SingPost's Q3 FY16/17 Results Analyst Briefing, 10 Feb 2017

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 (Assistant Vice President, Investor Relations):

Good evening. Welcome to SingPost's results briefing for our third quarter and nine months FY2016/17. My name is Jason from the Investor Relations team. With me today is Covering GCEO and GCFO Mr Mervyn Lim. I'll now hand over the session to Mervyn, who will bring you through the results.

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

Thank you, Jason. Good evening and thank you for joining us today. The Group registered revenue growth of 16.8% for the quarter ended 31 December 2016, with the inclusion of our US eCommerce subsidiaries. Underlying net profit, which represents the recurring earnings of the Group, declined 28.5% from S$43.9 million to S$31.4 million. This was largely due to operating losses in the US eCommerce business, costs related to the new Regional eCommerce Logistics Hub, as well as a decline in Postal operating profit due to lower domestic letter mail volumes.

We now share some highlights of the Group's revenue performance. In the Postal segment, revenue rose 2.9% with growth in International mail revenue driven by higher cross-border eCommerce related deliveries, in particular higher volumes from the Alibaba Group. Logistics revenue rose 5.6% in Q3, led by increased eCommerce logistics volumes on the network. eCommerce revenue rose with the inclusion of TradeGlobal and Jagged Peak from November 2015 and March 2016 respectively.

Expenses rose 23.3% with the consolidation of acquisitions and change in business mix. We have invested and built capacity in our network, and are in the process of growing volumes in order to derive cost synergies. 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 14.7%, led by higher International mail terminal dues. Outsourcing services & delivery expenses rose 51.6% due largely to cost of sales and outsourced services related to TradeGlobal and Jagged Peak respectively. Depreciation and amortisation expenses were higher with the depreciation of the Regional eCommerce Logistics Hub. Finance expenses improved as a result of favourable non-trade related forex translations.

Operating profit declined 31.7% to S$37.3 million. Postal operating profit dropped 6.6% due largely to the decline in Domestic mail operating profit in line with lower letter mail volumes. Logistics operating profit declined 30.2%, reflecting costs in relation to the Regional eCommerce Logistics Hub, as well as pricing pressures in the eCommerce Logistics space. In eCommerce, operating losses was S$8.4

million, impacted by higher costs and challenges in the US eCommerce business. Property & Others operating profit declined due to unrealised trade-related foreign currency translation differences.

This slide shows the movement of the underlying net profit between Q3 FY16/17 and Q3 last year. Underlying net profit declined largely due to investments in transformation, which represented a decline of $13.6 million. In the Logistics segment, we are bearing additional costs related to the completion of the new Regional eCommerce Logistics Hub. We are incurring higher costs in the US eCommerce business, resulting in operating losses.

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 higher depreciation cost due to business expansion in anticipation of greater volumes, mainly from the Alibaba Group. Lastly, the Postal segment declined $2.7 million, with the drop in domestic letter mail volumes.

This slide shows the P&L statement for the nine months. Revenue rose 22.8%, while underlying net profit declined 22.6%, due to: costs related to the new Regional eCommerce Logistics Hub; operating losses in the US eCommerce business; loss of rental income from SPC mall redevelopment; lower associates and JV contribution largely due to 4PX expansion plans; and lower domestic letter mail volumes.

In this slide, we detail the factors that led to the decline in underlying net profit for the nine months. The factors are largely similar to that shared in the Q3 slides. Investments in transformation contributed to a $27.6 million decline, while the postal decline was $6.5 million.

We now move to our cash flow and financial position. Net cash from operating activities rose to S$152.5 million, boosted by positive changes in working capital. Cash used for investing activities included capital expenditure for construction of the eCommerce Logistics Hub, which was officially opened on 1 November 2016, and SPC retail mall, which is targeted for completion by mid-2017.

The increase in cash was largely due to proceeds of $86 million from the sale of a 34% stake in Quantium Solutions International to the Alibaba Group. The funds will be applied to strengthen QSI's network in certain geographies. With cash and short-term funds utilised for committed capital expenditure for the Logistics Hub and SPC Retail mall, borrowings rose to $414.9 million. Interest coverage ratio remains strong at 24.7x. With the increase in borrowings, Net debt to total equity ratio was 14.9% as at 31 December 2016.

Let me now share some highlights on our eCommerce-related revenues. eCommerce-related revenue now represents 50.3% of total Group revenue. Postal contributes 31% of eCommerce-related revenues, with Logistics at 29%, and eCommerce contributed 41%. Overseas revenue now accounts for 51.4% of total revenue. 36% of overseas revenue was from the US; 27% from Australia; Asia accounts for 27% and Europe the remaining 10%.

We will now move on to the segmental results.

Postal revenue rose 2.9% with the growth in International Mail partially offset by decline in Domestic mail. Domestic mail revenue declined 3.1% in line with lower business letter mails, in particular with financial institutions pushing e-statements. International mail revenue growth was driven by cross-border eCommerce-related deliveries, in particular higher volumes from Alibaba Group. Post office products and services revenue declined by 13.6%, reflecting the shift to alternative online options such as internet bill payments.

