SingPost's Q2 & H1 FY19/20 Results Analyst Briefing, 4 November 2019

Operator:

Ladies and gentlemen, thank you for holding. We are now ready for the briefing. I shall now hand over to the management of SingPost to begin the briefing. Thank you, please go ahead.

Mr Jason Lim (Vice President, Investor Relations & Financial Analysis):

Good morning. Welcome to SingPost's results briefing for the second quarter and half year of FY2019/20.

I am Jason from Investor Relations.

With me today is our GCEO Mr Paul Coutts, GCFO Mr Richard Lai and CEO of Postal Services and Singapore Mr Vincent Phang.

Before I hand over the session to Richard to bring you through our results, I'll like to share an update on the Group income statements.

With Jagged Peak & TradeGlobal having filed for relief under Chapter 11 of the US Bankruptcy Code, the Group deconsolidated their financials with effect from the month of September.

The income statement is now presented as "Continuing Operations", which excludes the U.S. Subsidiaries.

Losses from the U.S. Subsidiaries for the period prior to deconsolidation are presented as a single line item called "Discontinued Operations".

Moving forward, the Group will no longer recognise profit or loss from the U.S. subsidiaries.

I'll now hand over to Richard.

Mr Richard Lai (Group CFO):

Thank you, Jason and thank you everyone for joining us today.

Revenue for Q2 FY2019/20 rose 2.0%, largely led by International post & parcel, offset by lower Domestic post & parcel and freight forwarding.

Profit on operating activities declined 22.2% largely due to lower domestic letter mail volumes and slowdown in the freight forwarding sector.

Share of associated companies & JV was a S$0.3 million profit as opposed to a S$3.6 million loss last year as we have ceased equity accounting for 4PX and disposed of our shares in Indo Trans Logistics.

Last financial year, the Group sold the GD Express warrants that it held and utilised the proceeds to increase its direct shareholding in GD Express. This has also helped to contribute to the S$0.3 million profit in share of associated companies & JV.

As such, we no longer have to recognise any fair value losses or gains that may arise from the warrants.

Loss from discontinued operations were lower by 55.8% due largely to the absence of depreciation and amortisation expenses, as assets of the U.S. Subsidiaries had been impaired down to zero since the close of the previous financial year.

Net profit attributable to shareholders rose 10.3% with the absence of the exceptional losses.

Excluding exceptional items, underlying net profit declined 4.6% to S$26.8 million and this is mainly due to improved results from associated companies and JV, partly offset by Post & Parcel and freight forwarding decline.

Let me now move on to Expenses.

Operating expenses rose 6.0%, largely due to higher volume-related expenses.

The growth in Volume-related expenses reflects costs to support the higher revenues at International post and parcel.

Labour and related expenses rose 5.2%, with additional postmen hired for the Singapore postal operations, as well as higher remuneration for the postmen.

From 1 April 2019, the Group adopted SFRS (I) 16 as required by accounting standards. This involves putting leases on to our balance sheet. Operating lease commitments are now recognised as right-of-use assets as well as lease liabilities on the balance sheet.

There is a reduction of rental costs (under Admin & others) and increase in depreciation costs (under D&A) as well as an increase in Finance expenses.

Largely as a result of the above, Admin, selling and other expenses declined 18.8% to S$28.3 million; Depreciation and amortisation expenses rose 79.1% to S$17.0 million; and Finance expenses rose to S$3.2 million, from S$1.9 million in Q2 last year.

There is a table on slide 4 which shows you that the net impact from these adjustments is actually just negative S$0.5 million which would be neutral as the lease expires.

In the next slide, we provide an overview of the various segments' contribution to Group revenue and profit on operating activities.

The Post & Parcel segment remains the largest contributor to Group revenue, followed by the Logistics segment.

For Profit on operating activities, Post & Parcel is the largest contributor, followed by the Property segment. The Logistics segment remains in a small operating loss position.

We will provide more details on the performance of each of the segments in the next few slides.

Under the Others segment, expenses rose to S$8.0 million, from S$5.6 million in Q2 last year, due to absence of one-off benefit items recorded in the corresponding period last year, as well as lower favourable trade-related foreign currency translation differences.

Let me now move on to the Cash flow and Financial indicators.

For the half year ended 30 September 2019, operating cash flow before working capital changes was S$104.8 million, largely stable compared to S$105.1 million last year.

Working capital movement for H1 was negative S$47.7 million due largely to negative movement for payables in respect to international postal settlements, as well as higher receivables in respect of cross-border eCommerce deliveries.

In H1 last year, there was a larger unfavourable movement for international postal settlements. As such, net cash inflow from operating activities improved to S$38.7 million, compared to S$11.8 million in H1 last year.

Free cash flow in H1 improved with higher cash provided by operating activities, as well as lower capital expenditure.

Moving on to financial indicators, cash and cash equivalents was lower at S$325.4 million compared to March 2019 due to payment of dividends, outpayments for international postal terminal dues, as well as net repayment of a bank term loan.

The cash position had improved as compared to S$285.2 million as at September last year.

