

COMPANY UPDATE

SATS (SATS SP)

WFS Acquisition: Buying A Strategic Fit In Uncertain Times

SATS has proposed to acquire 100% of WFS for a cash consideration of €1.19b (\$\$1.64b). While we acknowledge that WFS is a good strategic fit for SATS, we are cautious about the impacts that a possible global recession may have on air cargo businesses. In addition, the weak equity market sentiment amid the rising interest rate environment may not be in favour of SATS' equity raising plan. Downgrade to HOLD, with a lower target price of S\$3.82.

WHAT'S NEW

- **The proposed acquisition.** SATS has proposed to acquire 100% of Worldwide Flight Services (WFS) for a cash consideration of €1,187m (\$\$1,639m). Besides the acquisition of WFS' equity, SATS will assume the existing debts on WFS' balance sheet, leading to a transaction enterprise value (EV) of €2,250m (\$\$3,107m). The closing of the acquisition is subject to the satisfaction of precedent conditions, including shareholder approvals during an EGM (which SATS expects to convene by early-23). SATS noted that its 40% shareholder Temasek has provided an irrevocable undertaking to vote in favour of the proposed acquisition.
- **Financing plan.** To finance the purchase of WFS' equity, SATS has indicated a base funding plan entailing S\$1.7b of equity fund raising, which may comprise a renounceable rights issue to shareholders and a private placement of common or hybrid equity (eg convertible instruments) to institutional and/or strategic investors.
- **About WFS.** Founded in 1971, WFS is the world's largest air cargo handler, handling over 6.3m tonnes of cargo annually (compared with SATS' 2.8m tonnes p.a.). It has presence in 164 locations across 18 countries, and serves a diversified blue chip customer base with relationships spanning up to 35 years. WFS recorded revenue of €1.7b (\$\$2.6b) in the 12 months ending Mar 22, 79% of which was from cargo businesses (WFS' strategic focus) and the remaining 21% from ground handling and ancillary services. 59% of WFS' revenue was derived from North America, followed by EMEA (34%), South America (3%) and Asia (3%).

STOCK IMPACT

- **A good strategic fit.** We agree with management that WFS is a good strategic fit for SATS. The portfolio/network of SATS and WFS are highly complementary to each other – SATS is currently concentrated in Asia while WFS is strong in North America and Europe with leading positions at key air hubs in the two regions. Out of the 164 locations WFS operates from, only four overlap with SATS' existing locations. The acquisition will transform SATS from an Asia-focused operator to a global leader in aviation services.

KEY FINANCIALS

Year to 31 Mar (\$\$m)	2021	2022	2023F	2024F	2025F
Net turnover	970	1,177	1,812	2,163	2,453
EBITDA	120	77	190	325	465
Operating profit	(10)	(43)	25	160	298
Net profit	(79)	20	64	154	266
EPS (\$\$ cent)	(7.0)	1.8	5.7	13.7	23.6
PE (x)	n.m.	213.5	67.6	28.3	16.4
P/B (x)	2.8	2.7	2.6	2.5	2.3
EV/EBITDA (x)	32.4	53.9	22.3	13.3	9.3
Dividend yield (%)	0.0	0.0	0.8	2.6	4.9
Net margin (%)	(8.1)	1.7	3.6	7.1	10.8
Net debt/(cash) to equity (%)	(11.9)	(15.0)	(9.4)	(4.7)	(2.9)
ROE (%)	n.a.	1.3	3.9	9.0	14.6

Source: SATS, Bloomberg, UOB Kay Hian

HOLD

(Downgraded)

Share Price	S\$3.87
Target Price	S\$3.82
Upside	-1.4%
(Previous TP)	S\$4.20

COMPANY DESCRIPTION

Asia's leading provider of food solutions and gateway services with a presence in over 55 locations across 14 countries.

STOCK DATA

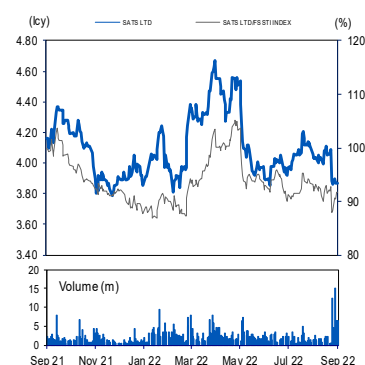
GICS sector	Industrials
Bloomberg ticker:	SATS SP
Shares issued (m):	1,124.2
Market cap (\$\$ m):	4,350.6
Market cap (US\$m):	3,009.1
3-mth avg daily t'over (US\$m):	6.2
Price Performance (%)	

52-week high/low S\$ 4.67/S\$ 3.79

1mth	3mth	6mth	1yr	YTD
(5.8)	(2.8)	(11.6)	(7.0)	(0.5)

Major Shareholders	%
Temasek Hldgs	41.0
-	-
-	-
FY23 NAV/Share (\$\$)	1.49
FY23 Net Debt/Share (\$\$)	0.13