Operating profit declined 6.6%, largely due to the decline in contribution from Domestic mail. The decline in margins to 26.9% reflects the shift in mix from Domestic mail to lower margin International transhipment mail. Despite the decline, our Postal margins are still one of the highest compared to other postal organisations, which demonstrates the efficiency of our postal operations.

In Logistics, revenue rose 5.6%, driven by higher contribution from Couriers Please and Quantium Solutions from increased eCommerce-related activities. Despite depressed freight rates and lower volumes in the industry, Famous revenue rose, driven by higher contribution from Europe.

Logistics Operating profit declined to $8.8 million, largely reflecting incremental costs incurred in relation to the Regional eCommerce Logistics Hub, which was officially opened on 1 November 2016. Operating profit was also impacted by pricing pressures in the eCommerce Logistics space. On a quarter-on-quarter basis, operating profit rose 78% driven by strong volumes over the peak season.

eCommerce revenue rose with the inclusion of US acquisitions TradeGlobal and Jagged Peak. In the US, TradeGlobal faced cost pressures and challenges with key customers, while Jagged Peak exceeded revenue and operating profit targets. Details will be shared by Marcelo in slide 18. For the eCommerce segment, Operating losses rose to $8.4 million.

Next, we will go through some business and corporate updates. First, I would like Marcelo Wesseler, our CEO SP Commerce, to present the slide on the US eCommerce performance over the holiday season. Marcelo is our man in the US and he has management oversight of our US eCommerce business units Jagged Peak and TradeGlobal, as well as Asia. Marcelo, please.

Mr Marcelo Wesseler (CEO, SP eCommerce):

Thank you, Mervyn. Good evening, this is Marcelo. I will like to provide an update on the US eCommerce performance over the peak holiday season. At Jagged Peak, we had a successful holiday season with good growth in volumes and revenue, which generated positive earnings for the Group. We also achieved several new customer wins over the period, such as Unilever.

At TradeGlobal, we prioritised customer satisfaction over the peak period, which is critical to the long-term success of the business. We succeeded and achieved good service level performance in fulfilling peak period orders. However, revenue and operating profit were impacted by developments at two of our key customers. One of TradeGlobal's largest customers faced financial difficulties, and we reduced our business with them as part of risk mitigation. The customer has since filed for bankruptcy under Chapter 11 of the US Bankruptcy Code. Another key customer had decided to in-source its eCommerce freight operations.

TradeGlobal also faced cost pressures. Due to labour shortage in the Cincinnati area, higher costs were incurred for temporary fulfilment labour. Warehouse automation and new customer implementation efforts took longer than expected, which impacted productivity. I would now like to hand you back to Mervyn.

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

Thank you, Marcelo. Next, we will next provide updates on other corporate matters. SingPost had successfully completed the two transactions in the Second Investment Agreement with Alibaba.

On 27 October 2016, Alibaba took a 34% stake in Quantium Solutions International, with SingPost owning the remaining 66%. On 11 January 2017, SingPost completed the issuance of 107.6 million new shares to Alibaba Investment Limited, which increased their stake in SingPost from 10.2% to 14.4%, while Singtel remains the largest shareholder with a 21.7% stake. The two transactions added about S$269 million to SingPost's cash and cash equivalents.

Next, we are pleased to share an update on the Group CEO appointment. Mr Paul Coutts was appointed by the Board to the position of Group CEO, and as a Non-independent Director of the SingPost Board effective 1 June 2017.

Mr Coutts joins SingPost from Toll Global Forwarding, where he was CEO since February 2013 in a global role based in Singapore. With more than 20 years of experience in C-suite positions at major global logistics and postal companies, Paul is well positioned to provide overall leadership to the Group, integrate SingPost's eCommerce logistics platform and build out a globally competitive business.

We now move to the summary and outlook.

In summary, revenue growth in Q3 rose with the inclusion of US eCommerce acquisitions. Underlying net profit declined as a result of investments in business transformation – namely: Operating losses in the US eCommerce business; Costs related to the new Regional eCommerce Logistics Hub; And lower Postal Operating profit due to lower domestic letter mail volumes. For the third quarter of FY16/17, SingPost has declared an interim dividend of 0.5 cent per share.

We now come to the Outlook section. SingPost continues to build its capabilities to transform from a Singapore postal company into a leading eCommerce logistics provider, which is fundamental to securing its future. SingPost has been working to integrate acquisitions and this will remain a priority.

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.

While the Logistics segment is expected to benefit from growing eCommerce trends, the industry faces tight operating margins. The focus is to increase volumes on the network so as to derive operating leverage from economies of scale but this will take time.

The Regional eCommerce Logistics Hub obtained TOP in April 2016 and enhanced SingPost's eCommerce logistics capabilities in the region. The facility has resulted in higher depreciation and operating expenses. This is a long-term investment, and there will not be any immediate benefits to the bottom line.