EBITDA rose to S$105.2 million for H1. EBITDA to finance expense stands at to 14.6 times compared to 19.0 times last year, due to adoption of SFRS(I) 16 *Leases*. However, if we adjust that to exclude the impact of SFRS(I) 16 *Leases,* EBITDA to finance expense would be 17.4 times for H1 which still remains at a healthy level.

Moving on to the next slide, the Board has declared an interim dividend of 0.5 cent per share, same as last year. The book closure date is on 19 November, and payment date is on 29 November.

Our dividend policy remains unchanged – based on a payout ratio ranging from 60% to 80% of underlying net profit for each financial year.

We will now move on to the segmental results, which I shall now hand you over to Jason.

Mr Jason Lim (Vice President, Investor Relations & Financial Analysis):

Thank you, Richard.

In the Post & Parcel segment, revenue rose 5.3% for Q2 and 2.9% for H1. International revenue rose on the back of higher cross-border eCommerce-related deliveries. This was partially offset by a decline in Domestic revenue, where growth from eCommerce-related deliveries was insufficient to offset an accelerated decline in business letter volumes, plus a reduction in admail volumes.

Profit on operating activities declined for Q2 and H1. The lower volumes were exacerbated by higher costs incurred for initiatives to improve service quality standards, such as hiring of additional postmen and enhancement of their remuneration.

In the Logistics segment, revenue was lower due largely to the depreciation of the A$ against the S$ for Couriers Please, our parcel delivery service in Australia. Without the depreciation of the A$, Logistics segment revenue would have been stable for Q2 and H1.

Quantium Solutions showed improved operational momentum in Q2 with the addition of new customers, which helped offset a decline in freight forwarding revenue from a slowdown in global trade activities.

Losses on operating activities stood at S$0.9 million for Q2 and S$2.6 million for H1 as Quantium Solutions benefited from improved operating leverage from higher revenue. However, this was offset by onboarding costs for eCommerce customers in Asia Pacific, as well as lower profits from the freight forwarding business due to lower volumes.

In the Property segment, revenue, which comprises commercial property rental and the self-storage business, remained largely stable for Q2 and H1, with SingPost Centre retail mall and office remaining at close to full occupancy.

Profit on operating activities rose 3.1% to S$13.8 million in Q2, with higher contribution from the SPC retail mall. For H1, profit on operating activities was stable at S$26.6 million.

Let me now hand over to Vincent to share some of the postal highlights for the quarter.

Mr Vincent Phang (CEO, Postal Services and Singapore):

Thank you, Jason. Good morning everybody, I would like to share some of the initiatives we have taken to address some of the longer term structural challenges.

As announced last week, SingPost will be introducing new package categories and adjusted postal products to meet eCommerce demand from 2 December 2019. The new Basic Package and Tracked Package categories are designed to better meet the needs of eCommerce deliveries in Singapore.

Among the numerous feedback received, tracking and letterbox deliveries were preferred compared to waiting at home for doorstep deliveries. The new services will be delivered directly to letterboxes for greater convenience and a notification will be sent to recipients when the items are in the letterboxes. We believe this will be a very competitive product against services provided by courier companies which use doorstep deliveries.

Separately, Basic Mail and Registered Service (Singapore) will be limited to letters and printed papers up to 500g in Singapore.These services had been used to send packages which inadvertently had put a considerable strain on our operations. This move will realign the services' original intent of sending letters and help streamline our processes, and improve efficiency.

Lastly, airmail rates for letters sent overseas and the Registered Service (International) fee will be revised upwards to mitigate increasing postal settlement rates.

The above product streamlining is only the start of our comprehensive plans to boost the postal service in Singapore.

I will also like to take a moment to share our vision on the Future of Post where we look to transform Singapore's postal landscape with 'Smart' Shared Letterboxes.

Imagine a postal ecosystem with the ability to track every single mail item, a faster and more accurate postal sortation system and an autonomous authentication and dispensing of letters.

Each smart letterbox is equipped with automated sorting and storage and an automated in-feed module for letters and packets to increase efficiencies. Recipients are also able to collect their parcels and mail at their convenience as notifications would be sent when items arrive.

Together, these features will significantly reduce our postmen's workload as we transition most of the products from the doorstep to letterboxes and also minimise misdeliveries. Importantly, this new infrastructure will significantly improve the overall customer experience.

We are currently in discussions with various authorities on this.

Let me hand you back to Richard for the Outlook.

Mr Richard Lai (Group CFO):

Thank you, Vincent.

In Singapore, domestic letter mail volume continues to decline while eCommerce-related packet and parcel volumes continue to grow. This is reflected in lower blended margins. The Group's cost leadership program continues to help mitigate the impact. An increase in international letter mail rates and a streamlining of domestic postal products will come into effect from 2 December 2019.

International mail continues to grow. The Universal Postal Union's member countries have reached an agreement on postal remuneration rates which will accelerate rate increases for the delivery of international bulky letters and small packets.

The Property segment is expected to remain largely stable, and a significant contributor to Group operating profit for the financial year.

With that, I conclude my presentation.

Mr Jason Lim (Vice President, Investor Relations & Financial Analysis):

We are now ready for Q&As, operator please.

