Responses to SIAS' questions on SingPost's Annual Report FY2015/16

14 July 2016

SingPost has received questions from Securities Investors Association (Singapore) relating to the Annual Report FY2015/16 as part of their initiative to improve the quality of Annual General Meetings. Our responses to the questions are as follows.

1. The Group's vision is to be the global leader in eCommerce logistics. Numerous acquisitions have been made in recent years to acquire technology and to access new geographical markets. How viable and profitable is this strategy of being essentially a B2B eCommerce logistics pure-play that does not own the customer? What are the investment hurdles for M&A? Can the board share some financial targets in terms of the returns on assets and invested capital? The acquisitions have increased revenue but profits have not followed. After spending more than half a billion, the underlying net profit fell to $154 million in 2016 from $160 million in 2015. It is also a very competitive sector as you can see the big boys (Yamato, DHL, UPS etc) and disruptors (NinjaVan, Anchanto) all investing heavily in the sector. Is the group still looking for more acquisitions? If so, what are the pieces that SingPost still lack?

How viable and profitable is this strategy of being essentially a B2B eCommerce logistics pure-play that does not own the customer?

We are an eCommerce logistics enabler. Our strategy is B2B4C, i.e. to enable our customers to tap the eCommerce market and serve the end-consumers. We provide end-to-end eCommerce logistics solutions from the online store front to the back-end logistics of warehousing and delivery.

We are making solid progress -

i) We process over S$5 billion worth of gross merchandise value annually through our eCommerce networks.
ii) We have over 100 leading brands as customers including names like adidas, Calvin Klein, Cole Haan and Muji.
iii) eCommerce related revenues grew 60% YoY in FY2015/16 to amount to approximately 36% of the Group's revenue.

What are the investment hurdles for M&A? Can the board share some financial targets in terms of the returns on assets and invested capital?

Any investment that the Group makes will have to exceed the weighted average cost of capital (WACC). The current WACC of the Group is 6.2%.

We target to generate returns on invested capital in excess of WACC and to grow the underlying net profit in the longer term. Our ROIC for FY2015/16 was 14%, an improvement from 10.3% the year before.

Is the group still looking for more acquisitions? If so, what are the pieces that SingPost still lack?

As the Group continues with its transformation initiatives, the focus will be on post-merger integration and extracting synergies from the acquisitions made over the last few years.

2. The group went from a net cash position of S$345.8 million as reported in the last annual report to a net debt of S$153.6 million in 2016 *(page 34)*. Goodwill on acquisitions increased to $493.5 million *(page 149)* from $167.2 million two years ago. As at 31 March 2016, there are also intangible assets such as $40.5 million in customer relationship and $41.9 million in trademarked brands *(page 149)*.

   Specifically, some subsidiaries acquired in the last two years came with huge goodwill recorded. For example, on their respective acquisition dates:

   - TradeGlobal (page 198-199): $176 million in goodwill on acquisition and $43 million in customer relationships (included in intangibles) out of purchase consideration of $236 million (on acquisition date - 13 Nov 2015)
   - JaggedPeak (page 200-201): $33 million in goodwill out of purchase consideration of $34 million (on acquisition date - 7 Mar 2016)
   - Couriers Please (page 150, 153): $110 million in goodwill out of purchase consideration of $109 million (on acquisition date – 15 Dec 2014) but restated to consist of $76 million in goodwill and $42 million in trademarked brands (at financial year end 31 Mar 2016)

   Had the target companies been consolidated for the full year in the year of the acquisition:

   - TradeGlobal would have reported consolidated net loss of S$1.56 million for the year ended 31 Mar 2016
   - Jagged Peak would have reported consolidated net profit of S$1.47 million for the year ended 31 Mar 2016
   - Couriers Please would have reported consolidated net profit of S$2.2 million for the year ended 31 Mar 2015

   Based on these assumptions, the P/E paid would have been between 23-50x and TradeGlobal would have been acquired when it was not profitable.