The eCommerce segment operates in an environment where margins are under pressure amid intense competition and changing consumer behaviour. The Group is facing challenges in the operating environment in the US. For the nine months ended 31 December 2016, TradeGlobal has not achieved the underlying profit assumptions of the business plan which supported the investment.

TradeGlobal incurred a significant loss instead of a projected profit in the third quarter peak season and it is expected to make a loss for the full year. The business is being restructured to improve its performance.

Due to the poor performance of TradeGlobal, the Board of SingPost is of the view that there is a risk of significant impairment to TradeGlobal's carrying value. The Board will also be conducting a review of all the investments of SingPost. Impairments, if any, will be assessed based on the full financial year results and future plans for the businesses.

The redevelopment of SPC retail mall is expected to be completed around mid-2017, and leasing of the mall is on track. The Group continues to forgo rental income during the redevelopment. For the rest of FY2016/17, there will be residual capital expenditure committed for the redevelopment of the SPC retail mall.

On 11 January 2017, SingPost completed the issuance of new shares to the Alibaba Group. This increased Alibaba's stake in SingPost to 14.4 per cent, up from 10.2 per cent, and has deepened the strategic partnership.

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.

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

Thank you, Mervyn. We shall now proceed to Q&As. We also have with us other senior management members – Mr Woo Keng Leong – CEO of Postal as well as Mr Marcelo Wesseler – CEO of SP eCommerce. We are ready to take questions, operator please.

Q&A

Operator:

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 Sachin Mittal from DBS. Thank you, please ask your question.

Mr Sachin Mittal (DBS):

Thank you for the opportunity. Looks like this quarter TradeGlobal had increasing losses, the question is – is there some visibility whether going forward the losses could reduce or no? At this point it's difficult to have that visibility on TradeGlobal business. And related to this question is, I know that the SPC mall redevelopment and your logistics hub contribute. But the bigger question is would the growth from these businesses – could these be offset by the increasing losses at TradeGlobal? That seems to be the key concern for me. If you can explain…because there are some other customers that are insourcing or whether there's a bankruptcy – these are factual factors in that industry. Please share your thoughts with me on this.

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

Thank you, Sachin. This is Mervyn here. The first question on TradeGlobal losses; why? I think we explained that earlier on it's due to the challenging operating environment in the United States. Certainly the two key customers contributed towards that challenge, and these were rightfully structural events that have taken place outside the company's control. The other one which is quite unique to TradeGlobal in the Cincinnati area, Sachin, is that labour is tight down there and that has resulted in the need to increase labour rates because we needed to make sure we have enough labour for the peak season so as to meet customer satisfaction which is critical towards long-term viability of the business. And so we managed to do that successfully but unfortunately were at the expense of margins, and so that was one other reason on the cost area.

The other reason was warehouse automation and new customer implementation efforts which took longer than was envisaged and this had adversely impacted productivity. Going forward, we have already addressed this with immediate action plans and we are also re-looking at how the business can be restructured moving forward.

In terms of whether SPC retail mall and logistics hub – in terms of the contributions being able to offset the losses in TradeGlobal, certainly I think SPC retail mall, as we have mentioned in our previous quarter results, remains a non-core asset but it is a stable source of income which helps us in the transformation journey. This remains the position as we continue to reap good returns from rentals and with the SPC coming for completion by mid of this year, we see that certainly it will help in terms of contribution to the Group.

In terms of the logistics hub, that was completed on 1 April 2016, TOP, and officially launched on 1 November 2016 and that certainly is an important milestone because it completes our eCommerce infrastructural network, and so the focus that we have right now is executing on that strategy to try and push more volumes onto that network. The Alibaba transaction that has been consummated on 27 October 2016 and on 11 January 2017 has certainly accelerated the process of driving more volumes, and with that in mind is where we can get economies of scale and have operating leverage on that network. So this again, as we had mentioned in the past quarters, is a long-term investment which we will not see immediate benefits to the bottom line.

Mr Sachin Mittal (DBS):

Got it, thank you. Just a related question in terms of the three segment; Mail segment looks like the operating profit is on a downward trend because of high margins domestic mail being cannibalised. So essentially in your opinion, one should expect the operating profits to increase at eCommerce and the Logistics segments? Is that a fair assumption or no; at this point one should not assume that?

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

The key pillars are postal, eCommerce and eCommerce logistics, that is correct. Postal still remains and will remain our infrastructure and backbone to the whole business. You are right to also say that there is a dynamic change in the revenue mix as domestic mail goes down; we have not sat down and done nothing but we have really executed on our growth strategy which is where our network has pushed transhipment mail across to benefit international mail; you see the change in revenue mix between domestic and international – domestic drawing a higher margin as compared to international and so that's where you see the operating profit margin for Q3 and nine months adjusting downwards from 29.6% to 26.9% on Q3 and from 30.1% to 28.0% for nine months.