Operator:

Thank you. Ladies and gentlemen, we will now begin the question and answer session. If you wish to ask a question, please press *1 on the telephone and wait for your name to be announced. If you wish to cancel your request, please press the '#' key. Your first question comes from the line of Pang Vittayaamnuaykoon from Goldman Sachs. Please ask your question.

Ms Pang Vittayaamnuaykoon (Goldman Sachs):

Hi, thank you very much for the opportunity, a few questions from me please. Firstly on the Post and Parcel segment, we see that the margins continue to decline even if in the previous quarter we already added in a lot of the service quality and improvement programme. Can we have colour on how much more will we see – whether this impact is largely due to the decrease in Domestic volume and increase in International so the the margins have decreased as a results? On top of that, how much more will we see the Domestic volume decline until we reach the stable period? And how should we think of the impact coming from your new packet categories, the eCommerce ones?

Secondly maybe on Logistics, I understand that without the FX impact, the revenue would have been flat. So on that point, can we have more colour on the performance of each of the entities? So for CouriersPlease – how is it doing, and Quantium Solutions? Especially Quantium Solutions since you mentioned that there is improved operational momentum? So I would love to hear some colour on that please.

Mr Richard Lai (Group CFO):

Pang, this is Richard Lai here. Before I hand it off to my colleague Vincent to help add a bit more in terms of the Post and Parcel performance, it's quite important to note that the infrastructure cost for Domestic mail is actually relatively fixed. So labour-related expenses aside, which is mainly the postmen which you rightfully pointed out had been accounted for in the last quarter – in fact it's been accounted for in the last two quarters so that issue is a separate issue. But with the Domestic mail volumes continuing to drop, every dollar that doesn't get passed through revenue or doesn't come through as revenue means that you get a lot less in terms of profit, which is the reason why you see a margin erosion because while International mail continues to grow, International mail doesn't have the same margin as compared to Domestic mail. As to how long this is going to last, I wish I had a crystal ball that can give you the answer to that but it generally comes in spurts; that's because a lot of this have got to do with corporate mails as opposed to individual so it actually comes more in spurts as you might have noticed in the past. I'll let Vincent to probably add a bit more colour, Vincent.

Mr Vincent Phang (CEO, Postal Services and Singapore):

Sure, thanks Richard and thanks Pang for the questions. Indeed, this is pretty much the key focus of all the postal activities as we look at the longer term structural challenges that we have. Just to add on to what Richard had said, indeed the cost of running the Domestic postal service is a rather fixed cost – there is machinery, there is also a certain structure that with declines in traffic, it's extremely difficult for us to change how we run things overnight, it needs a fundamental transformation at some point in time. For most part as we can see – maybe I can explain in a different way.

If you look at our global postal peers and let's just take some of the European postal organisations for example, they've seen declines in their domestic mail volumes in the last decade or so. We have been fortunate perhaps in a sense that we haven't seen those kinds of numbers over the last few years; maybe we are starting to see some of the impact now. But even with their eCommerce growth which is a lot more penetrated in their markets versus ours, they have not been able to offset all that traffic declines with all these eCommerce growth so that's something that we are looking at as well, potentially. At the same time as I have said, what is important for us right now is to relook and review the horizon, what we have in place, what is the installed architecture and infrastructure that we have to support the postal service, and how do we customise that for a changing world which involves more and more eCommerce products.

So the few things that I said earlier where I briefed about the streamlining of products – that will go a long way to help us in mitigating some of these challenges and in the long term we believe that with the application of the smart type of infrastructure we could still make a dent in eCommerce deliveries as well so I am optimistic some of these measures will yield results in time, we have to be patient in looking at how this will evolve. Hopefully that gives you some information, let me know if you need more.

Ms Pang Vittayaamnuaykoon (Goldman Sachs):

That's really helpful. Maybe on Logistics?

Mr Paul Coutts (Group CEO):

Thanks for the questions, it's Paul Coutts here. I'll touch on the Logistics side. As Jason talked about, overall Logistics and what Richard touched on the Logistics was reasonably what I would call resilient for the quarter considering the slowdown across industries and obviously the ongoing trade discussions between China and the U.S.

If I look at the individual business units, we made mention of the fact that for Quantium Solutions we were quite pleased with the progress that it was making. We did take a decision almost two years ago now to exit from a number of loss-making customers; some of the customers were under contracts so it took us some time to exit those customers. At the same time, we've been on-boarding new customers and we are starting to see the benefits of that coming through to the results of the organisation so for Quantium Solutions revenue was up 9% for Q2 and losses narrowed by 25% and we should get operating leverage.

Moving forward of course as we are currently now in peak, we are very much focused on execution during the peak in terms of executing the large promotions and campaigns that are underway for our eCommerce customers, and we will continue as well in intensifying our sales efforts. We are also putting in place a re-engineering project on our I.T infrastructure which we think will be significant and will improve our competitiveness and our cost base even further. The other dimension which affects the Logistics business was the on-boarding on some new eCommerce customers, and normally when you on-board new eCommerce customers there is a start-up cost which is obviously front loaded before the revenues kick in so that's part of the investment that we make upfront and the financial benefits for those will come in over the following quarters as the revenues start to materialise from the on-boarding.

