SingPost's Q2 FY16/17 Results Analyst Briefing, 4 Nov 2016

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.

Mr Jason Lim (Assistant Vice President, Investor Relations):

Good evening everyone. Welcome to SingPost's results briefing for the second quarter and half year FY2016/17. I am Jason from the Investor Relations team. With me today is Covering Group CEO and Group CFO Mr Mervyn Lim. I'll hand over the session now to Mervyn, who will bring you through the results.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Thank you, Jason, and a very good evening to everyone. Thank you for joining us today, allow me to take you through the results. The Group registered revenue growth of 22.3% for the second quarter ended 30 September 2016, with the inclusion of our new US eCommerce subsidiaries. Rental and property-related income declined 10.7% due to the redevelopment of SPC Mall. Miscellaneous income last year was boosted by one-off gains from divestment of DataPost.

Operating Profit and Net Profit declined 40.9% and 41.2% respectively, due largely to one-off gains from divestment of DataPost last year. Underlying net profit, which represents the recurring earnings of the Group, declined 27.9% due to higher costs in the eCommerce business, costs related to the completion of the new Regional eCommerce Logistics Hub, loss of rental income from SPC mall redevelopment, as well as lower domestic letter mail volumes.

We now share some highlights of the Group's revenue performance. In the Mail segment, revenue rose 0.8% driven by growth in International mail revenue, partially offset by the decline in Domestic mail revenue and deconsolidation of Novation Solutions and DataPost which were divested last year.

Logistics revenue declined 1.2% in Q2 with lower revenue from non-eCommerce related activities such as freight forwarding, amidst the global economic slowdown. eCommerce revenue rose with the inclusion of TradeGlobal and Jagged Peak from November 2015 and March 2016 respectively.

Expenses rose 23.7% due to the consolidation of acquisitions and change in business mix. Labour and related expenses were higher with additional headcount from new subsidiaries. Volume-related expenses are largely driven by the growth in International Mail and eCommerce Logistics.

Traffic and related expenses rose 10.9%, as International mail outpayments were partially offset by lower conveyance costs related to the freight forwarding business. Outsourcing services & delivery expenses rose 100.3% largely due to outsourced services engaged by Couriers Please & Jagged Peak, and cost of sales related to the eCommerce business. Depreciation and amortisation expenses were higher mainly from depreciation on the Regional eCommerce Logistics Hub which attained TOP in April 2016. Finance expenses declined as a result of favourable non-trade related forex translations.

Excluding one-off gains, operating profit declined 30.5% to S$33.8 million. Postal operating profit dropped 10.6% due to the decline in domestic mail volumes and deconsolidation of DataPost and Novation Solutions, partially offset by growth in international mail volumes.

Logistics operating profit declined 35.6%, reflecting costs in relation to the completion of the Regional eCommerce Logistics Hub as well as pricing pressures in the eCommerce Logistics space. Property & Others operating profit declined 60.7% due to loss of rental income from the SPC retail mall redevelopment and trade-related exchange losses. In eCommerce, operating losses increased to S$6.8 million, impacted by higher costs arising from tight competition for seasonal fulfilment labour.

This slide shows the movement of the underlying net profit between Q2 FY16/17 and Q2 last year. Underlying net profit declined largely due to investments in transformation, which represented a decline of $8.5 million. As stated earlier, we are incurring higher costs in the eCommerce business, resulting in operating losses.

In the Logistics segment, we are bearing additional costs related to the completion of the new Regional eCommerce Logistics Hub. In the Property & Others segment, we have a temporary loss of rental income as we redevelop SPC retail mall, which will almost double our retail space when completed. For our associates and JV, 4PX is incurring expansion costs in anticipation of greater volumes. Lastly, the Postal segment declined $3.9 million, with the drop in domestic mail volumes.

This slide shows the P&L statement for the half year. Revenue rose 26.5%, while underlying net profit declined 19.3%. These are largely due to the same factors that we shared in the earlier slide on the Q2 results.

In this slide, we detail the factors that led to the decline in underlying net profit for the half year. The factors are largely similar to that shared in the Q2 slides. Investments in transformation contributed to a $14.0 million decline, while the postal decline was $3.8 million.

We now move to our cash flow and financial position. Our operating cash flow improved to $105.1 million. Boosted by positive working capital movement, net cash provided by operating activities rose to $99.9 million after income tax paid.

Cash used for investing activities included capital expenditure for construction of the eCommerce Logistics Hub and SPC retail mall. With cash and short-term funds utilised for capital expenditure, borrowings rose to $406.4 million. Interest coverage ratio remains strong at 26.6x. Excluding the one-off gains last year, the ratio in March was 29.8x. With the increase in borrowings, Net debt to total equity ratio was 21.0% as at 30 September 2016.

Let me now share some highlights on our eCommerce-related revenues.

Our eCommerce-related activities continued to grow at a good pace. eCommerce-related revenue now represents 48.8% of total Group revenue. Postal now contributes 30% of eCommerce-related revenues, with Logistics at 29%, and eCommerce contributed 40%.

SingPost continues to expand beyond Singapore. Overseas revenue now accounts for 50.8% of total revenue or $332.8m. 34% of overseas revenue was from the US eCommerce companies TradeGlobal and Jagged Peak. 28% was from our Australian business, largely from the parcel delivery entity Couriers Please. Asia accounts for 27% and Europe the remaining 11%.