If we compare ourselves – benchmarking to most major postal companies in the world, we are still markedly better than them; they are generally reporting single digit to teens numbers, under 20% as it were, and so we are very much privileged to be in the much higher rank in the operating profit margin position.

eCommerce certainly is going through a stage of transition and we are addressing problems within the operating environment of TradeGlobal. Jagged Peak however, is doing well and is ahead of targeted profits and revenue and so this is something that we are executing on in terms of the focus on certain key challenges in the United States.

In the Logistics area, it continues to be our priority to drive volumes on that network, not only through Alibaba's collaboration but also through other commercial collaborations that we are having because at the end of the day, our network again is non-exclusive, it's an open network, people plug and play in the network and so it drives volumes up onto the network and we are seeing this to be our focus at least for this year.

Mr Sachin Mittal (DBS):

Actually – the other thing is in the longer term or in the medium term, would we see stabilisation of operating profit? Because revenue is growing, margins are lowering, reducing, would the operating profit at the Mail segment stabilise at some point in time or no, the possibility of that is low because your margins have been quite high in the past.

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

As mentioned Sachin, the change in business mix in Postal still continues; financial institutions are driving the customers towards e-statements and so we see that there is a downturn in the domestic and letter mail volumes. It will continue, it will continue, we have not reached a tipping point yet and so we are seeing that gradual dilution in that margin; where it ends we are unable to say but what we can say is that we are still significantly above most other postal companies in the world.

Mr Sachin Mittal (DBS):

Got it, thank you.

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

Don't mention it, Sachin.

Operator:

Your next question comes from the line of Low Horng Han from CLSA. Please ask your question.

Mr Horng Han Low (CLSA):

Hi, good evening. I have a few questions here, the first is with regards to the regional processing centre. Can we have an idea what is the utilisation currently that we are seeing and your earlier forecast of 10% utilisation going towards I think – it was 40%, 50%? Does it still stand?

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

Yes, currently our capacity is at 18%, we are filled up to 18% from 10%.

Mr Horng Han Low (CLSA):

Is there any updates with regards to the targeted utilisation in the next 12 months and what is the rough breakeven?

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

Sorry Horng Han, we don't give guidance on that but I can report what we are at now and so we have progressed since the last update and we are now at 18%.

Mr Horng Han Low (CLSA):

Sure.

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

As we grow the volumes, obviously the capacity will gradually be utilised over time.

Mr Horng Han Low (CLSA):

OK, just to follow up on this similar issue I have asked as well previously. Will SingPost consider allowing competitors to use your regional processing centre? Just to fill up the space and you can also leverage on their volume and so you get better economies of scale. Is that something that management will consider?

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

We are not dispelling that possibility and this is something that we throw open on the table for consideration.

Mr Horng Han Low (CLSA):

OK. Second one is again on your expenses; I do recall in my first conference call with you about a year ago, I was asking about the volume-related expenses. If I look in terms of your revenue line and the volume-related expenses consistently over the last five, six years, I do recall going through your historical numbers, the volume-related seems to be higher in terms of the year-on-year growth and I till now still don't exactly understand. I still struggle because the international mail side – I would think that the cost structure is very conducive for players like you; you have certain volumes, you should be able to squeeze customers and prices have not been raised severely high, so I'm trying to understand what goes into this 29% increase in the expenses line. It seems to be unable to reverse.

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

The volume-related very much is a function of our change in business mix, we are still going through that change, Horng Han, the business mix as we go more towards logistics volumes the margins are thin, as you know the competition currently is quite intense and with the economy as it were, pricing pressures are also adding on to that challenge. So as such, we do see the disparity between the expense increase of 23% and the revenue increase of 16.8%. When do we see that trending down towards a more tandem increase in both expense and revenue? We would see that happening as we get operating leverage when volumes are driven on it, then we would see it. Obviously when the economy turns around, pricing pressures become less intense, that will also help the process.

Mr Horng Han Low (CLSA):

My last question is on eCommerce. I'm trying to understand with regards to the business strategy, I understand that there may be a likelihood of impairment; that could be more of an accounting treatment in my perspective, but from an operational perspective, is that a likelihood that SingPost will look to scale down because it seems like the more eCommerce volumes, the more you sell the higher the losses, and that doesn't seem to be able to reverse given the trend. I'm just trying to gauge what sort of quarterly losses should we be projecting from the eCommerce line?

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

The problems in TradeGlobal in particular, have been identified and action plans have already been executed for those problems; they are quite unique to TradeGlobal.

As regards to the other eCommerce entities, we are quite happy with the performance; Jagged Peak has done well, it is well ahead of the profit and revenue targets and the Singapore eCommerce entity has also done well by turning around the position in terms of both revenue and losses, cutting down the losses. So both these entities are moving in the right direction.

In terms of TradeGlobal however, that has its own peculiar challenges which we are aware of and we have already addressed. We have also stated clearly that some of those challenges unfortunately, have been structural in nature, Horng Han, we would have liked it not to happen but again we are not living in a perfect world and so with one entity declaring bankruptcy under Chapter 11 on 17 January 2017, and another deciding to choose to in-house its freight business, we've had now to put forward the focus of finding replacements to that revenue that have been lost.