For CouriersPlease, we all believe that CouriersPlease is moving in the right direction. In Australian dollar terms, both revenue and earnings are up despite a slowdown in the Australian economy, it continues to remain a competitive market in Australia where we are certainly trying to diversify our customers and also we are focusing specifically on some fairly large retailers in the Australian market for growth. The other key dimension which has helped improve our operating results there is that we are seeing some major cost leadership programme benefits coming through, such as fleet efficiency and procurement plus some re-engineering of processes that have improved the cost base there to the point that our revenues in Australian dollars are up about 1.6% year-on-year and our profit on operating activities as well is up versus the prior year. The one headwind that we are facing is very much on the freight forwarding side that's more to do with the overall global slowdown in trade and economic activities which obviously is affecting the whole of the freight forwarding industry, and of course our Famous Holdings business is caught up in that scenario so we are seeing some decline there. Hopefully that gives you enough colour around the Logistics segment.

Ms Pang Vittayaamnuaykoon (Goldman Sachs):

Yes, that's really, really helpful. Thank you very much, all.

Operator:

Your next question comes from the line of Rachael Tan from UBS. Please ask your question.

Ms Rachael Tan (UBS):

Hi, good morning. A couple of questions from me, one is on your postal initiatives especially for the Basic Package and Tracked Package. Just checking, what are the barriers to entry for competitors? What is stopping other couriers from also pursuing a similar letterbox delivery strategy?

Mr Vincent Phang (CEO, Postal Services and Singapore):

Hi Rachael, would you like to go through all your questions or do you want it one at a time?

Ms Rachael Tan (UBS):

OK, second would be how much did your business letter mail decline by versus your increase in Domestic eCommerce under the Post and Parcel business? Those are my two questions.

Mr Vincent Phang (CEO, Postal Services and Singapore):

Let me answer your first one. What's the benefit of our streamlining of these postal products? The background is this – our entire infrastructure is optimised, our all machinery, our processes – entirely optimised as a postal service and for a large over a decade the postal service is really a utility for letters as you can imagine. So we've got the letterboxes that we have in positions and in a high-rise place like Singapore that's really working very well. In fact, I can go on and let you know that as a postal service we are probably one of the most intensive in the sense that we have the least number of postmen per capita of any industrialised country and that's obviously given because of the advantage having letterbox infrastructure.

Your question was how this would help us. A lot of these deliveries that we are making of late have changed in formats, they are increasingly bigger, they have increasing requirements for a sign-off authentication so customers got to sign off to acknowledge that they have received their items. As a result, the current postal service which reaches every single door in Singapore gets used to deliver items that go beyond letters and that necessitates us making a doorstep delivery, completely negating the advantage that we have as a nation in having letterbox infrastructure for high-rise buildings. So that has put considerable strain on our business and operations so what we have done is to rethink what can be offered to the public, to customers.

Postal service continues to be the most cost-effective way, the most assured way of transmission of items this way. In a nutshell, what we have done is to streamline the products so that the basic fundamental premise of the postal service is not compromised; we continue to deliver letters as we have through the years despite the declining traffic, but at the same time have competitive customer centric products out there that help workloads as well that bring the doorstep deliveries to the letterboxes which are installed. So in a sense that gives us a way of addressing the customer experience while also utilising the infrastructure that will help us in continuing our good work for the country in a cost-effective manner. I hope that answers your question so let me know if that was what you were asking.

I'll go on to the next question you have which is the letter mail decline versus the eCommerce increase as we have answered in the previous question. That remains top and foremost in our minds, obviously it is a very important metric that we track but I just want to be cautious about this because letter mails in our environment – we've seen increasing substitution by digital products and some of our biggest institutional clients, banks included, have switched to e-bills and digital communication and this has been very progressive. We continue to see very spiky, lumpy decreases through the last few months, we have seen what I believe to be maybe an acceleration in the first half of this year; we have never seen those kinds of rates before. Will they be sustained? I'm not sure, I think we can't answer that question apart from the customers. I don't think it's a function of our service that gets this traffic eroded or decline if it is just basically the customers choosing to go to digital communications, so that impact continues to happen which makes it very difficult for us to forecast and estimate. What we can do is make sure our system is robust and adequate to support the agility, the transformation of the volumes from letter based to packet based, and that's all as I have described in the initiatives. When will this stabilise and when will this switch across is extremely hard to say, the base of eCommerce deliveries at this moment is still very low compared to the volumes of letters that we see so from a one-to-one point of view I think that there is order of magnitude difference in terms of volume and traffic. So those are very long term structural challenges that we have to react – how do we continue to keep the utility service running and not compromise the service standards and at the same time look at structuring ourselves with the right kind of infrastructure, right kind of processes to support what is to come in the future.

Ms Rachael Tan (UBS):

OK, I'll probably just want to follow-up on the first question that I asked i.e. the barrier to entry. What is stopping any other courier from also pursuing a letterbox delivery strategy?