We will now move on to the segmental results.

Postal revenue rose 0.8% due to strong growth in international cross-border eCommerce related deliveries, partially offset by decline in Domestic mail volumes. Domestic mail revenue declined 5.5%, impacted by one-off postings in Q2 last year for SG50 and General Election 2015, as well as a one-off boost from philatelic sales at the World Stamp Exhibition 2015 which was held in Singapore last August.

Post office products and services revenue declined by 19.1%, reflecting the shift to alternative online options such as internet bill payments. Operating profit declined 10.6%, largely due to the decline in contribution from Domestic mail. The decline in margins to 26.2% reflects the drop in Domestic mail contribution and the change in mix between Domestic and International mail.

In Logistics, revenue declined 1.2%, with lower contribution from non-eCommerce related activities amidst a general economic downturn. Famous' revenue was impacted by depressed freight rates and lower volumes. Couriers Please revenue rose on strong increase in volumes, but operating profit was impacted by costs incurred to increase handling capacity.

The Logistics Operating profit declined to $5.0 million, which reflects costs incurred in relation to the completion of the Regional eCommerce Logistics Hub as well as pricing pressures in the eCommerce Logistics space.

eCommerce revenue rose with the inclusion of TradeGlobal and Jagged Peak. SP eCommerce's performance improved year-on-year as it continued to gain traction with customers in Asia-Pacific.

The Group continued to invest in IT and operational capabilities. In particular, tight competition for seasonal fulfillment labour in the US drove up cost significantly. As a result, operating losses rose to $6.8 million.

Next, I will share some business and corporate updates.

SingPost officially opened its Regional eCommerce Logistics Hub on 1 Nov 2016. This is SingPost's largest eCommerce investment in Singapore at a total cost of S$182 million.

The Log Hub is a fully automated parcel and warehousing facility, housing two warehousing floors, 150 simultaneous loading bays as well as an office block. The ground floor houses a fully automated parcel sorting facility with a capacity of up to 100,000 parcels a day, and end-to-end sorting, shipping and returns management capabilities that enable quicker order fulfillment. Everything in this building is scalable, which means we can keep upgrading it to meet the needs of the future. The eComm Log Hub is expected to provide improvements in operating and cost efficiencies.

We have strengthened our eCommerce logistics collaboration with Alibaba Group Holding Limited.

On 27 October, Alibaba completed the investment of S$86.2 million for a 34% stake in QSI, with SingPost owning the remaining 66%. QSI will be a common platform to grow and enhance eCommerce logistics capabilities in Southeast Asia and Oceania, to better serve the region's rapidly growing online retail markets. Funds will be used to strengthen QSI's end-to-end eCommerce logistics network, building scale for future profitability.

Further, approval from the Info-communications Media Development Authority has been obtained for Alibaba to increase its interest in SingPost to 14.4%, from 10.2% currently. Alibaba's further investment of S$187.1 million into SingPost is targeted to be completed by 28 February 2017, in light of the timeline required to obtain the remaining approvals from SingPost's shareholders and from the Singapore Exchange.

Next, we will provide an update on corporate matters. SingPost has substantially implemented recommendations of the CG review. To enhance financial governance, the ExCo is reconstituted as a Finance and Investment Committee. Other key implementations include adopting a Mergers and Acquisition Policy, adopting a Market Disclosure Policy and forming a Market Disclosure Committee.

To bring broader perspective and diversity, 3 new Non-Executive, Independent Directors, namely Mrs Fang Ai Lian, Ms Elizabeth Kong and Mr Bob Tan, were appointed to the Board on 10 Oct 2016 as part of the implementations of the CG recommendations. SingPost now has 11 Directors, seven of whom are Independent. On the GCEO search, the Board expects to make an appointment by the end of this calendar year.

We have completed a review of the dividend policy. The principle guiding the Board in setting the policy is that dividends must be sustainable and paid out of underlying earnings. SingPost's dividends in the past had been largely supported by the domestic mail business, which continues to see declining volumes.

To provide future sources of earnings, significant transformational investments have been made in eCommerce, eCommerce Logistics and in the redevelopment of the SPC retail mall. In the short term, however, these investments will impact earnings. We have raised capital and taken on debt to fund these investments. The need to review the dividend policy should be understood in this context.

The Board is very aware of the importance of dividends to our shareholders and the objective is to grow underlying earnings and dividends over time. The dividend policy has been revised from an absolute amount to one based on a payout ratio ranging from 60% to 80% of underlying net profit for each financial year, paid quarterly. For the second quarter of FY16/17, SingPost has declared an interim dividend of 1.0 cent per share.

We now move to the summary and outlook. In summary, revenue growth in Q2 was driven by the inclusion of contributions from new subsidiaries. Underlying net profit declined as a result of investments in business transformation – namely higher costs in the eCommerce business; costs related to the new Regional eCommerce Logistics Hub; loss of rental income from SPC mall redevelopment; as well as lower domestic letter mail volumes. For the second quarter of FY16/17, SingPost has declared an interim dividend of 1.0 cent per share.

We now come to the Outlook section. In the Postal segment, Domestic mail remains under pressure with declining volumes but the impact was partially offset by growth from International mail volumes. The shift in revenue mix towards International mail will lead to a decline in margins on a blended basis.

The Logistics segment is expected to continue to benefit from growing eCommerce trends. As the Group scales up the business for future growth, higher operating expenses are expected from investments in further network development. The opening of the new Regional eCommerce Logistics Hub on 1 November 2016 will also result in higher depreciation expenses.