Mr Horng Han Low (CLSA):

Now, those two customers – the one that has filed for bankruptcy and the other which is going to do in-house, how much revenue contribution do they account for?

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

They are two of our top customers, Horng Han, but we have not disclosed yet on quantum that these two have contributed towards the whole revenue. It's part of our market disclosure policy, I'm sorry.

Mr Horng Han Low (CLSA):

This point I understand, just one last one – will you look to scale down TradeGlobal; if I could rephrase my question then, rather than just focus on eCommerce but TradeGlobal? Given that having the presence there and the operating leverage – the negative operating leverage may take quite a while to reverse.

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

One of the things that we have identified is of course things that we can improve in our process flows, in our productivity area within the warehouse area and as we are building a standardised platform, the only way we can get additional improvement in the business is perhaps by getting more volumes onto the platform. So just as we have lost volumes from these two key customers, we need now to source for replacement revenues in new businesses and so this is where the marketing team is going out.

Simultaneously we are looking at our cost structure and we are looking at how we can restructure it, how we can perhaps operate more efficiently with productivity coming in through warehouse automation; although it's a bit low, we hope to get that implemented this quarter, we would see then that there should be cost savings which will grow in tandem with additional businesses coming in from the sales team. So the sales team is working very hard now to try and get the replacement revenues for the two key customers that have been lost.

Mr Horng Han Low (CLSA):

OK. Thank you very much, Mervyn. Thank you, appreciate that.

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

No mention, Horng Han.

Operator:

Your next question comes from the line of Thai Wei Ying from UOB Kay Hian Research. Please ask your question.

Ms Thai Wei Ying (UOB Kay Hian):

Hi, thank you for taking my questions. I just have a question regarding SPC mall, can I know how much has been committed in terms of tenancy as of today?

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

I'm unable to comment because again of market disclosure policy, but we can say again the statement which we have earlier made just in case you were not aware of it. We have secured Kopitiam, we have secured GV Grand, and we have secured a supermarket.

Having said that, we have made a statement in our announcement that it is on track in terms of filling up the new SPC mall in time for the opening mid of this year.

Ms Thai Wei Ying (UOB Kay Hian):

OK, just another question. Can you sort of give me a sense of how much the cross-border eCommerce volume has increased year-on-year for this quarter?

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

Wei Ying, we are again unable to comment on that. But we can say that we are benefiting from the increase in cross-border transhipment volumes and you can see this indirectly by looking at International mail. If you look at International mail, our volumes have increased and this has resulted in an 11.0% increase in the Q3 on Q3 revenue stream for International mail; a large portion of that comes from transhipment mail.

Ms Thai Wei Ying (UOB Kay Hian):

OK, thank you so much.

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

Thank you, Wei Ying.

Operator:

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

Ms Fransisca Widjaja (Macquarie):

Good evening, thank you for the presentation. I have two questions on SingPost, the first question is the competition in terms of logistics and postal business; to what extent is this caused by new players trying to enter and then discounting heavily? And do we expect an improvement at some point or an easing of competitive environment at some point when they are happy with their market share and such? And the second thing is the issue with TradeGlobal – is the vision still to do an end-to-end eCommerce; because the idea was to have this US arm where you sort of have collaboration with the different brands and then you also maybe bring it to Asia and this could also boost your logistics volume. Is there sort of a fundamental issue with the vision or it's still the same?

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

OK thank you, Fransisca. Addressing the first question – the competition on the logistics and postal platform, we have shared with our folks out there that our network is unique; it is non-exclusive to anyone and what we do as a network is we collaborate with people, we have partners, we have business partners and so really, no one is our true competitor on the network. Anybody that can add value and bring volumes on it, we take.

However having said that, within the postal and within the logistics area they would have their own unique competitors in that area; Logistics would have their own unique competitor, but we have also the first right of refusal wherein each pillar head must be competitive in terms of pricing and so if the customer finds – or if for purposes of satisfying the customer and giving him good service, we can find a third party supplier with better margins and better pricing that the pricing that we can give based on our own business, we will then use that partner. And so the only way that these pillar heads can keep the business to themselves is by making sure that they are as competitive as their own external competitors within that same pillar. So from that angle, we see everybody as potential collaborators on that network.

The area on TradeGlobal end-to-end, could you repeat that question again, Fransisca? I didn't quite get you on that question.

Ms Fransisca Widjaja (Macquarie):

So the end-to-end eCommerce – I mean the whole idea was sort of to partner up with different retailers to become the monobrand; to have this monobrand strategy, to do the end-to-end eCommerce for these guys right?

Mr Marcelo Wesseler (CEO, SP eCommerce):

Yes.

Ms Fransisca Widjaja (Macquarie):

Is the vision still the same? I mean looking at the recent issues, is it a fundamental problem with the business model or is it something – the vision is still the same it's just that company specific issue?

