.0
PATMI	54.8	38.1	52.6	43.8	4.2	129.1	286.5	(54.9)	78.6
Exceptionals	(0.4)	(0.5)	(2.3)	(20.0)	(82.6)	(0.9)	(159.0)	(99.4)	nm
Core PATMI	54.4	37.6	50.3	44.7	8.2	128.2	127.5	0.5	78.1
EPS, basic	4.9	3.4	4.7	44.1	4.5	11.5	25.5	(54.8)	79.0
EPS, diluted	4.9	3.4	4.7	44.2	4.5	11.5	25.5	(54.8)	79.0

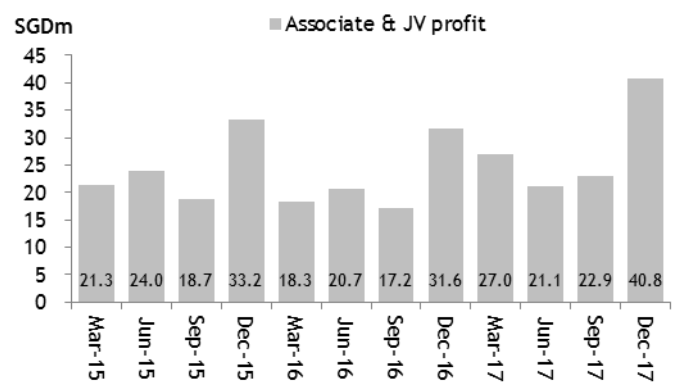
Source: Company, Maybank Kim Eng

Fig 2: Quarterly revenue and EBITDA margin



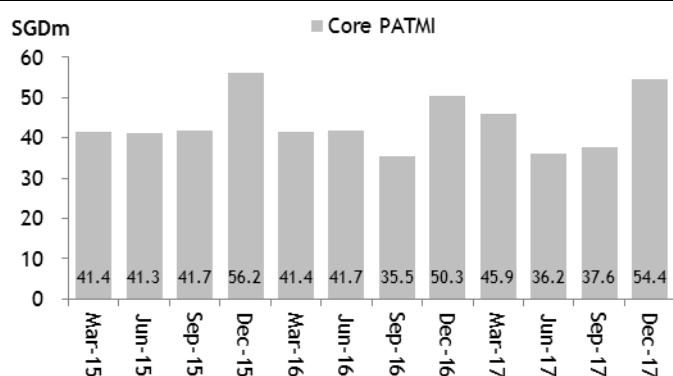
Source: Company

Fig 3: Associate & JV profit



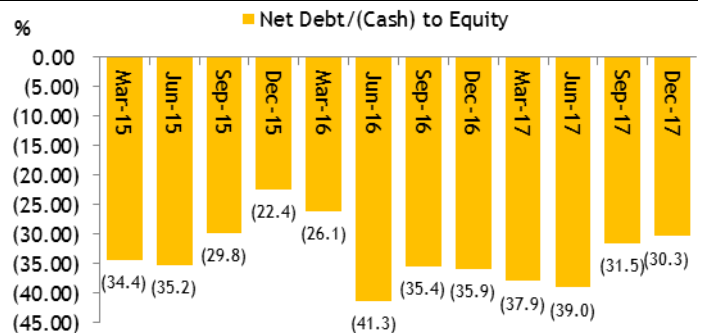
Source: Company

Fig 4: Core net profit



Source: Company

Fig 5: Net gearing

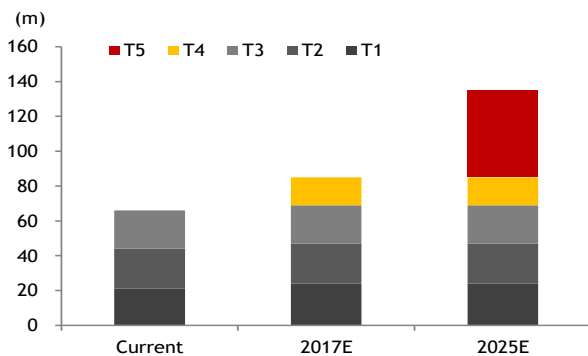


Source: Company

Value Proposition

- Leading aircraft maintenance, repair & overhaul (MRO) service provider in the world. National flag carrier, Singapore Airlines, owns 78% and is an anchor customer.
- JVs with various aircraft OEMs contribute half of its earnings. This implies strong competitive positioning as technology transfers are secured.
- Dominant line-maintenance provider at Changi with ~80% market share. Benefits from Changi's plans to double annual capacity to 135m passengers by mid-2020.
- Lower ticket prices with competition and moderate oil prices should stoke air-travel demand near term.
- Ability to consistently generate high ROEs led to high valuation multiples.