Under eCommerce, the businesses of the US eCommerce entities TradeGlobal and Jagged Peak are highly seasonal and will be entering the holiday peak months of November and December where volumes are expected to pick up. While the businesses have been preparing for the peak period, tight competition for seasonal fulfilment labour is expected to drive up costs significantly. This will impact margins, but will be partly mitigated by investment in automation.

The redevelopment of the Singapore Post Centre ("SPC") retail mall is expected to be completed around mid-2017, and leasing for the mall has commenced. The Group continues to forgo rental income during this period of redevelopment.

Capital expenditure is expected to remain high in FY2016/17 from committed capital expenditure for the ongoing redevelopment of SPC retail mall. The share of profit of associated companies and joint ventures will be impacted by a decline in share of profits from GD Express due to a lower equity shareholding percentage following a partial divestment last year. SingPost will continue to invest in transformation while integrating and extracting synergies from its acquisitions.

That ends my presentation. The rest of the deck consists of supplementary slides provided for additional information.

I will now hand you back to Jason, Jason please.

Mr Jason Lim (Assistant Vice President, Investor Relations):

Thank you, Mervyn. Let me now introduce other senior management members on the call. We have with us Mr Woo Keng Leong – CEO of Postal, Mr Sam Ang – CEO of Quantium Solutions and Famous Holdings, Mr Marcelo Wesseler – CEO of SP eCommerce, as well as Mr Pranay Mehra – SVP of SP eCommerce. With that we can begin the Q&A section, operator please.

Q&A

Operator:

Thank you, Jason. Ladies and gentlemen, we will now begin the question and answer session. If you wish to ask questions, 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. We have the first question from the line of Horng Han Low from CLSA, please ask your question.

Mr Horng Han Low (CLSA):

Hi, good evening everyone, Horng Han from CLSA. I have a few questions here, Mervyn. First relates to the postal margins, I do understand the product mix shift could drive the margins to erode on a year-on-year basis. Could you provide some insights on the individual standalone margins for Domestic and International? Doesn't have to be on number basis but just in terms of the drop, segment A versus segment B, which is Domestic versus International – which one has fallen more on a year-on-year basis?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Hi Horng Han. Yes, in respect of that question, the Postal margins have gone down if you look at H1 – from 30.3% to 28.6%, and if you look at the background slides Domestic mail as friends know out there, has a significantly higher margin, International mail lower margin of course, and so this is where you rightly said the blended mix of Domestic and International will ultimately determine that final OPM margin which we see now to be 28.6% on H1 this year. And so as to where we see it, it really depends on the tipping point which we have no clarity on.

Domestic mail is still dipping. If you look at the Domestic mail volumes or revenue, it has gone down by 4.8% on H1 and 5.5% in the quarter, so it continues to decline. Fortunately for us of course the International mail volumes have continued to expand which shows that our eCommerce Logistics strategy is working very well in terms of cross-border transshipment mail across the network.

Mr Horng Han Low (CLSA):

Sure, OK, moving on to second question. The new regional processing Centre, very state-of-the-art facility that's just opened recently. Can you guide with regards to the expected utilisation within the first year of operations?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Yes, we have stated – first of all, the capacity is 100,000 parcels per day and Sam has also indicated that we are currently more than 10,000 parcels a day, but having said that, it takes time to integrate and synergise and I think that's a very important thing that friend, you need to understand that it is not immediate savings, immediate benefits to the bottom line. Our investments are all looked upon at the long term basis, and so long term means that we will seek to integrate across by building scale – the word 'scale' is key. It's key because as I've mentioned to all of you, scale enables us to get all the cost synergies in so that as we increase volumes on our network, that's where cost synergies kick in and that's where you would probably see the margins reflecting the position of long term network solution.

Mr Horng Han Low (CLSA):

Alright, so if I were to look in terms of the volumes, from the more than 10,000 parcels per day to hit close to 70%, 80% utilisation of 70,000 to 80,000 parcels per day, that would largely come from share gains. Is that how I should look at it?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Yes, that's the way, you could – just a moment, Sam would like to talk about that point.

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

Hi, Sam Ang here. Basically yes, it's the market share but also at the same time because this is the regional centre – not just for Singapore but also for the region, so we are also expected to grow our share from the region too.

Mr Horng Han Low (CLSA):

Hi Sam, OK just one follow-up on this. Sorry if this is a silly question, given the scale and size and the investments you have put in, does it make sense for you to work with your competitors and do processing for them, so you can perhaps enhance your stickiness or get more leverage in terms of volume? Is this part of the overall strategy?

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

We are actually an open platform, we are open to all our competitors that can help to utilise our scale and correct, that is one of the areas we are looking at.

Mr Horng Han Low (CLSA):

OK.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

I think the advantage here, my friend, is that always we say it is non-exclusive, it is a plug and play network, and ultimately our solution is more collaboration.

Mr Horng Han Low (CLSA):

OK, are any of your competitors talking to you with regards to utilising this facility? It could be smaller players who don't have the scale and they want to leverage on you, can you provide…

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

Definitely, we are already in touch with some of our competitors but obviously we have to see how that works through our strategies.