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

Fransisca, I'll let Marcelo take this question.

Mr Marcelo Wesseler (CEO, SP eCommerce):

The vision is still absolutely the same and we've had some good examples with customers like Calvin Klein that we've had in the US that we've launched now in Hong Kong and across Asia Pacific. We've also had good examples with Nestle that we've had in the US that we've rolled out in Asia. The vision is still definitely the same.

Ms Fransisca Widjaja (Macquarie):

OK. Alright, thank you. The other thing that I wanted to ask was on the Alibaba partnership. So on the third quarter it seems to average on 20% to 30% for the past two quarters and this quarter is about 11%. Is there any reason for the slowdown? Do you think it's going to pick up? Any detail around that would be great.

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

Hi Fransisca, the reason why you are seeing a lower growth rate in the International mail revenues is because the collaboration with Alibaba and Cainiao started in October 2015, so for the past three quarters the year-on-year growth rate does not have an equivalent comparable in the base, whereas for this Q3 we are having a comparable base last year.

Ms Fransisca Widjaja (Macquarie):

Right, right, OK.

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

So it's an apple for apple comparison that we need to be mindful about.

Ms Fransisca Widjaja (Macquarie):

OK, alright. Thank you, thank you very much.

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

Thank you.

Operator:

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. Just on TradeGlobal – sorry to harp on that, based on your review so far, do you see the asset turning profitable in the two, three or five years' time horizon? And as part of your review that you're conducting now, what needs to change? Is it the material improvement in volume as you mentioned as you go out for customers, or a material drop in cost? That's the first question.

Second one, you mentioned two of your top customers – one took the eCommerce business in-house, the other one bankrupt. If I just stretch that argument, possibly a customer which sees eCommerce growing would take it in-house and what would end up being with SingPost would be smaller or mid-tier customers, which would be possibly open to risk of business challenges.

So in that kind of scenario, how do you see TradeGlobal in having a very viable and sustainable business on a medium to long-term basis? Thanks.

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

Roshan, let me take the second question, still fresh in my mind. So the two customers – one filing for bankruptcy, the other one you asked about choosing to insource its freight business and this really hits the nail on the head because one of the things that we said earlier on is that we took the decision to get in temporary fulfilment labour, even though the labour rates went up significantly during the holiday period and this has impacted our margins and gross margins significantly. And we did that because we did not want the risk of losing the customer relationships or customers and so the only way to do that is by making sure that we can satisfy the peak period volumes in terms of picking and packing. The team did a very good job there and they managed to meet all SLAs and so that meeting of SLAs has in that sense managed to secure those customers who are doing a good business with us, and we doing good business with them. And so that is vital for us in making the customers sticky and getting their loyalty; if we don't do that then there is certainly a risk, that business could be insourced and so this is again explaining the reason why we took that decision, notwithstanding the fact that the rates went up during that holiday period and logistics companies in the Cincinnati area were actually competing with each other for temporary labour.

In terms of the TradeGlobal asset, how long it would take to turnaround – again, what we are doing is immediate action plans, low hanging fruits that we can easily see as having to be taken from a cost side. You asked what are the two key areas; certainly from the cost side, not only that, you would understand that business has grown smaller in size now by the two customers which we have lost and we need now to grow out the business, grow out the business by getting additional volumes to replace those that had been lost. So while we manage cost, Marcelo's team is working very hard to get new businesses in and I think he has made some good progress in new brands which have been secured but again, we have not disclosed that again, for market disclosure reasons as yet.

Mr Roshan Behera (Bank of America):

Thanks, Mervyn. If I may follow up, this review that's been done for TradeGlobal and some of the other assets, is that review just around the book value of these assets and hence a look at their potential risk of impairment? Or stretching it further out, you'll see if TradeGlobal kind of business would add long term value to the company or not? Just some colour there would be helpful.

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

The review is strategic, Roshan. It's strategic meaning that it looks at the overall business to see how we can improve the business and therefore we're looking at the review side of the business plan. The business plan would comprise a number of items which indirectly as a subset of the business plan then looks into the forecasts and the projections which then ultimately go into more accounting base requirements as part of the audit, which is impairment reviews. So when we look at the word 'review', it's more of a holistic angle, then we're looking at how it can contribute towards the business or the value of SingPost as a whole, and in so doing, we are reviewing also the forecast projections which in turn goes towards driving future cash flows and therefore determine the value in use.

Mr Roshan Behera (Bank of America):

Very clear. Thanks, Mervyn.

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

Thank you, Roshan.

Operator:

Thank you. Your next question comes from the line of John Cheong from Maybank. Please ask your question.

Mr John Cheong (Maybank Kim Eng):

Hi, a question on the US eCommerce business. I understand that this is the peak quarter and Jagged Peak did pretty well and TradeGlobal actually incurred some losses. Maybe you can share with us what kind of profitability – a breakdown of the profitability between TradeGlobal and Jagged Peak so we can fine tune our modelling.