Mr Vincent Phang (CEO, Postal Services and Singapore):

I see, your question is about the letterbox. As you are aware, as the national Public Postal Licensee we have the primary right to deliver into the letterboxes. The other courier companies, there are examples out there where there are locker systems as well, that's also quite prevalent but we do believe that for small packets that constitute the bulk of eCommerce deliveries at the moment, the current letterbox infrastructure at every void deck of a HDB or the bottom of a condominium or even at a landed property that remains the most competitive way to deliver products and we will continue to use that to our advantage.

Ms Rachael Tan (UBS):

Sorry, so competing courier companies cannot put packages into the letterbox?

Mr Vincent Phang (CEO, Postal Services and Singapore):

We are not talking about parcels here, Rachael, so just to be very clear.

Ms Rachael Tan (UBS):

Yes, for small items right?

Mr Vincent Phang (CEO, Postal Services and Singapore):

Yes, small items.

Mr Richard Lai (Group CFO):

Rachael, we are the only one who has the master key to the letterbox currently so that should answer your question, meaning no one else can open that letterbox and put in a packet that is up to the size of 2kg.

Mr Vincent Phang (CEO, Postal Services and Singapore):

I hope you don't get confused because what we are talking about is customers choosing to use the postal system to deliver their eCommerce products. If that come through our postal system, we have the sole use of the letterbox; customers can always choose a courier provider to deliver eCommerce items to the doorstep, that continues to happen, that continues to be a choice. I suppose that is not your question so we are only talking about customers choosing to put eCommerce items through the postal system that we run because it has the best reach and it has the most cost-effectiveness. And yet what we are trying to do is to make sure that it doesn't affect our primary utility of serving letters. Does that make sense?

Ms Rachael Tan (UBS):

Yes, so maybe just a little bit more. How many parcels realistically can you put into a letterbox versus the mail volume?

Mr Vincent Phang (CEO, Postal Services and Singapore):

Parcels we can't obviously, you know the size of the letterbox. We are really talking about small eCommerce items, packets that you typically get from your platforms. We do see a lot of that and we believe that in our discussions with customers, that is still the best, most cost-effective way of delivering those items.

Ms Rachael Tan (UBS):

OK so eventually in the long term, if you are looking at volume for volume i.e. letters versus the small little packets, will the earnings that come through from delivering these small packages be able to offset the same amount of letters?

Mr Richard Lai (Group CFO):

Rachael, this is Richard here. I think I understand where you are coming from, the short answer to your question – sorry to get ahead of you because I am mindful of the timing and other people who might have questions – the short answer to your question is that letters are very profitable and have been profitable in the past, but the reality is that your packets will never be as profitable margins wise as compared to domestic mail. That's the reality of all postal companies, all of them face the same problem not just us – all international postal agencies have the same issue. The answer to that isn't just trying to deal with that in a piecemeal basis, the answer to it would have to be a complete rationalisation and you need a fairly radical solution to the postal system.

So going forward we cannot be just handling letters and small packets which is why we have launched the 'Smart' Letterbox prototype in Singapore not too long ago which will enable us to handle letters, packets and parcels going forward and in the future, help us to establish ourselves as national deliverer of all things and not just be confined to letters. There has got to be a further diversification of our business because if we are relying purely on domestic mail as a continued driver for our business, there will only be one answer to that – that will continue to decline until a point where business is no longer relevant. So hopefully that answers your question; we are well aware of the challenges but we are moving towards a certain direction which hopefully will give us a sustainable business model for the long run.

Ms Rachael Tan (UBS):

Alright, fair enough. Thank you very much.

Operator:

Your next question comes from the line of Lim Rui Wen from DBS. Please ask your question.

Ms Lim Rui Wen (DBS):

Hi, good morning. I have two questions, one I would just like to check about the rate of decline of business letters. Is the rate of decline actually accelerating in this quarter or how has it been as compared to previous quarters? The second letter relates to the 'Smart' Letterbox prototype that you have mentioned, what is the impetus to launch it and are we expecting a nationwide rollout and what are the costs related to it? And is SingPost going to be fully in charge of rolling out such letterboxes across the country? Thank you.

Mr Vincent Phang (CEO, Postal Services and Singapore):

Thanks Rui Wen. Once again the keen interest on the rate of decline of business letters this quarter, we have seen, as we have announced in Q1 that we are seeing some signs of acceleration. We have verified that in Q2 so H1 was indeed an accelerated decline as well as a concern compared to previous quarters previous years. But like I explained earlier, this decline is largely dependent on customers and we are really talking about institutional customers; we are talking about biggest segments coming out from say the likes of telcos, insurance companies, banks, so these are decisions made by customers to go on digital substitution, basically going through digital communication rather than letters. So I can confirm that the rate of decline this first half has accelerated but as I said, it remains to be seen for the rest of the year whether those numbers continue because once they are gone chances are they won't come back, but whether more will follow suit remains to be seen.

Directionally what we can say is obviously we are in secular decline here, the rates that we are seeing aren't anything surprising compared to other global postal organisations, everybody's been seeing this same level of decline. If anything, some of our more advanced peers like the Europeans have seen larger declines over the last four, five years so they are kind of ahead of us in terms of decline so hopefully that answers that question.