   Could the board please explain to shareholders how strategic and/or synergistic these acquisitions are to the group's strategy? What are the board/management's financial and operational targets for these new acquisitions?

   The Group has undertaken various strategic acquisitions over the last few years to build an end-to-end eCommerce logistics network across geographies. These include eCommerce logistics companies, TradeGlobal and Jagged Peak in the US, and courier operator CouriersPlease in Australia.

   These strategic acquisitions have strengthened the Group's eCommerce capabilities and extended its eCommerce logistics footprint globally:

   i) Footprint – We have acquired a footprint in the US, the second largest eCommerce market in the world after China. We now operate more than 50 fulfilment centres in 19 territories across all key eCommerce markets in the US, Europe, China and the rest of the Asia Pacific markets.

   ii) Expanded market – We now provide integrated eCommerce logistics solutions to customers across a global network, giving them access to their home markets and helping accelerate their expansion into other geographies. We gained direct access to eCommerce customers in the US via TradeGlobal and Jagged Peak and will leverage our logistics network in Asia-Pacific to expand these customer's online footprint in Asia. At the same time, we will also leverage TradeGlobal and Jagged Peak's logistics network to bring our Asian eCommerce customers to the US.

   iii) Increased customers / volumes – We have a stronger customer base and greater eCommerce volumes, with more than S$5 billion of gross merchandise value processed annually across our networks.

   iv) Technology – We have access to and can leverage Jagged Peak's leading technology in omni-channel order management systems. The EDGE technology and Flexnet order management system provided by Jagged Peak allows us to plan and store our goods in warehouses closest to customers' locations, ensuring cost efficient and timely delivery.

CouriersPlease completes our end-to-end eCommerce logistics offerings in Australia by providing the last-mile delivery component of the value chain. We now offer the full range of eCommerce front-end solutions, warehousing and last mile delivery in the Australian market.

The acquisitions are monitored and tracked regularly against the business case put up by management in each of the acquisition proposals. The metrics tracked include revenue growth, margins, EBIT, EBITDA and shareholder returns.

3. With the ongoing board renewal, please elaborate to shareholders the skills and competencies that a new board director should bring with him/her to complement the current set of directors? What is the process that the board (or the NC) is going through to identify new director candidates? What is the progress made with the senior management hire? There is a fairly new team in the board and the top management tier. Any new addition to the team will have to hit the ground running. How effective can the team be at integrating the acquisitions and delivering profits to shareholders?

Please elaborate to shareholders the skills and competencies that a new board director should bring with him/her to complement the current set of directors?

We will prioritise the appointment of directors with expertise in the fields of law, eCommerce logistics, and finance and accounting – as recommended by the corporate governance review advisors, Heidrick & Struggles and Lee & Lee.

We will also adopt a board composition matrix recommended by the corporate governance review advisors. The board composition matrix tracks how the Board measures against its ideal composition given the strategic priorities of SingPost, and will help with the recruitment of directors with the appropriate skills and competencies.

These are detailed in our 4 July 2016 SGX announcement on the Corporate Governance Review.

What is the process that the board (or the NC) is going through to identify new director candidates?

As recommended by Heidrick & Struggles and Lee & Lee in the Corporate Governance Review report, we are establishing a structured process for selecting and assessing new directors based on an evaluation against the agreed 'Pivotal Expertise' and 'Board Leadership Competencies' required in the role, depending on needs as mapped out through the board composition matrix.

The existing nomination process is detailed in page 48 of the Annual Report under Principle 4.

What is the progress made with the senior management hire?

There are candidates for the position of GCEO in the process of due diligence. Given where we are in the process, we should expect the next GCEO to take up the appointment at the end of the year.

How effective can the team be at integrating the acquisitions and delivering profits to shareholders?

We have experienced senior and middle management who continue to drive the operations including integration of the acquisitions.

The post-merger integration activities are overseen by the Strategic Investments & Integration team led by the Deputy GCEO (Corporate Services) and GCFO.