Mr Horng Han Low (CLSA):

OK, one last question here Mervyn, which is with regards to the tenancy for SPC mall. I understand that it will only TOP in about more than half a year's time. Roughly how much has been committed in terms of tenancy?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Horng Han, I would very much like to give you a bit more but I can't. We have always said that we have got NTUC Fairprice, as well as Kopitiam, GV Grand – these are the three tenants that are publicly out there. Suffice to say that we have progressed from that point and that's all I can say for the moment.

We do have an eight-month runway before we TOP the building in June and we are certainly looking towards filling that space up, towards that completion date.

Mr Horng Han Low (CLSA):

OK, got it. Thank you very much, thank you Mervyn.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

No mention.

Operator:

Your next question comes from the line of Sachin Mittal from DBS. Please ask your question.

Mr Sachin Mittal (DBS):

A couple of questions…First of all, the depreciation and amortisation from SPC is included – was it there already or is it something that would kick in from this quarter onwards after the opening? What kind of…at what point level will this kind of breakeven? Any estimated idea on that?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

The accounting treatment for depreciation on methods in construction mode is that it is capitalised on depreciation of an as and when basis. So as part of the building is completed, we have already started to depreciate that, and so if you are looking at the financial effects on the bridge that we have given to you – quarter or H1, you will see that the depreciation position which is included in the eCommerce Logistics Hub cost was $1.4M on quarter and $3.2M on H1. So a large part of that $1.4M and $3.2M bridge on eCommerce Logistics Hub comprises depreciation.

Of course, when you look at it on a six months plus six months basis which is one year, you could extrapolate the numbers, I don't have to do it for you. So if you look at $3.2M on six-month basis, you could extrapolate that on a year basis.

Mr Sachin Mittal (DBS):

OK great. The breakeven, what kind of level will the breakeven will happen?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

I'm afraid I can't give that as I can only mention at this moment, we look upon it as a long term investment and we will continue to grow scale in the network.

Mr Sachin Mittal (DBS):

Lastly, if we were to exclude any one-off write-off and everything else right, can we say that given the SPC mall will kick in now…given the mall will come in in June, and utilitisation will increase at the regional eCommerce centre, can we call that the bottom of the operating – the bottom of your operating numbers or no, there are issues which we can expect in the future quarters also?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

I think the question cannot be looked upon purely from SPC mall or the white space in eCommerce Logistics Hub. The better guidance which I can give you is what we have given to all of you in this round which is the bridge, and the bridge we have added in to help guide you into the various reasons why we are looking at a $10M fall quarter-on-quarter, or $15M fall H1-on-H1. And the reasons there – you can then look at it say 'Is it a one-off? Is it going to continue on?', and you could then have better clarity as to whether you're going to see a continued drag on the bottom line.

So if I were to look into various boxes, higher costs in eCommerce business – that's a continuing position, people. Integration and synergies is a mid to longer term position, execution risk is what we have highlighted all the time. If we look at TradeGlobal, right now going into its peak period which is November, December. And so to say whether it will go up, whether it will go down – we can't do it until the full year.

If we look at costs related to Regional eCommerce Logistics Hub, $1.4M…on H1 it's $3.2M, you could see that it hits the bottom line continually because it's depreciation. You need to depreciate the building so there will be a constant hit to the bottom line, and it will be overcome or mitigated certainly as we increase scale on that network. So that will be time, time will depend on the speed we are able to increase the scale on our network. The deepening collaboration with Alibaba on 27 October has certainly helped to accelerate that speed but nevertheless it needs time.

In terms of SPC mall redevelopment, we know there is an eight-month runway and so we have also indicated down there in one of the bullets that we will seek to almost double our retail space. So while we forgo rental which is here $1.1M on Q2 or $2.0M on six-month basis, we hope to recover that certainly because our net lettable area will increase almost twice and so hopefully we will get that back once we TOP and complete the building in June next year.

And of course the associates that we have remarked down here is because of expansion costs. Cainiao has invested 15% in 4PX so certainly it brings good volumes, but the volumes – they have low margins so we need to wait it out. And so again, is as a result of expansion costs.

Mr Sachin Mittal (DBS):

OK good, thank you for the comprehensive answers .

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Thank you, Sachin.

Operator:

Thank you. Your next question comes from the line of Joshua Lee from Deutsche Bank. Please ask your question.

Mr Joshua Lee (Deutsche Bank):

Hi, good evening SingPost team, I have three questions for Sam. I'm just wondering, firstly can you share with us what needs to be done or improved in your division, say within the next year? Secondly, I'm just wondering what has been done since you joined? I know it's pretty short since July. And thirdly, how is SingPost logistics versus the competition? Thank you.

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

Hi, Sam Ang here. The first question is what needs to be done, did I get it correct?

Mr Joshua Lee (Deutsche Bank):

Yes, what needs to be done.

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

I think that basically you know that the eCommerce Logistics is a lot to do with the volume. Basically volume will drive down our costs and we will become more competitive in the market, so a very important area is how much we can pump into our system to reduce the costs of our operations, at the end of the day make us more competitive and draw in more volume and that's where the profitability will come in.