Now, certainly that ties in with the 'Smart' Letterbox initiative that we talked about. It is an extremely delicate balancing act that we have to take because we do still have to serve the nation's postal requirements. We have a mandate, we are the national Public Postal Licensee, we continue to have to serve to what I must add, are extremely stringent and rigorous service levels measured amongst all international postal organisations; ours are probably one of the most stringent.

It's a small country, extremely vertical, a lot of high-rise buildings, a lot of that work has now been transitioned to more doorstep deliveries as eCommerce items become prevalent and either because of size or because of sign-off requirements or because of authentication that requires a physical hand-off which in our opinion is entirely not sustainable. In the eCommerce world that we see today if I can just add – the courier companies that we see around, and we operate a courier business ourselves, are going to the doorstep. It's really nothing more than a man to a van, we are just moving items through a van going to the doorstep and you wonder how productive that can be. You take a leaf out of what we have been operating as a national postal licensee using the letterbox infrastructure that we've had all these years, it's an order of two of magnitude difference between the productivities that we can drive because every time we touch a letterbox we touch every single household without actually having to go to every single household. So that is the impetus – how do we continue to use infrastructure to our advantage the way it has always been worked to our advantage, not just for the company's advantage but also for the whole nation. Can we actually afford the urban footprint of increasing eCommerce deliveries using the "a man in a van" concept or should we be looking at infrastructure improvements that enhance what we actually have right now, using the same footprint, to serve a better customer experience and at the same time address some of these productivity issues.

So the Smart Letterbox that we have unveiled as Richard earlier mentioned, is not just about letters – it's letters, packets and potentially aligned with what the government is driving for the Locker Alliance, in a larger format so that we can deliver parcels as well. So in that sense we could potentially eradicate all doorstep deliveries unless customers actually require it and that efficiency that we can drive nationwide would be in my opinion, very, very favourable and very useful or else the postmen per capita is going to have to increase and that's a massive cost avoidance that we as a nation, as a postal service, would have to address. So all these are ideas, all these are concepts we've been in deep discussions with the authorities. We will be looking at further news, hopefully in the near future around what we can be doing, around pilots to test out this concept so I'll ask that perhaps you can stay tuned and wait for that which may be coming out soon. Hopefully that answers.

Ms Lim Rui Wen (DBS):

Yes, thank you very much.

Operator:

Your next question comes from the line of Lucas Teng from UOB Kay Hian. Please ask your question.

Mr Lucas Teng (UOB Kay Hian):

Hi, good morning. I'll just like to check on the UPU agreement that was announced, I understand there will be an acceleration of rates so I just want to ask what is the timeline that can be felt for your end? I understand it might be about 2021 when the new rates would come in and secondly, is there a cap on the new rates for this new UPU agreement? Thanks.

Mr Paul Coutts (Group CEO):

Hi Lucas, it's Paul Coutts here, let me try and address that. It's quite a complex picture when it comes to the UPU and particularly the recent outcome from the congress which took place. I think the starting point is that it's obviously a considerable threat that the U.S would pull out of the UPU and I'm pleased to say – because I do think that it's positive that we managed to avoid that so the U.S is staying as part of the Universal Postal Union and the UPU at the same time also approved all countries to self-declare rates with certain conditions. It's not an immediate, one size fits all implementation but it's a transition plan for the implementation of self-declared rates and that's deliberately put in place to avoid shocks to the markets.

We certainly will see an accelerated terminal dues increase in 2020 across all countries. In terms of self-declared rates, that would be launched in 2021 and there is a cap to that – it is a maximum of 15% increase of self-declared rates year-on-year and also the end state would be a maximum of 70% of the domestic rate of each country. So look, there are a lot of moving pieces there as you can imagine and we have to work our way through as to what that means for SingPost. We are working our way through that since the announcement; we were working our way through that before the announcement. There are opportunities, there are certainly some threats arising from the changes which we're not only fully evaluating but we are also making sure that we have the mitigation plans in place, but I think what you will definitely see is the multilateral approach to cross-border postal shipments not only remains intact as it is today but it will in fact increase on a bilateral basis as well.

So the opportunity that comes out of this is that all countries are or will be on a level playing field in terms of costs. Previously Group 3 had a cost advantage over Group 2; SingPost sat and sits in Group 2, so Group 3 countries were able to basically get lower pricing because they were paying a cheaper rate on the terminal dues. In terms of threat, it's quite simple – terminal dues and costs overall for the industry will increase significantly for existing international business and volumes, and therefore we have to make sure that we are properly prepared in terms of how we mitigate those increases and those are the plans that we are currently working on.

It's not just about the pricing as well, it's also about making sure from a cost perspective we are managing some of the other costs, we are developing our last mile platform, agile platform for international cross-border network development using SingPost as a nerve centre. That means that we will connect with other postal operators and through our technology be able to have the most comprehensive last mile delivery infrastructure in each of the countries in which we operate or in which we partner and we do think that will be a key distinct advantage for us.