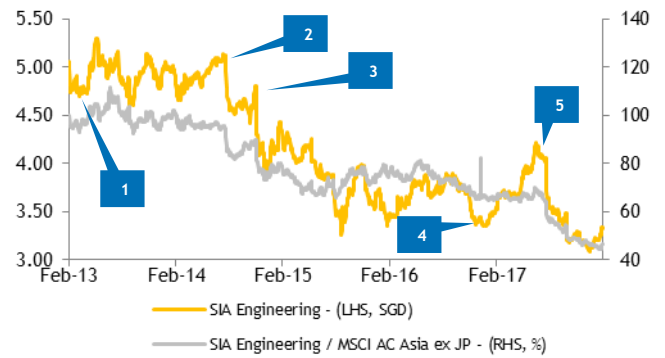
Capacity expansion at Changi Airport



Source: Company

Price Drivers

Historical share price trend



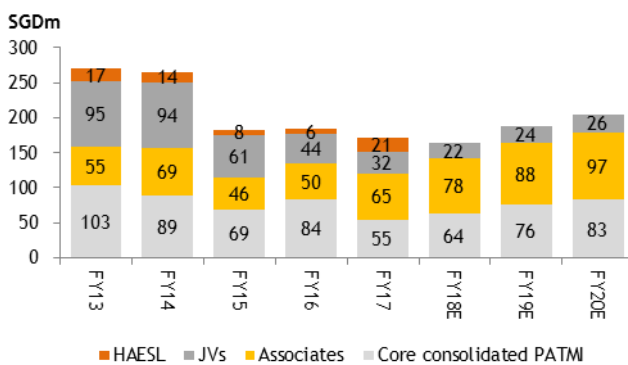
Source: Company, FactSet, Maybank Kim Eng

1. Company seen as proxy for rising air traffic in post GFC regional travel recovery.
2. Start of earnings-downgrade cycle after first earnings miss. Falling heavy-maintenance visits and improved reliability of Rolls-Royce engines.
3. Significant EPS cuts after earnings miss.
4. Expectations of special dividends after restructuring engine JVs with Rolls-Royce and HAECO
5. Share placement of c3.5% of outstanding shares at a 4.6-10.1% discount to market in block trades.

Financial Metrics

- Earnings could be capped by smaller maintenance workloads from fewer heavy-maintenance visits and improved reliability of Rolls-Royce engines.
- Pace of recovery in engine at JVs critical for earnings rebound and momentum.
- Flight traffic at Changi Airport is a good indicator of maintenance workload.
- Generates high level of FCF (including distributions from Associates & JVs), which allows high dividend payout to shareholders.

Associate/JV earnings a current pressure point



Source: Company, Maybank Kim Eng estimates

Swing Factors

Upside

- Bigger-than-expected workload for Rolls-Royce Trent engines.
- Acceleration in aircraft deployment.
- Increased use of older aircraft on improving economics from lower oil prices.

Downside

- Rising labour costs.
- Fleet renewal by airline customers that could reduce maintenance work.
- Poorly-executed acquisitions.

