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Research Update:

Singapore Post Ltd. Rating Lowered To 'A' From 'A+' On Continuing Business Risks; Outlook Stable

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Overview

- SingPost's transformation initiatives are yielding results; but the company continues to face revenue pressure at its core letters business, and its profit margins and financial metrics are weaker than our prior base-case expectation.
- We are lowering our long-term corporate credit rating on SingPost and our issue rating on the company's fixed-rate notes to 'A' from 'A+'. We are also lowering the rating on the Singapore-based postal and logistics services provider's perpetual securities to 'A-' from 'A'.
- At the same time, we are affirming our 'axAAA/axA-1+' ASEAN regional scale rating on SingPost, the 'axAAA' rating on the fixed-rate notes, and the 'axAA+' rating on the perpetual securities.
- The stable outlook reflects our expectation that ongoing business transformation will prevent a material decline in SingPost's profitability over the next 12-24 months.

Rating Action

On Feb. 19, 2014, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on Singapore Post Ltd. (SingPost) and the issue rating on the company's fixed-rate notes to 'A' from 'A+'. The outlook on the corporate credit rating is stable. We also lowered the long-term issue rating on the company's perpetual securities to 'A-' from 'A'.

At the same time, we affirmed our 'axAAA/axA-1+' ASEAN regional scale rating on SingPost, the 'axAAA' rating on the fixed-rate notes, and the 'axAA+' rating on the perpetual securities.

SingPost is a Singapore-based postal and logistics services provider.

Rationale

The downgrade reflects SingPost's exposure to declining letter volumes, and profit margins and financial metrics that are weaker than our prior base-case expectation. We expect the company's margins to weaken further on continuing pressure on volume and costs at its letter business and the increasing contribution from lower-margin logistics and e-commerce activities.

We believe the increasing contribution of SingPost's logistics and overseas businesses to total revenue will temper the impact of declining profitability.

SingPost's business transformation is already yielding results. Revenue from the company's core mail and parcels business rose 13% for the nine months ended Dec. 31, 2013, due to strong growth in e-commerce package volumes. This alleviated some of the effects of margin pressure and the continued decline in domestic mail volumes. The company's reported operating profit for the mail segment grew 2% for the nine months ended Dec. 31, 2013. Overall, the SingPost's business transformation contributed to a 32% increase in revenues and a 10% increase in adjusted EBITDA, compared with the previous corresponding period.

Our assessment of SingPost's business risk profile as "strong" reflects the company's relatively stable earnings profile and dominant market position in the domestic and international mail business in Singapore. We expect SingPost's expanding logistics network and growing e-commerce capabilities to enhance the company's competitive advantage and the scale and diversity of its revenue base over the next 12-24 months.

SingPost's operating efficiency remains solid, in our view. The company's relatively smaller geographic coverage and use of technology in the core mail business have resulted in historically high profitability. While SingPost's margins are under pressure, we believe the EBITDA margin is likely to remain stronger than that of postal-company peers that we rate. Furthermore, we expect the company to proactively manage its cost base to prevent its profitability from materially declining.

Our assessment of SingPost's financial risk profile as "modest" incorporates our expectation that the company's financial strength will gradually improve because of its business transformation. We expect solid growth in SingPost's consolidated revenues as the company's recent acquisitions begin to contribute to full-year earnings and its e-commerce activities continue to grow. We estimate that SingPost's ratio of debt to EBITDA will remain below 2.0x over fiscals 2014-2016 (ending March 31).

We expect SingPost's free operating cash flows to remain positive. This is despite higher capital expenditure toward infrastructure development over the next three years at the mail business and the company's ongoing acquisitions with an inclination toward the logistics business.

SingPost is investing about Singapore dollar (S$) 100 million over the next three years in infrastructure to improve the efficiency and service quality of its mail network. At the same time we anticipate annual acquisition expenditure of about S$50 million. Any sizable acquisitions above this amount could put pressure on SingPost's financial risk profile, in our view. This is because the company has negative discretionary cash flows after considering its capital investments and annual dividend payments of about S$130 million.

