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Research Update:

Singapore Post Ltd. Rating Lowered To 'A-' On Increased Earnings Volatility; Outlook Stable

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Overview

- We believe SingPost's transformation into a logistics and e-commerce provider will increase contributions from these businesses relative to its traditional postal business, increasing overall earnings volatility.
- Postal services have higher and more stable margins than the more competitive logistics and e-commerce segments, where SingPost's market position is less established.
- We are lowering our long-term corporate credit rating on SingPost to 'A-' from 'A' and our long-term ASEAN regional scale rating on the Singapore-based postal operator to 'axAA' from 'axAAA'. We are also lowering the various ratings on the company's debt. We are removing all the ratings from CreditWatch, where they were placed with negative implications on Nov. 6, 2015.
- The stable outlook reflects our expectation that SingPost will reduce its debt markedly, such that the debt-to-EBITDA ratio is below 2.0x by end-March 2017, following its recent high spending on existing infrastructure and growth.

Rating Action

On Feb. 24, 2016, Standard & Poor's Ratings Services lowered its long-term corporate credit rating on Singapore Post Ltd. (SingPost) to 'A-' from 'A'. The outlook is stable. We also lowered the long-term issue rating on the company's senior unsecured notes to 'A-' from 'A' and that on its senior perpetual securities to 'BBB+' from 'A-'. At the same time, we lowered our long-term ASEAN regional scale rating on SingPost and the senior unsecured notes to 'axAA' from 'axAAA' and that on the perpetual securities to 'axA+' from 'axAA'. We are removing all the ratings from CreditWatch where they were placed with negative implications on Nov. 6, 2015. SingPost is a Singapore-based postal operator.

Rationale

We downgraded SingPost because we believe that the company's e-commerce growth strategy will contribute to increased earnings volatility due to higher competitive pressures. In our view, SingPost's expansion into e-commerce and logistics is offsetting the profitability of its traditional postal business, which has higher and more stable margins.

We expect SingPost's EBITDA margins to decline to about 20% in fiscal 2016

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(year ending March 31, 2016), from 23% in fiscal 2015 and 26% in fiscal 2014, as the company transitions into a global e-commerce enabler. As the national postal service provider of Singapore, SingPost has historically enjoyed high and stable profit margins, benefiting from its protected domestic market position. The company's highly efficient domestic postal infrastructure, high population density, and small geographic footprint further supported its margins. However, as traditional mail volumes decline as a result of e-substitution, SingPost is moving into more volatile and lower margin e-commerce and logistics business lines, particularly outside Singapore.

In our view, SingPost has less established competitive positions in its new e-commerce and logistics markets than its dominant position as a postal provider in Singapore. We believe that the company will likely face strong competition from the traditional logistics and express delivery providers that are also ramping up their Asian presence in order to profit from the e-commerce boom in the region. These players benefit from their ownership of strong infrastructure throughout the entire delivery process and high service standards. Despite this, we note that SingPost's foray into these fields has sparked revenue growth in the face of a structural decline in the mail business. The company's competitive advantage lies in its ability to provide a low-cost range of e-commerce and logistics solutions by leveraging on its unique blend of postal and commercial (provided by wholly owned subsidiary Quantium Solutions) networks. This has helped SingPost to gain a solid foothold in the business-to-consumer market in Asia.

We continue to view Singapore as a key strength for SingPost when compared to peers that are based in less geographically strategic locations with less sophisticated logistics infrastructure.

We believe that SingPost has meaningful intentions to reduce its leverage, following high capital spending in the past two years. We anticipate that the company will pause its acquisition activities in the near to medium term to focus on integrating its recent acquisitions with its existing network. In addition, we believe that SingPost is committed to reducing its debt. The upcoming Singapore dollar (S$) 187 million equity infusion from Alibaba Group Holding Ltd., which SingPost expects to close in June 2016, will also support deleveraging, on top of various other initiatives including potential divestment of non-core assets.

