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Ratings

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Research Update:

Singapore Post Rating Lowered To 'BBB+' On Higher Tolerance For Leverage; Outlook Stable

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Overview

- We believe SingPost will continue to focus on protecting its operating margins and acquisitions integration.
- To that extent, we believe SingPost's priority for lowering its leverage in the medium term has reduced. We forecast its debt-to-EBITDA ratio will remain above 2.0x in the next 12-18 months.
- We are lowering our long-term corporate credit rating on SingPost to 'BBB+' from 'A-' to reflect our view of the company's comfort with a sustainable, higher leverage.
- The stable outlook reflects our expectation that after recent high spending and cost inflation, the company's debt-to-EBITDA ratio will stabilize below 2.5x by end March 2018.

Rating Action

On Nov. 9, 2016, S&P Global Ratings lowered its long-term corporate credit rating on Singapore Post Ltd. (SingPost) and the issue rating on the company's senior unsecured notes to 'BBB+' from 'A-'. We also lowered the long-term issue rating on the Singapore-based postal and logistics services provider's senior perpetual securities to 'BBB' from 'BBB+'. The outlook on the corporate credit rating is stable. At the same time, we lowered our ASEAN regional scale ratings on SingPost and the senior unsecured notes to 'axA+' from 'axAA'. We also lowered the ASEAN region scale rating on the perpetual securities to 'axA' from 'axA+'.

Rationale

We lowered the rating on SingPost because we believe the company's emphasis on reducing leverage has diminished. SingPost's adjusted debt-to-EBITDA ratio as of Sept. 30, 2016, was about 3.0x, and we believe it is unlikely to fall below 2.0x in the next 12-18 months.

The recent half-year results (for the fiscal year ending March 31, 2017) showed a clear acceleration in cost inflation at a time of modest revenues, with quarterly reported EBITDA margin falling to 13.6% from 16.2% in the previous year. Much of the recent increase in costs is attributable to the seasonal ramp-up in labor and expenses in relation to the completion of the new Regional eCommerce Logistics Hub.

Despite this, we understand management will prioritize margin protection through improved operating efficiencies and synergies with its new acquisitions, as the company establishes itself as an e-commerce and logistics enabler. Hence, despite the highly competitive and lower-margin e-commerce market, we believe margin erosion could be somewhat limited in the next 12-18 months. We expect SingPost's EBITDA margin to decline to about 16% in fiscal 2017 from 17% in fiscal 2016 and 23% in fiscal 2015.

SingPost is focusing on the consolidation of its competitive positions in its e-commerce and logistics markets. The company's competitive advantage is in its cost-effective range of e-commerce and logistics solutions through its unique blend of postal and commercial (provided by subsidiary Quantium Solutions International [QSI]) networks. We view the investment of Alibaba Group Holding Ltd. in QSI as a positive step to deploy SingPost's offering regionally.

We believe SingPost will not divest its minority stakes in the near term. Instead, it will focus on increasing the value of its non-core assets for divestment. Thus, we no longer believe SingPost intends to reduce its leverage meaningfully beyond the upcoming Singapore dollar (S$) 187 million equity infusion from Alibaba that is expected to be completed in February 2017, following high capital spending in the past two years. However, we still believe the company will pause its acquisition activities in the next 12 to 18 months to focus on existing operations and network.

After recent turbulence surrounding SingPost's board of directors' corporate governance practices and lack of transparency, we believe the company has implemented procedures to prevent those issues from reoccurring.

SingPost's ties with Alibaba and operations in Singapore are a key strength for the company when compared to operators that are based in less geographically strategic locations with less sophisticated logistics infrastructure. It compares favorably with other companies with similar earnings profile, in our view.

Likewise, our target debt-to-EBITDA ratio is below that of other companies in the same capital structure category. We therefore assign a favorable comparable rating adjustment.

Our base case assumes the following:

- EBITDA of about S$275 million in 2017, increasing to about S$300 million in 2018.
- Capital expenditure of about S$250 million in 2017 and about S$105 million in 2018, mainly for maintenance and the completion of the Singapore Post Centre's redevelopment. We expect this to fall to about S$60 million in subsequent years.
- Equity infusion of S$187 million from Alibaba, which is likely to be completed in the first quarter of 2017.
- SingPost will stick to its policy of steady returns to shareholders, with payout of 60%-80% of underlying net profit. We expect the company will pay total dividends of about S$100 million in fiscal 2017.

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

- Unadjusted net debt of about S$100 million over the next two years.
- Adjusted debt-to-EBITDA ratio of approximately 2.5x.

Liquidity

We view SingPost's liquidity as adequate. Its sources of liquidity will likely cover its needs by more than 1.2x in the 12 months ending Sept. 30, 2017. We forecast liquidity sources will exceed uses even if EBITDA declines 15%.

Principal liquidity sources include:

- Cash and equivalents of S$162 million on Sept. 30, 2016.
- Funds from operations that we estimate at about S$200 million in the period.
- S$86 million invested by Alibaba for a 34% stake in logistics subsidiary QSI.
- S$187 million from the upcoming equity investment from Alibaba.

Principal liquidity uses include:

- Upcoming debt maturities of S$189 million in the next 12 months.
- Some, yet limited, increase in working capital.
- Maintenance capital expenditure of about S$60 million in 2017.
- Dividend payments of about S$100 million annually.

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

Outlook

The stable outlook for the next 12-18 months reflects our expectation that SingPost's leverage will reduce substantially following Alibaba's S$187 million equity infusion in the first half of 2017. We also expect SingPost to pause spending to reduce debt through organic cash generation. In addition, the outlook incorporates our view that SingPost will consolidate its operations in the logistics and express delivery markets in Asia-Pacific and the U.S. We anticipate that the company will manage its costs and logistics capacity to support earnings growth and control its profitability decline.

Downside scenario

We may lower the rating if SingPost's debt-to-EBITDA ratio stays above 2.5x on a sustainable basis. This would happen if the company does not receive equity from Alibaba and does not allocate cash flow to debt repayment. In a less likely scenario, we may also lower the rating if the company faces more revenue and cost pressures in its mail business and fiercer competition in the non-mail business than what we anticipate, such that its profitability weakens materially.

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 establishes a track record of more robust and transparent governance practices. Additionally, we expect SingPost's capital structure to improve substantially, with debt-to-EBITDA ratio below 2.0x on a consistent basis. In a remote scenario, a stronger contribution of logistics and e-commerce to operating profit, with limited dilution of margin, could lead us to reassess the company's earnings quality.

Ratings Score Snapshot

Corporate Credit Rating: BBB+/Stable/--

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

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

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: Fair (no impact)
- Comparable rating analysis: Positive (+ 1 notch)

Related Criteria And Research

Related Criteria

- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 7, 2013
- S&P Global Ratings' National And Regional Scale Mapping Tables, June 1, 2016
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Railroad And Package Express Industry - August 12, 2014

- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology - November 19, 2013
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue - April 15, 2008
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition - September 15, 2008
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013

Ratings List

Downgraded; Ratings Affirmed

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

Downgraded

	To	From
Singapore Post Ltd.		
Senior Unsecured	BBB+	A-
Senior Unsecured	BBB	BBB+
Senior Unsecured	axA	axA+
Senior Unsecured	axA+	axAA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.