So our plans going forward are quite simple; we continue to develop our partnerships and alliances with postal organisations and perhaps some other partners and that's certainly including bilateral agreements to deliver cross-border items at the same time as we continue to explore commercial solutions to offer best rates for the combination of postal and commercial solutions, and that will give us the most effective cross-border network.

Mr Lucas Teng (UOB Kay Hian):

OK, thank you.

Operator:

Your next question comes from the line of Varun Ahuja from Credit Suisse. Please ask your question.

Mr Varun Ahuja (Credit Suisse):

Hi, thanks for the opportunity. I got a few questions. First, can you provide some colour on the strategy for Southeast Asia? I remember you mentioned you were going to focus more on Southeast Asia so just want to hear what you were thinking, and over the next two to three years how do you want to make progress? Secondly, can you give some colour on the market share for Domestic eCommerce? How much market share do you have – because that is one of the focus areas when you started the new strategy – have you increased? Is it maintained or is it declining? Some colour would be helpful.

Thirdly on dividends, if the losses from U.S are going to be deconsolidated hopefully there would be some increase in earnings. Would that lead to a higher dividend payout or would you still try to maintain the current dividends and reduce the payout ratio? Any colour on that would be helpful.

Lastly on the terminal dues that have increased, will it lead to further margin pressure in the International mail segment similar or what happened last year? Or am I wrong in terms of thinking if China had a cost advantage so now that they've been brought on par, will that be beneficial for you? Just want to understand the implication of terminal dues and International mail margin. Thank you.

Mr Paul Coutts (Group CEO):

So maybe what we'll do is we will work in reverse, so we will deal with terminal dues and margin pressure and then go from there, Varun. Thanks for the questions.

In terms of the margin pressures, we do think in actual fact that we will have some benefits for pricing overall for the postal industry globally and we see that as obviously being a positive thing for the overall UPU. What it means in terms of market by market, as I said, we are still working our way through. Getting back to what you said earlier, I do think in terms of pricing it will continue to be competitive but you are right. Touching upon the thing I said earlier, the overall market is on a level playing field and that's going to open up a number of opportunities for us within those current Group 3 markets that we talked about earlier. So what the eventual outcome of the pluses and minuses of those are too early to tell, and also because as I said there is a gradual increase and a gradual change in those legislations will take place; we need to wait for some time for that to come through.

This is not quite the same as has been before where it was just a straight terminal dues increase, this is more structural in nature and because it is more structural in nature it will take a bit longer to play out and so that will be my view on it at this point.

If we maybe come to the question on dividends, Richard maybe you could deal with that question?

Mr Richard Lai (Group CFO):

Varun, if I can refer you to page 2 of the SGXNet announcement, if you notice that right at the bottom the "Profit after tax" which is after you have taken into account the loss from discontinued operations for U.S basically, you'll find that profit has actually increased from S$39.5 million last H1 to S$52.1 million in the first half of this year. This is in spite of the fact that profit on operating activities has actually declined because of the challenges and the headwinds that we are seeing at the Domestic Post and Parcel side. So that gives you an indication of the sort of savings we are getting from the deconsolidation of the U.S business.

What I think you are trying to get at is as a result of all these, will we actually see an improvement in the dividend payout and the answer to that question isn't purely linked to the U.S per se because as you can see and if you had been following the conversations just now with some of the other analysts, the future is really going to be heavily rationalising our postal business and in that respect we have got to be careful with how we spend the money; last year we had actually lent a lot to the U.S which we have stemmed now with the Chapter 11 filings but going forward the savings that we make from that – we have to use it to a large extent to rationalise the postal business first and foremost in Singapore, and then hopefully in the future we could expand beyond Singapore to help to project some of these technologies and knowhow to the neighbouring countries which dovetails in to the question of the strategy for Southeast Asia.

Now, you are absolutely right to say that the mention and the intention to pivot back towards Asia Pacific which Southeast Asia is one of our key priorities, but in actual fact if you look back at the announcement we actually talked about Asia Pacific per se. We can't actually talk about some of the measures or some of the things that we are currently looking at until we are ready to make an announcement on it but needless to say, we are actually looking ahead as to some of the things that we would love to do in Asia Pacific but at this juncture is too early to be discussing about it.

Mr Paul Coutts (Group CEO):

So maybe if could just add a little bit to what Richard talked about in terms of some of the key changes that are taking place in the market particularly with regard to Southeast Asia. One of the developments which is emerging is the going from a B2C model to B2B2C model, we see that definitely emerging in the market. In previous times, most of the large brands, the super brands had a supply chain built for their B2C products which was specifically for eCommerce obviously, and ran a B2B supply chain platform. We are seeing the lines converge and that again holds some opportunities for us, so we are developing our thoughts around what that means for SingPost in terms of each of the markets; too early to talk about specifically right now but we certainly see that as an emerging trend that we want to make sure that we are at the front end of in terms of capitalising.