Our base case assumes:

- Solid growth in revenues in the next 12-24 months as recent acquisitions begin to contribute to full-year earnings and e-commerce activities continue to grow.
- Adjusted EBITDA of about S$275 million in 2016, increasing to about S$315 million in 2017.
- Continued decline in EBITDA margin to around 20%.
- Capital expenditure of about S$290 million in 2016 and S$210 million in 2017, mainly for the redevelopment of the Singapore Post Centre and the construction of the logistics hub. The spending will fall to S$60 million-S$80 million in subsequent years.

- Equity infusion of S$187 million from Alibaba.
- SingPost will stick to its policy of steady returns to shareholders, with total dividends of about S$150 million in the year.
- No meaningful acquisitions in the next 12-24 months.

Based on these assumptions, we arrive at the following credit measures over the next two years:
- Ratio of adjusted debt to EBITDA of 2.3x-2.5x in 2016 and less than 2.0x in 2017.
- Adjusted EBITDA margins of 19%-20%.

Liquidity

We view SingPost's liquidity as adequate because its sources of liquidity will likely cover needs by more than 1.2x in the next 12 months. We forecast liquidity sources will exceed uses even if EBITDA declines 15% in the 12 months ending Sept. 30, 2016.

Principal liquidity sources include:
- Estimated cash and equivalents of S$220 million as of Jan. 31, 2016.
- Funds from operations that we estimate at about S$220 million in the period.

Principal liquidity uses include:
- Upcoming debt maturities of about S$92 million in the next 12 months.
- Some, albeit limited, increase in working capital.
- Minimum capital expenditure of about S$100 million.
- Dividend payments of about S$150 million annually.

We expect the upcoming equity investment from Alibaba and the potential divestments of non-core assets to further support SingPost's liquidity.

SingPost's bonds do not have any financial covenants.

Outlook

The stable outlook reflects our expectation that SingPost will take the necessary steps to reduce its debt so that its debt-to-EBITDA ratio returns to below 2.0x by March 31, 2017. The outlook also reflects our view of reduced event risk, given the company intends to focus on integrating recent acquisitions and consolidating its market positions in the logistics and express delivery markets in Asia-Pacific and the U.S. We also anticipate that SingPost will manage its costs and its logistics capacity to support earnings growth and stem the decline in its profitability.

Downside scenario

We could lower the rating if SingPost fails to protect its balance sheet, such that the company's debt-to-EBITDA ratio is higher than 2.0x on a sustained basis. In a less likely scenario, we may also lower the rating if revenue and

cost pressures in SingPost's mail business, and competition in its non-mail business are greater than we anticipated, significantly eroding its market positions and earnings.

Upside scenario

An upgrade looks unlikely for SingPost over the next two years, given the company's exposure to declining mail volumes and the strong competitive pressures in the logistics and express delivery businesses. We may raise the rating if SingPost's capital structure improves substantially, with the debt-to-EBITDA ratio below 1.5x on a consistent basis. In a remote scenario, we would consider an upgrade if stronger contribution of logistics and e-commerce to operating profit, with limited dilution of margins, improves the company's earnings quality.

Ratings Score Snapshot

Corporate Credit Rating: A-/Stable/--

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

Financial risk: Modest
- Cash flow/Leverage: Modest

Anchor: bbb+

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+ 1 notch)

Related Criteria And Research

Related Criteria

- Standard & Poor's National And Regional Scale Mapping Tables, Jan. 19, 2016
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 20144
- Key Credit Factors For The Railroad And Package Express Industry, Aug. 12, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013

- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Group Rating Methodology, 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; CreditWatch/Outlook Action

	To	From
Singapore Post Ltd.		
Corporate Credit Rating	A-/Stable/--	A/Watch Neg/--
ASEAN Regional Scale	axAA/axA-1	axAAA/Watch Neg/ axA-1+
Singapore Post Ltd.		
Senior Unsecured	BBB+	A-/Watch Neg
Senior Unsecured	A-	A/Watch Neg
Senior Unsecured	axA+	axAA/Watch Neg
Senior Unsecured	axAA	axAAA/Watch Neg

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