FYE 31 Mar	FY16A	FY17A	FY18E	FY19E	FY20E
Key Metrics					
P/E (reported) (x)	23.7	12.4	22.8	19.9	18.3
Core P/E (x)	20.4	21.8	22.8	20.0	18.3
P/BV (x)	2.5	2.4	2.5	2.5	2.5
P/NTA (x)	2.6	2.5	2.6	2.6	2.6
Net dividend yield (%)	4.2	5.4	5.1	5.1	5.1
FCF yield (%)	3.2	5.2	5.9	4.8	5.2
EV/EBITDA (x)	25.0	28.9	23.6	21.3	19.9
EV/EBIT (x)	35.5	50.1	39.6	33.6	30.4

INCOME STATEMENT (SGD m)

Revenue	1,112.7	1,104.1	1,128.2	1,172.1	1,236.6
Gross profit	1,068.8	1,051.3	1,073.5	1,117.4	1,181.1
EBITDA	148.3	124.8	135.0	150.0	160.6
Depreciation	(43.9)	(52.8)	(54.7)	(54.7)	(55.6)
EBIT	104.4	72.0	80.4	95.2	105.0
Net interest income / (exp)	1.7	3.3	3.0	3.1	3.0
Associates & JV	94.2	96.5	100.0	112.3	122.4
Exceptionals	(7.2)	160.4	0.0	0.0	0.0
Other pretax income	8.9	22.9	0.0	0.0	0.0
Pretax profit	202.0	355.1	183.3	210.6	230.4
Income tax	(20.8)	(17.9)	(14.2)	(16.7)	(18.4)
Minorities	(4.6)	(4.8)	(5.0)	(6.0)	(7.0)
Reported net profit	176.6	332.4	164.2	187.9	205.0
Core net profit	183.8	172.0	164.2	187.9	205.0
Preferred Dividends	0.0	0.0	0.0	0.0	0.0

BALANCE SHEET (SGD m)

Cash & Short Term Investments	393.9	601.7	619.3	607.3	608.6
Accounts receivable	220.8	229.9	200.9	208.7	220.2
Inventory	155.1	147.8	117.8	118.2	120.2
Property, Plant & Equip (net)	340.9	331.6	327.1	328.2	334.0
Intangible assets	63.4	65.3	65.2	64.8	64.1
Investment in Associates & JVs	491.5	542.0	549.2	557.3	565.9
Other assets	156.5	0.0	0.0	0.0	0.0
Total assets	1,822.1	1,918.3	1,879.5	1,884.5	1,913.1
ST interest bearing debt	8.8	4.0	4.0	4.0	4.0
Accounts payable	229.4	259.6	258.5	266.0	280.1
LT interest bearing debt	24.5	21.9	21.9	21.9	21.9
Other liabilities	48.0	45.0	45.0	45.0	45.0
Total Liabilities	310.2	330.3	329.2	336.7	350.8
Shareholders Equity	1,485.5	1,554.0	1,515.8	1,512.7	1,526.6
Minority Interest	26.4	34.0	34.5	35.1	35.8
Total shareholder equity	1,511.9	1,588.0	1,550.3	1,547.8	1,562.4
Perpetual securities	0.0	0.0	0.0	0.0	0.0
Total liabilities and equity	1,822.1	1,918.3	1,879.5	1,884.5	1,913.1

CASH FLOW (SGD m)

Pretax profit	202.0	355.1	183.3	210.6	230.4
Depreciation & amortisation	43.9	52.8	54.7	54.7	55.6
Change in working capital	(65.9)	29.7	57.9	(0.7)	0.5
Cash taxes paid	(18.6)	(20.4)	(14.2)	(16.7)	(18.4)
Other operating cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from operations	77.1	131.8	178.8	132.6	142.7
Capex	(45.4)	(41.9)	(50.1)	(55.4)	(60.6)
Free cash flow	118.2	195.1	221.4	181.5	195.7
Dividends paid	(162.9)	(135.2)	(202.3)	(191.1)	(191.1)
Equity raised / (purchased)	4.3	11.7	0.0	0.0	0.0
Change in Debt	0.8	(8.7)	0.0	0.0	0.0
Perpetual securities distribution	0.0	0.0	0.0	0.0	0.0
Other invest/financing cash flow	64.3	267.7	91.3	102.0	110.4
Effect of exch rate changes	(1.1)	2.3	0.0	0.0	0.0
Net cash flow	(68.7)	205.5	17.6	(11.9)	1.3