And of course the second point is regarding what I have done? Well, the first thing that I've done…what we do is to connect all the various parts of our end-to-end logistics flow, for example from line haul which is the Famous or the freight portion to the order fulfilment, warehousing, pick and pack which is the Quantium Solutions and the last-mile delivery, which is the Speedpost and SP Parcels part of it. So the end-to-end process includes Couriers Please in Australia, so it's the end-to-end process. What I did is to connect all the points together, all the dots together then obviously the important part of it, which is now what we do is to be able to provide a hybrid solution for postal and freight together, and that is a very important part because that gives us a good advantage in being able to service our customers with a wide range of options.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Sam, if I may…while Sam answers the third part which is how does SingPost compares with its competitors, allow me to perhaps add on while Sam looks at that third question. I would also like to add that one of Sam's definite strengths which he brings to the Group is that he is also the CEO of Famous Holdings.

Famous Holdings is part of Logistics and so one of the things that…now that he is the CEO of Quantium Solutions, that has brought a lot of synergies and integration across the Logistics pillar because now we are able to look at freight, customs regulation as well as last-mile, and warehousing and fulfilment all under one hat. And so that is greatly synergised and we have success stories in that area in terms of clients being able to be pulled across the different sub pillars within Logistics. Sorry Sam, go ahead please.

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

Coming from the other side of the fence, spending a long time on the other side of the fence on the multinational companies…every one of them has their strength, we have to look into SingPost – what area, what is the area of our strength where we can compete on and that's where earlier when I mentioned that we are in a very good, advantageous position.

We are able to offer a hybrid of postal and commercial so that the customer – because eCommerce is basically a question of ability to provide options, ability to provide competitive options and how you string together the various parts of the Logistics chain because you know, we will always be judged on our weakest link. How are you able to string them up together to enjoy the synergies?

And as I said, there are many competitors in the market, either very good in the postal part or majority of them will be on the commercial part of it…and that's where our niche is to offer both solutions, comprehensive solutions to the e-retailers, to our customers.

Mr Joshua Lee (Deutsche Bank):

Thanks Sam, the reason why I asked third question was because I noticed that very large DHL building next to your regional logistics hub so just wondering if you are fighting on similar turfs.

In terms of your integration, how long more do you think you will take to tie up all these loose ends?

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

Integration is always ongoing…depends on which level you are moving to because the logistics landscape is ever changing and the defining factor or the winning factor is how fast you can adapt to it.

Now, today if we are integrated to certain level, tomorrow the logistics landscape changes again – and then you have to adjust and stay relevant all the time. So it's always how fast you can stay ahead of the curve.

Mr Joshua Lee (Deutsche Bank):

OK, thanks. Thank you very much.

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

Thank you.

Operator:

Thank you. Your next question comes from the line of Eric Lin from UBS Securities. Please ask your question.

Mr Eric Lin (UBS):

Hi, good evening Mervyn and the SingPost team. Actually some of my questions are already addressed earlier, but let me focus on eCommerce, two questions to follow up. The first one is can you give me some more colour on the upcoming peak season, I am curious to know in particular what magnitude of the season pick-up shall I expect, this third quarter versus the last quarter you have reported. It doesn't have to be a number, just more colour will be helpful.

My second question is also about eCommerce. You mentioned about tight competition for labour in the U.S, has that been resolved as of now or shall we expect it to worsen as you go into peak season? Thank you.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Allow me to address the first question. As to the expectations of volumes this coming peak, we can only give you perhaps qualitative answers because they are not specific, but I think that we would envisage higher volumes coming up. However, having said that, coming to the second point and that is that – in order to prepare for the holiday peak, we have taken upon ourselves to protect the volumes by kicking in additional labour, and amid the fact that labour market in the seasonal fulfilment side is extremely tight in that area…in Cincinnati in particular and so of course the rates, the hourly rates have also gone up which has impacted our gross margins.

So having said that, that is a cost that we have sought to incur in order to prepare ourselves for the holiday peak, and we are looking towards higher volumes this coming peak.

Mr Eric Lin (UBS):

Just to follow up on the answers, I think firstly I appreciate it because TradeGlobal and Jagged Peak are new consolidations so there isn't much track record to follow. But I recall last year, just one and a half months – actually TradeGlobal did $29M and then…which is actually the same number for the last quarter, same quarter. So if we try to just analyse or attribute that to a quarter, it actually shows seasonality is end up having the revenue doubled for the business. Is that a good reflection of the seasonal pick-up?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

You look at the revenues, Eric – your question is whether the revenues of Q2 will continue in Q3, is that your question?

Mr Eric Lin (UBS):

That's correct.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

OK, so if you look at revenues in TradeGlobal on H1 basis, the H1 revenue is $60.5M, and so as you mentioned – do you expect revenues to go up in Q3 it should in line with the fact that that's our peak period. So it's a very logical conclusion that we would expect revenues to go up as volumes go up during the peak period, yes.

It's a seasonal business Eric, and it's for that very reason that it's difficult to assess the full performance of TradeGlobal at this moment because it's less than a year and hasn't gone through the period.

Mr Eric Lin (UBS):

OK, and then the other thing is the hourly rate of the U.S labour. I assume it will also continue to go up as you go into the peak season so this is something that you know, could be a pressure on your margins, is that correct?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

I think hourly rates is something not within our control, it's really market-driven and in Cincinnati of course the labour position there is extremely tight and so we are guided by the market. Obviously if you want to compete for labour, there are other people there and this is where rates may go up or it really depends on the labour market there.

Mr Eric Lin (UBS):

OK, got you. Thank you.

Operator:

Thank you. Your next question comes from the line of Roshan Behera from Bank of America. Please ask your question.

Mr Roshan Behera (Bank of America):

Hi, thanks for the opportunity. Three questions…

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Hi Roshan.