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

John, again I think we had been asked that question in the previous quarters. Again unfortunately, we can't disclose that, our results are all by segments; we do a breakdown at revenue level but we don't do a breakdown at operating profit level. Suffice to say however that Jagged Peak is profitable and TradeGlobal is in loss for Q3.

Mr John Cheong (Maybank Kim Eng):

OK, or another way – is TradeGlobal's losses or US eCommerce losses going to go deeper moving forward after this due to more structural issues, and also the end of the peak period where Jagged Peak actually can buffer for the losses of the US eCommerce business?

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

Maybe perhaps to give a bit more detail on the operational improvements that we are making in TradeGlobal, I'll let Marcelo speak to you about it but certainly in terms of Jagged Peak it is well ahead of the business case, both at revenue and profit level.

So Marcelo, would you like to share some improvements that we are looking at in TradeGlobal?

Mr Marcelo Wesseler (CEO, SP eCommerce):

I think the key improvements here are on the warehouse automation side and so there we become more efficient and productive within the warehouses. The second part is then related to the current structure of the business so that we can be more efficient when it comes to on boarding new customers. So these are the two main challenges that we currently see. You might have seen that we've also announced a new President for TradeGlobal that joined us in the later part of last year. So with those changes, I think we feel very comfortable that we will see better performance going forward.

Mr John Cheong (Maybank Kim Eng):

OK, another question on the International mail revenue. Someone asked the question just now; we've gone from about 20% down to 11% growth year-on-year. Moving forward, is this going to continue at double digit or this growth is going to decline as we have reached a higher base?

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

International mail in itself has two main components. The first is transhipment mail and the second would be your incoming, outgoing mail, and so what we are trying to do now as a focus is to increase our outgoing mail which also commands better margins as compared to transhipment mail which mainly we benefit from Alibaba's volumes from Cainiao right into our transhipment network. So we expect to grow that revenue from both sources which is transhipment as well as outgoing, and so our focus for this current year is actually trying to improve our outgoing mail while the transhipment mail continues to grow quite well especially with Alibaba's two transactions which have consummated, which have deepened our collaboration. Our collaboration also extends towards conversations with Cainiao, Lazada and even Redmart.

Mr John Cheong (Maybank Kim Eng):

OK, on the operating margin front for Domestic mail and International mail, do you see a decline in the operating margin in International mail?

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

International mail currently is about one-third of Domestic mail. The decline in mail margins – International mail margins is really the function of the change in the business mix between transhipment mail and incoming, outgoing mail and so we are managing that dynamic change in both sources of revenues in International mail.

Domestic mail remains high per se but the problem here is that the volumes are coming down right? So while that gets a higher margin percentage, our margins absolute dollars will come down if the volumes are driven down. So what we are managing here is to try and grow our outgoing mail in

International mail so that we can at least improve the operating profit margin of International mail per se.

Mr John Cheong (Maybank Kim Eng):

Has the operating profit margin for transhipment been falling or holding still?

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

It's more or less there. Hold on please.

John, I will hand you over to Mr Woo. He can perhaps explain that.

Mr Woo Keng Leong (CEO, Postal Services):

Hi, I am Woo Keng Leong here from Postal. So I think for the mail profile – both Domestic mail as well as International mail, if there are changes in the revenue mix, if there changes in the mail type, the margins definitely will be adjusted accordingly; there will be some higher, there will be some lower. So it will go with the revenue change, it will go with the mail profile change.

Mr John Cheong (Maybank Kim Eng):

OK. Maybe – I am just trying to clarify, you've gotten more volume from Alibaba right? So do you charge Alibaba lower prices in exchange for higher volumes?

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

John, we can't disclose that. That is commercial so we can't disclose information on pricing.

Mr John Cheong (Maybank Kim Eng):

OK, no problem. Thank you very much.

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

Thank you, John.

Operator:

Thank you. Your next question comes from the line of Jessalynn Chen from CIMB. Please ask your question.

Ms Jessalynn Chen (CIMB):

Hi Mervyn and team, thanks so much for having this call. I have a couple of questions; the first one is on International mail again, just trying to understand what specifically led to the increase in the International mail revenue – was it largely AliExpress volumes during the peak period or did you expand into a new market?

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

Yes the question there – it comes from Transhipment mail which is from AliExpress, yes.

Ms Jessalynn Chen (CIMB):

Was it just because of the peak period, because of Singles' Day, Black Friday and all that? Or…?

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

Contributed, yes Jessalynn. Certainly.

Ms Jessalynn Chen (CIMB):

OK.

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

So the bulk of the increase in 11% - I think one of our other folks out there asked a similar question, I said the increase in International mail really comes from that cross-border transshipment mail, cross-border transhipment volumes which is aided very much through AliExpress, yes.

Ms Jessalynn Chen (CIMB):

I see, were there any new markets that you expanded into?

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

No, no new markets.

Ms Jessalynn Chen (CIMB):

And, correct me if I am wrong but I understand that your terminal dues could be revised up next year. Do you think that this will significantly affect your competitiveness in the transhipment business?