Nevertheless, SingPost's strong liquidity and easy access to capital markets should continue to underpin the company's financial risk profile. We also anticipate that SingPost will continue to conservatively execute its capital investment plan, while maintaining a financial risk profile in line with the

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current rating.

Our base case assumes:

- 17%-20% revenue growth in fiscal 2014 from growing parcel and logistics business, declining to 10%-15% in fiscal 2015.
- EBITDA margins trending down to 30% in fiscal 2014 and to the high 20% level in fiscal 2015.
- Moderately higher capital expenditure due to infrastructure investments in domestic mail operations and ongoing acquisitions.
- No incremental gross debt.
- Discretionary cash flows to remain marginally negative.
- We consider 75% of cash and cash equivalent as surplus cash and deduct it from debt. We classify the senior perpetual security as debt as per our criteria.

Based on these assumptions, we arrive at the following credit measures over the next two years:

- Ratio of debt to EBITDA of 1.7x-1.9x.
- Ratio of free operating cash flow to debt of 38%-43%.

Liquidity

SingPost's liquidity is "strong," as our criteria define the term. We expect liquidity sources to exceed liquidity uses by at least 1.5x for the next 12 months and by at least 1.0x over the subsequent 12-month period. We forecast liquidity sources will exceed uses even if EBITDA declines 30%.

Principal liquidity sources include:

- Cash and equivalents of S$362.5 million as of Dec. 31, 2013.
- Committed unused credit lines of S$80 million.
- Minimal working capital inflows.
- Average annual funds from operations that we estimate at about S$180 million in 2014 and 2015.

Principal liquidity uses include:

- Annual capital expenditure and acquisitions of about S$100 million in 2014 and 2015.
- Dividend payments of about S$130 million annually.

SingPost's bonds do not have any financial covenants to which the company needs to adhere.

Outlook

The stable outlook reflects our expectation that Singapore Post will continue to enhance its market position in the logistics and express delivery markets in Asia-Pacific via its investment activities. We also anticipate that the company will proactively manage its cost base to support stable earnings growth and prevent a material decline in its profitability over the next 12-24 months. We expect the company to conservatively execute its capital investment

plan, while maintaining a financial profile adequate with the rating, including a ratio of debt to EBITDA below 2.0x.

Downside scenario

We could lower the rating if: (1) SingPost's business risk profile weakens more than we expect, due to revenue and cost pressures in its mail business and competitive pressure in the non-mail business that causes its profitability to deteriorate materially; or (2) the company opts for an aggressive expansion policy resulting in additional debt or large cash outflows such that its ratio of debt to EBITDA rises above 2.0x on a sustainable basis.

Upside scenario

An upgrade for SingPost looks unlikely over the next two to three years, given SingPost's exposure to declining mail volumes and the strong competitive pressures in the logistics and express delivery businesses. We may raise the rating if the company's business risk profile improves substantially and its profitability and financial metrics remain at current levels.

Ratings Score Snapshot

Corporate Credit Rating: A/Stable/--
ASEAN Regional Scale: axAAA/axA-1+

Business risk: Strong
- Country risk: Low risk
- Industry risk: Low risk
- Competitive position: Strong

Financial risk: Modest
- Cash flow/Leverage: Modest

Anchor: a

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014

- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Key Credit Factors For The Railroad And Package Express Industry, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Downgraded; Outlook Action

	To	From
Singapore Post Ltd.		
Corporate Credit Rating	A/Stable/--	A+/Negative/--

Downgraded

Singapore Post Ltd.		
Senior Unsecured	A-	A
Senior Unsecured	A	A+

Ratings Affirmed

Singapore Post Ltd.	
ASEAN Regional Scale	axAAA/--/axA-1+
Senior Unsecured	axAAA
Senior Unsecured	axAA+

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