Mr Roshan Behera (Bank of America):

Hi Mervyn. The first question I have is, is it possible to give us a guidance on the amount of one-off gain in Mail in 2Q last year so that we can kind of get a sense of how the organic trend has evolved in particular in Domestic mail. The second question was with regards to what you've announced for

Alibaba – how should we expect this to evolve; more from an operational side of the business and what exactly are you going to do on the ground as you look at tapping into these markets?

Related question is what's the size of the eCommerce logistics in Southeast Asia and in terms of your footprint market? And how should I look at your market share currently and evolution over the next two to three years perhaps? Third question perhaps when you're done with these two then I'll come to that.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Thank you, very nice of you Roshan. I will get Sam to answer the second question on partnership as well as eCommerce size, allow me to answer the first one which is the one-off gains in Q2 of last year.

So if you need to do perhaps, an apple for apple comparison, Q2 was DataPost and DataPost we had a one-off profit of $25M in Q2 and so you need to less that off. If you're looking at six months, Roshan, then you need to less off $33M; out of $33M, $8M is from Novation Solutions in Q1, $25M is from DataPost in Q2, together they form $33M.

There's one more item that Roshan, you need to bear in mind, that when you are comparing to the previous period, there were three events that are one-off postings – the first is as we have mentioned in the narration which is SG50, the second is the General Election and the third would be the Philatelic Stamp Exhibition so these are one-off postings. So as a result, you do have that slight peak in last year for these various one-off events.

I will now perhaps ask Sam to answer…

Mr Roshan Behera (Bank of America):

Thanks, thanks Mervyn. Just for the last three events, is it possible to sort of quantify the benefits from them?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Well, in terms of the three events, I will give it to Mr Woo to perhaps help answer that question.

Mr Woo Keng Leong (CEO, Postal Services):

Thanks Mervyn, this is Woo from Postal. The three major events – I'm afraid that we can't provide the breakdown but you can see from the events there; you can imagine that SG50 will have the biggest effect. The other two will be the General Election as well as the philatelic sales of the World Stamp Exhibition. I think as compared to SG50, these two will be smaller.

Mr Roshan Behera (Bank of America):

Thank you.

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

Roshan, Sam Ang here. Your question on what are we doing with Alibaba, what kind of collaboration we have with Alibaba…Bascially as a eCommerce logistics player, what we do other than order fulfilment we also do the shipments in and out; parcel shipments in and out, especially for Singapore as a hub into the various regions and also the last-mile delivery, including doing that for Alibaba's newly acquired baby; Lazada, we are also working with them. So on all aspects of it, we are doing the physical movements of the goods for Alibaba to the region – both in and out.

As for the third question regarding the size of eCommerce, in 2015 – or rather the eCommerce market in whole of ASEAN is about US$5.6, US$5.7 billion, and Singapore itself is about 17% of it which is close to a billion dollars; all these are growing at a very fast rate so that is the size of the market.

And with the high internet penetration rate in the country, in Asia – especially in Asia, Singapore is about 86%, the rest of the countries about over 40%, the potential for this eCommerce is very high. Not only that, if you look into the factors of the mobile phone penetration rate, it's growing by leaps and bounds in the country and that will result in a potential market especially with the growing middle income group for the region. While we personally always see that it's a tremendous growth potential with eCommerce and to support it as eCommerce logistics.

Mr Roshan Behera (Bank of America):

Thank you, thank you very much, Sam. Just a very basic question, a hypothetical package for example, which needs to be delivered somewhere in Indonesia for example. So the product comes here to Singapore, Singapore to perhaps the immigration centre in Jakarta or a particular location; but what happens thereafter? Is it your partner in Indonesia who takes care of the last-mile delivery or you already have a presence? I am not very clear, and is the focus to increase your presence on the ground for Southeast Asian countries?

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

Now, basically in terms of the eCommerce, I think I mentioned earlier that all the eCommerce customers are looking at options; what are the options? There are various options – whether you go by postal, you go by commercial or you go by express will depend on the condition. For example, normally a lot people ship more with free shipment; free shipment obviously the seller will ensure that it's most economical because it's free shipment and most likely will go under postal. And if it's something that is more valuable, something that they have to pay for, they likely go express or hybrid solution which I mentioned earlier. Now, when they arrive at the destination, it depends on the country, different countries – some of them we operate ourselves, some of them we work with partners, depends what is the best and most competitive option that they can give to the customers.

And on your question on whether will we be beefing up our last-mile delivery in the countries – fulfilment, order fulfilment, yes we are actually…I think you would have read the Alibaba investment into QSI; 34% of QSI, and that is an opportunity for us to reinforce and to strengthen our position from first mile to the last mile, and in areas that we believe that we need to operate on our own or areas we will pump in to build our infrastructure; in areas where we think are better off not just for us, but for our customers' customers where by going into strategic alliance with local players…we will do so.

Mr Roshan Behera (Bank of America):

OK, thank you very much, Sam. The third question I had was just checking on the trend – traffic expense has gone up by much lesser extent but your outsourced has gone…almost doubled on a year-on-year basis of course. How should we look at it for the next few quarters or the next year? Why is there such a big difference in the two?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Well, Roshan, when you talk about volume-related expenses, the expenses as you know, can be mainly divided into two parts which is traffic-related expenses and that mainly comes from International mail. So if you look at the increase in International mail and therefore the increase in outpayments, outpayments will be very much part and parcel of the increase in International mail. This has been offset also by the lower freight costs in terms of the conveyance costs, because if you remember in the last quarter, I said to you that for traffic expenses, it comprises outpayments and conveyance; outpayments is International mail, conveyance is freight, freight forwarding or Famous Holdings.