FYE 31 Mar	FY16A	FY17A	FY18E	FY19E	FY20E
Key Ratios					
Growth ratios (%)					
Revenue growth	(0.7)	(0.8)	2.2	3.9	5.5
EBITDA growth	17.0	(15.8)	8.2	11.1	7.1
EBIT growth	24.3	(31.0)	11.6	18.5	10.3
Pretax growth	(1.7)	75.8	(48.4)	14.9	9.4
Reported net profit growth	(3.7)	88.2	(50.6)	14.5	9.1
Core net profit growth	0.3	(6.4)	(4.5)	14.5	9.1
Profitability ratios (%)					
EBITDA margin	13.3	11.3	12.0	12.8	13.0
EBIT margin	9.4	6.5	7.1	8.1	8.5
Pretax profit margin	18.2	32.2	16.3	18.0	18.6
Payout ratio	88.9	60.7	116.4	101.7	93.2
DuPont analysis					
Net profit margin (%)	15.9	30.1	14.6	16.0	16.6
Revenue/Assets (x)	0.6	0.6	0.6	0.6	0.6
Assets/Equity (x)	1.2	1.2	1.2	1.2	1.3
ROAE (%)	12.6	21.9	10.7	12.4	13.5
ROAA (%)	10.6	9.2	8.6	10.0	10.8
Liquidity & Efficiency					
Cash conversion cycle	nm	nm	nm	nm	nm
Days receivable outstanding	65.5	73.5	68.7	62.9	62.4
Days inventory outstanding	1,146.8	1,032.6	874.4	775.7	772.3
Days payables outstanding	nm	nm	nm	nm	nm
Dividend cover (x)	1.1	1.6	0.9	1.0	1.1
Current ratio (x)	3.6	3.5	3.4	3.3	3.2
Leverage & Expense Analysis					
Asset/Liability (x)	5.9	5.8	5.7	5.6	5.5
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	na	na	na	na	na
Debt/EBITDA (x)	0.2	0.2	0.2	0.2	0.2
Capex/revenue (%)	4.1	3.8	4.4	4.7	4.9
Net debt/ (net cash)	(360.6)	(575.8)	(593.4)	(581.4)	(582.7)

Source: Company; Maybank

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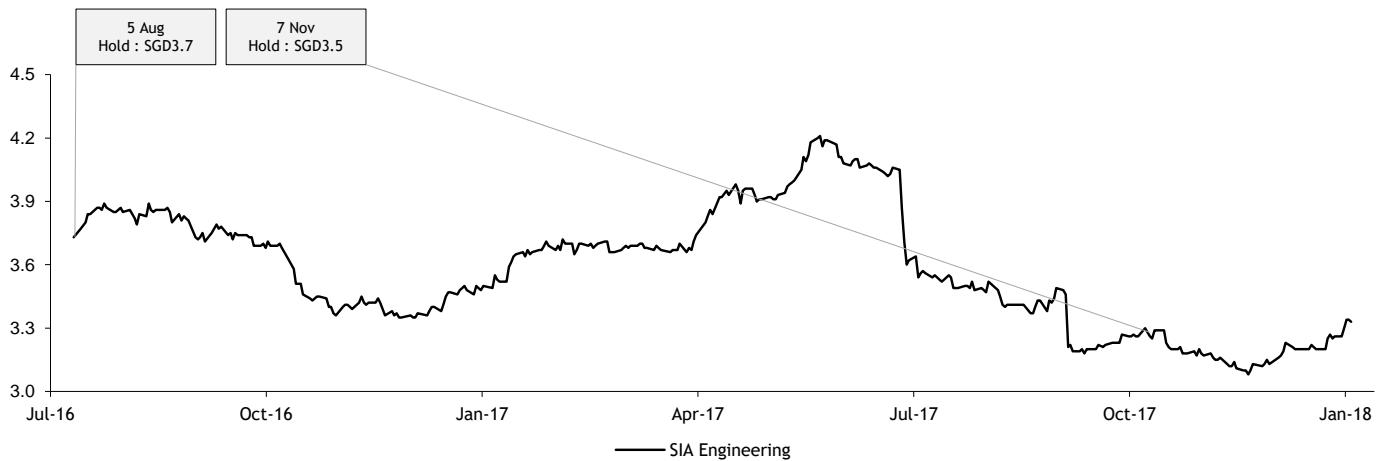
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