The other thing I was going to say was the other interesting thing is that we have started to develop some opportunities on an Eastbound basis from Europe. In other words, there are customers in Europe who are moving traffic into Asia including Southeast Asia which is an attractive proposition for us using our postal network and postal alliances within ASEAN. There are discussions taking place as we speak on that particular opportunity as well and we definitely are keen on that. Just one other indicator is that when you look at the Quantium Solutions business that we talked about earlier – they are starting to grow, that 9% growth in Q2, some of that is also going into Southeast Asia and therefore we are seeing some early signs that the earlier strategies are working with various partners in that part of the world. As Richard mentioned, it's very much key – we kind of look at Singapore as number one, Southeast Asia as number two and Asia Pacific as number three.

Mr Vincent Phang (CEO, Postal Services and Singapore):

Varun, Vincent here, I'll try to answer the question on the domestic market share for eCommerce – I think that was the question. Market share is always a difficult thing to say because it's by our own measure, our own assessment. I can give you what I think about where we stand at the moment, what I can say is that we have grown strongly for Domestic eCommerce volumes year-on-year – in the quarter we are looking at about 34% growth year-on-year so that gives us a pretty good indicator of how our products have been competitive and how our service has been appreciated.

As far as market share is concerned, we believe that we are just shy of 50% of the market – like I have said, market share is a sensitive one, by our own measure. A large part of that strong performance is due to our dominance in the small packets, small package traffic and as I mentioned earlier this goes very well with the idea that for something that is small, something that is relatively affordable and cheap, the postal network continues to be the best and the most cost-effective way of delivery.

We are very disciplined in what we want to do for the larger format. As you know the space is very crowded, there are quite a few sellers in the space, we will remain very disciplined around how we grow in the larger format for parcels. But as far as the small packets are concerned, the announcement that we made last week – once again to reiterate, it helps with the costs, it streamlines the products, it gives a better customer experience going to the letterbox and beyond that I do expect that once we get the customer experience and the costs right then certainly there will be some revenue and traffic upsides as well; I am very optimistic of that, hopefully that answers your question.

Mr Varun Ahuja (Credit Suisse):

Yes.

Mr Jason Lim (Vice President, Investor Relations & Financial Analysis):

Thanks Varun. Operator, we will take one last question.

Operator:

Your final question comes from the line of Ngoh Yi Sin from CIMB. Please go ahead.

Ms Ngoh Yi Sin (CIMB):

Hi, morning. Thanks for the opportunity, three quick ones here. Firstly I wanted to check with the stabilised – the introduction of postal initiatives, when are we expecting admail services to resume? Secondly on Logistics, for all the freight forwarding companies, because they are facing headwinds are we saying that there are accelerated headwinds on a month-on-month basis? And for U.S eCommerce, I want to check also when will the discontinued operations be reflected in the financial statements till?

Mr Vincent Phang (CEO, Postal Services and Singapore):

I'll do the first one on admail, Yi Sin I think that was your question. The admail by itself is also subject to substitution so I just want to be conscious about the admail volumes that are coming through us, but with the service improvements that we have put in place we have a fair bit more capacity this year compared to last, and certainly we have the option to turn the tap back on. We are, like I said, very disciplined about our priorities and service capabilities at this point in time so we are cautious about the peak that is coming, the Q3 peak that we have for 11.11 and the year end. But what I can say is that we have partially restored admail volumes in Q2 and that have come through the pipe again but we are being very selective about the quality of the revenue, about the type of admail that we are doing which is aligned with the business that we have so hopefully that will start to contribute again through the next few quarters.

Mr Paul Coutts (Group CEO):

We'll move on to the Logistics question specifically on the freight forwarding side. Look, in terms of – you broke up a little bit but I think the question was in terms of what the month-on-month trend is looking like, so let me just try to address that.

The month-on-month trend at the moment is moving in the positive direction but that wouldn't be unusual in itself because it is the peak so it tends to be that it ramps up August, September, and gets busier in October, November and really the big peak months and then the first couple of weeks in December before it starts to tail away.

Traditionally year-on-year that tends to be the flow and it's been the same this year. The real question will be in terms of how we perform year-on-year, and as I said when we look at the year-on-year results for Q2 we mentioned earlier that we certainly see a slowdown in our activities particularly in terms of the volumes. As I said, that's not just affecting us, it's affecting the global industry both in terms of the carriers and the freight forwarders so we just need to continue to manage our cost base especially tightly through this process and try and generate as much activity as we possible can. Certainly month-on-month we are seeing an increase during the peak and that's what we expect to see, and that's positive.

Mr Richard Lai (Group CFO):

And for the last question, the losses from discontinued operations will have to carry on being represented in our accounts until September next year because we deconsolidated from September this year, so it will have to run for 12 months for comparative purposes.

However, the losses from discontinued operations will not be increasing; what you will see is the same number will carry on for the full financial year, and in the next financial year it will be more of a point of reference – a comparable number for analysis purposes.

Ms Ngoh Yi Sin (CIMB):

Thank you very much.

Mr Jason Lim (Vice President, Investor Relations & Financial Analysis):

Thanks everyone for dialling in, I think we have reached the end of the call. If you have any further questions, please feel free to contact me.

Mr Paul Coutts (Group CEO):

Thank you.

End of transcript