So here, we have seen that your outpayments have gone up but it's partially offset by conveyance costs in Famous Holdings area. In terms of the outsourcing position, outsourcing position is more in light of our asset-light strategy and that is mainly a function of both Couriers Please as well as Jagged Peak. In particular, Couriers Please incurred higher payouts and so this is an outsourcing cost which is really a reflection of our asset-light strategy in terms of deliveries that we outsource. So it is very much a variable cost and very much related to our strategy.

Mr Roshan Behera (Bank of America):

Alright, thank you very much Mervyn.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Thank you, Roshan.

Operator:

Thank you. Your next question comes from the line of Fransisca Widjaja from Macquarie Capital. Please ask your question.

Ms Fransisca Widjaja (Macquarie):

Hi everyone, just two questions from me. The first question is where you have in your presentation, 'rising pressures in eCommerce Logistics' – can you elaborate on this? Has there been growing competition in this space? And secondly on the decline in the Domestic business – if I look at…in the past, your decline has been maybe, 0% or maybe -1%; what's causing the more drastic decline in, I suppose, in this recent quarter? Thank you.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Thank you, Fransisca. For the first question, I will let Sam take it and the second question – I will handle that. Thank you.

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

When we mention about the competition in eCommerce Logistics, as you know there is a lot of upcoming players in the market; there are now the local players too, they are now bleeding very hard for market share and as such the pricings are very, very competitive which is a challenge to us in many aspects of it. And obviously when you have a market that the competition is very keen just to get market share, it will always erode your margin. And obviously the other point that we have is that – which is to my earlier point about pumping the volume; with volume, with our eLog hub, we hope that in the whole true aspect of the eCommerce Logistics, we can be very competitive on the true end-to-end picture.

And coming back…the point is, yes, there is increasing market competition now from various players – big and small and medium competing for the increasing share of your market.

Ms Fransisca Widjaja (Macquarie):

Has that been more competitive in this quarter compared to the other quarters or it's just been like…the thing is there has been new players since a lot time ago, I am sure, not just recently. Am I right?

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

No, but the problem is that when the eCommerce space is becoming a hotter piece now, has more visibility now, like everything else everybody wants to jump into the game to have a bite of it, and I think – especially so over the last three, four months I think the competition is very intense because we are coming close to the year end and people expect the volumes to pick up, and that's where the competition is intense.

Ms Fransisca Widjaja (Macquarie):

OK, thank you.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

In terms of the second question, Fransisca, the reason why Domestic mail has gone down again, is no surprise, it is just the way in which the trend is going throughout the world; Singapore is no exception. But in particular when you look at Q1 which is 4.3% and you look at Q2 which is 5.5%, you would see that fall has also partly been due to what we call e-substitution. E-substitution is where in particular, government and business mail has taken a fall and so what we are doing is not simply reacting to that fall, but we are trying to pro-act and…perhaps I would get Mr Woo to just explain a bit about various steps that we have taken in order to provide for cost as well as productivity savings and some of the initiatives in order to capture some of the e-substitution that is lost. Mr Woo, please.

Mr Woo Keng Leong (CEO, Postal Services):

Thanks Mervyn, this is Woo from Postal. As Mervyn mentioned, there are two reasons – one is of course the e-substitution which is a world trend; I will come back to that later, and the other one is of course that last year it was actually a very strong base as we mentioned just now. So against a stronger base, this year the drop is faster. So back the e-substitution, yes – I think a lot of the bulk mail centres like the banks and the utilities companies are actually going digital so this is something that…we still try to manage our costs so that…

Among managing the costs, there are a few things. Over at the post office side, we are actually introducing the one man half day post office; I think that is one way to manage our costs. And then we also try to use technology to drive productivity so one of them will be the S.A.M machine – that's the self-service automated machine, so we'll be replacing the machines to improve productivity.

We are actually certainly aware of the margin pressure but having talked about the cost savings, I think we also need to strike a very good balance between reducing costs and maintaining our service quality. We remain committed to provide quality service for our people. Thank you.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Thank you, Mr Woo.

Ms Fransisca Widjaja (Macquarie):

Thanks, I'm just wondering if I could follow up with something else. The Logistics margin has come down quite significantly is this related to the competition as well or is there something else that I am missing?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

So once again, I think that question was asked earlier on also. The margins at OPM level – Operating Profit Margin, has gone down from 4.9% to 3.9% half year on half year, and 4.9% to 3.2% quarter-on-quarter. The fall is due to a number of factors; the first one will be the opening of the eLog hub and that is one of the items in the bridge that we have shared with you, which is a $1.4M effect on a quarter basis and a $3.2M effect on a six-month basis. The second would be cost or pricing pressures in Quantium Solutions and SP Parcels as a result of the sluggishness in the world economy, and the third perhaps is the rather depressed trade rate and volumes across the network in terms of Famous Holdings. So a number of things have caused the OPM to decline.

Ms Fransisca Widjaja (Macquarie):

OK great, thank you so much.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Don't mention it.

Mr Jason Lim (Assistant Vice President, Investor Relations):

Operator, I think we have time for just one last question. One last caller.