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

I will perhaps hand you over to Mr Woo. Suffice to say that we are looking at this separately, but Mr Woo, you may want to shed some light.

Mr Woo Keng Leong (CEO, Postal Services):

Thank you, Mervyn. Yes, transhipment business is a very competitive business but we never compete on price because transhipment business is not just about the pricing; it's also about the turnaround, the service quality. So we always compete on service quality together with price, so even though terminal dues may have some effect on the pricing, we will find the cheapest way, we will find the most cost effective way to move around the mail. Together with the service quality, I think we'll still be a leading player there. Thank you.

Ms Jessalynn Chen (CIMB):

Thank you, and I just have a question on TradeGlobal. Can we expect the staff costs to fall next quarter given that the peak period is over and TradeGlobal would no longer need this seasonal fulfilment labour?

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

The staff costs is put under cost of sales so if you look at our volume-related expenses on slide four, you will see that volume-related can be divided into traffic-related as well as outsourcing and outsourcing would have an item there called cost of sales; so cost of sales would relate to the temporary fulfilment labour. So as we have finished the peak season, most of that temporary labour has already been released. However, we are still keeping some labour to cater for customer returns. But certainly in terms of the temporary fulfilment labour, most of them have already been released.

Ms Jessalynn Chen (CIMB):

Are you able to share with us how much has TradeGlobal contributed to this volume-related expense?

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

Well, if you look at the increase, the delta between last year and this year for cost of sales and outsourced services, the increase is very much due to TradeGlobal as well as Jagged Peak.

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

Yes, when we talk about the outsourcing and delivery expenses, that comprise two areas – cost of sales as well as outsourcing which goes into Couriers Please and Jagged Peak, so you're looking at a mix of three possibilities down there.

Cost of sales is uniquely related to TradeGlobal. The split in that number – we don't usually disclose that split, we keep it purely to outsourcing and delivery expenses but suffice to say it comprises cost of sales as well as outsourcing which is most of the cost related to rentals for warehouses because in the case of Jagged Peak, it is asset-light and so they don't own most of the warehouses; it is leased out so that goes into outsourcing piece.

Ms Jessalynn Chen (CIMB):

OK, just one last question from me. Do you think that the US will continue to be a part of your core strategy or do you think that you will divest the business and refocus on Asia?

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

Our strategy still remains intact in terms of providing an end-to-end eCommerce logistics solution. Certainly we are strong in Southeast Asia and our plan to try and have a two-way flow from Southeast Asia, Oceania into the US and vice versa still remains our position; we have not however integrated very fast. We wanted to but because of the unique challenges that have come about in the US, some being structural and others being things that are unique to a particular location like Cincinnati, we had to have perhaps delay on that integration efforts to solve the problem first of all in the entity first, before we talk about integration.

As regards to Jagged Peak, it is proceeding well and so Jagged Peak is looking towards brands that we can then cross into Southeast Asia like Ironman.

Ms Jessalynn Chen (CIMB):

OK, thank you so much.

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

Thank you so much.

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

Hi everyone, I think we just make time for one last question before we call it a day. Operator, can we have one last question please?

Operator:

Your next question comes from the line of Roshan Behera. Please ask your question.

Mr Roshan Behera (Bank of America):

Hi, just a clarification on a potential impairment. This would not impact your dividends right, it would be considered one-off, just wanted to reconfirm that.

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

That is correct, Roshan. Our dividend policy has been set at 60% to 80% of underlying net profit. An impairment is first of all non-cash in nature and secondly it would not impact our underlying net profit.

Mr Roshan Behera (Bank of America):

OK, just two more questions. One, is there any sort of colour you could share on trends you are seeing in the March quarter? And second question would be for the postal revenue and profit, particularly on the Domestic side, do you expect the low to mid single digit kind of drop to continue or you see a risk of accelerated drop in the Domestic postal business?

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

OK, I'll let Mr Woo answer the second question on postal, how we see the tipping point going forward. But in terms of the first question, in terms of the trends in March or Q4, again I'm sorry; market disclosure, we cannot give you any guidance there Roshan. Mr Woo, second question please.

Mr Woo Keng Leong (CEO, Postal Services):

Thank you. On the Domestic mail volume, I think with the financial institutions pushing for e-statements I think we continue to see the drop in the letter and statement business, but we do have other growth areas within the Domestics mail although they could be quite small.

We have been seeing the growth in the eCommerce items in Singapore – that is growing and we are putting all our resources together to grow the direct mail as well although there are some challenges, we are also putting our best efforts to grow. So overall, while we see big challenges in the drop in letter mail, we do have other plans to grow other types of mail, that is as far as Domestic mail is concerned. Back to Mervyn.

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

Thank you, Mr Woo. Thank you, Roshan.

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

OK. Thank you, everyone for dialling in. I think that is all the time we have for the questions. If you have any follow-up questions, please feel free to contact myself.

Thank you very much and have a good night.

End of transcript

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