Operator:

Sure, sir. The next question comes from the line of John Cheong from Maybank. Please go ahead.

Mr John Cheong (Maybank Kim Eng):

Hi Mervyn and SingPost team. Couple of questions…so I noticed that the peak capex cycle is going to be over after your SPC mall so do you expect your gearing position to reduce, and do you have any targeted net gearing ratio over the longer term? Is it possible for us to see the company going back into net cash position in the near future?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

So, you would see that in terms of the message I have shared with all of you – it's consistent, has not changed, and that is our committed capex is going to come down and our free cash flow is going to significantly improve.

So if you go to page five of the SGXNET announcement on the balance sheet, it will help you a lot by looking at that footnote and that shows that we have an outstanding capital commitment of $177M on to page five of the SGXNET announcement, which is the balance sheet. That $177M is not in the balance sheet but it represents residual capex on essentially two projects; the first is SPC mall which will represent about $170M odd, and the balance $7M is on residual capex on eLog hub. So that would be the last particular project which is SPC mall before we then see that cash flow from investments coming down to a minimum.

Of course as I have guided you all the time, we would need to have at least a running capex of about $56M to $60M to keep our network up going and in current position. So for your financial modelling, using a $56M to $60M recurring capex to maintain the cleanliness and workability of our network…it's something that is quite safe for you.

In terms of our net cash flow position, certainly I think you would see that we are in a net current liability position right now because we have intentionally funded a long term asset which is in this case capex on SPC mall, with short term borrowings and so you will find that it is lopsided from that point of view and understandably so because it is so cheap to borrow.

If you look at the cost of borrowing, it is difficult not to go short term. But having said that, our net debt position is still $248M; it's gone up from $153M and the reason is of course because of our additional borrowings for that reason that I said. Our borrowings have gone up $127M H1 on H1 and that $127M comprises mainly short term borrowings of $118M and $9M from long term borrowings. But in terms of whether we are comfortable with 21.0% gearing level, you know what, it is still very low. Is that the optimal capital structure? I think as I mentioned to you, we are very much guided by our shareholders who are very risk averse and so while we can still take on more debt, we are mindful that we need to try and balance it up with the risk profiles of our shareholders and investors. And in particular, can we take up more debt if we want to? Yes we can, because if we look at the interest cover it is a very healthy 26.6X, which is just marginally lower than 29.8X which is the previous period. So yes, we can take on. Do we want to? Maybe not at this moment because we want to balance that with the risk profile of our investors.

Mr John Cheong (Maybank Kim Eng):

OK, any chance you will retire the perpetual securities of $350M?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

The $350M has a step-up provision of 1.5% in 2022. That of course encourages the company, of course to do that buy-back so I can't give you that decision but I think the markets are aware that there is a step-up position of 1.5% of pricing.

Mr John Cheong (Maybank Kim Eng):

OK, thank you. For Alibaba investment right, so the Quantium $86M is quite clear, that will be used for investment; what about the plan for the S$170M which you are issuing shares for? Can you share what is your plan for that proceeds?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

That is public disclosure, John. In terms of the 5% that we will probably get in February, that $187M as indicated in the second placement agreement that we have signed off, is essentially in the detailed that will be indicated. But also I think in the past, in the public domain, we have already got the guidance there to the folks that 75% will be spent on strengthening our eCommerce Logistics business, with 25% for general working capital purposes. So we have guide utilisation in that respect, but there will be details in our circular that will be put out just before the EGM.

Mr John Cheong (Maybank Kim Eng):

OK, and last…during the opening of eLog hub, Tharman actually mentioned the opening of self-collection point nationwide in second half next year. How will that impact you?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

I will get Sam to take that question, John.

Mr Sam Ang (CEO, Quantium Solutions and Famous Holdings):

Well, basically SingPost…our POPStation network strategy is aligned with the government's plan to launch the federated lockers, so we started this way ahead of the market since 2005. Basically, what we are doing is we are putting out a plan to work with the government on how to manage the federated lockers; whether in what shapes and forms is still early days, but we are working a very thorough plan to ensure that we are part of this federated lockers community, so to speak.

Mr John Cheong (Maybank Kim Eng):

OK, for dividend policy that you just revised right, it's tied to your earnings – will it be tied to your earnings every quarter, say, if your 3Q earnings are very high and then you will pay a higher dividend in 3Q; or it will still follow the previous pattern where you pay the bulk of the dividend in 4Q?

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Firstly it's not tied to earnings, John, it's tied to underlying earnings; underlying earnings is the recurring part of the earnings, and we have set a 60% - 80% range on UNP. As to what every quarter's dividend will be will be decided by the Board and will be announced in that quarter. So what we have in Q1 is 1.5 cents and what we have just declared in Q2 is 1.0 cents; what will be paid in Q3 will be dependent on Q3's results, but we are guided by the range of 60% - 80% of UNP for the full year.

Mr John Cheong (Maybank Kim Eng):

Alright, OK. Thank you very much.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Thank you.

Mr Jason Lim (Assistant Vice President, Investor Relations):

Operator, I think that is all the time that we have for the questions. For all the analysts who have dialled in, thank you for taking time to dial in to our results briefing. If you have any unanswered questions, you can reach out to myself at Investor Relations. Thank you.

Mr Mervyn Lim (Covering Group CEO and Group CFO):

Thank you, everyone.

End of transcript