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- Potential for synergy realisation.** According to management, some near-term synergies would include: a) cross-selling opportunities to the combined customer base, b) enhanced service offerings backed by the enlarged network, and c) savings from cost mutualisation and economic of scale. Synergies that may be realised in the medium term include: a) the potential launch of e-commerce cargo partnerships across the globe, b) acceleration of cargo automation and c) reinforcement of downstream cargo logistic offerings. Management estimates that SATS could realise EBITDA synergy in excess of S\$100m p.a. in 3-5 years after the acquisition, on top of WFS' current EBITDA of €232m (S\$350m).
- Acquisition valuation not a bargain but within reasonable range.** The implied transaction EV/EBITDA multiple of 9.7x (pre-synergies) is slightly richer than SATS' current price implied FY25 (normalised year) EV/EBITDA of 9.3x by our estimate. However, it is slightly lower than 10.2-10.7x peer transaction EV/EBITDA multiples provided by SATS' financial advisor.
- Pro forma financial impacts.** Based on SATS' assessment, assuming the acquisition had been completed at the start of FY22, SATS' FY22 pro forma revenue would have expanded about 3x to S\$3.8b (FY22 reported: S\$1.2b). FY22 pro forma EBITDA would have expanded about 5x to S\$445m (FY22 reported: S\$94m), and pro forma gross-debt-to-equity ratio at end-FY22 would have risen to 71% (end-FY22 actual: 46%). As WFS had negative net tangible assets of €829m (negative S\$1,250m) as of 31 Mar 22, the transaction is expected to lead to a significant amount of goodwill and intangible assets being recognised on SATS' balance sheet, but the exact amount of goodwill and intangible assets are subject to SATS' purchase price allocation.
- Cautious about air cargo outlook amid global recession.** While acknowledging the good strategic fit of WFS for SATS and the synergies that could be potentially realised, we are cautious about a weakening air cargo demand outlook amid a potential global recession. In its most recent press release, globally leading cargo airline FedEx Express reported that its air cargo business saw a US\$500m revenue shortfall in the three months ended in 31 Aug 22 against its previous forecast as "macroeconomic trends significantly worsened" and FedEx expects "business conditions to further weaken". Another global leading logistic player DHL, in its Sep 22 issue of Airfreight State Of The Industry report, noted that global air freight demand had declined 10% yoy in Aug-22. Volumes remain softened with inflation playing a major role in global volume movements and reduced purchasing power. DHL also noted that the improving conditions in sea freight were pulling some business away from airlines.
- Market sentiment may not be in favour of equity raising.** Stock market sentiment is expected to be weak in the near term amid the rising interest rate environment. Based on the median forecast by Federal Reserve (Fed) officials, the Fed is expected to hike benchmark rates to as high as 4.6% in 2023, from the current level of 3-3.25%. The rate hike expectation has led to investors staying on the sidelines as they wait to buy shares at cheaper valuations. We caution that the weak stock market sentiment may not be in favour of SATS' planned equity raising and may lead to sell-offs of SATS shares ahead of the equity raising.

EARNINGS REVISION/RISK

- No change.** We have yet to incorporate any financial impact from the WFS acquisition as it is still early stages and there remain uncertainties related to SATS' equity financing plan. We will update our forecasts pending more clarity.

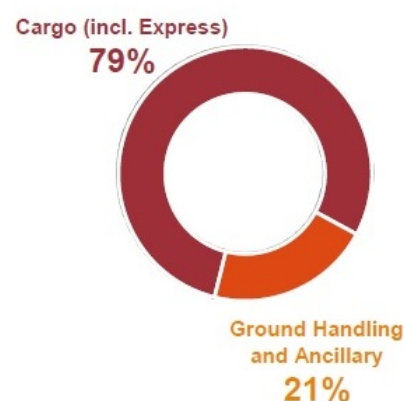
VALUATION/RECOMMENDATION

- Downgrade to HOLD with a lower DCF-based target price of S\$3.82.** We have hiked our WACC applied by 50bps from 7.5% to 8.0% to account for the upward pressure of risk-free rates. Based on our sensitivity analysis, our target price for SATS would be lowered to S\$3.50 if a WACC of 8.5% is adopted.

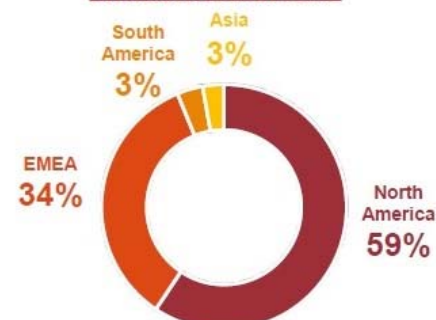
KEY FACTS ABOUT WFS



Strategic Focus on Cargo LTM March 2022 Revenue



Diversified Global Footprint LTM March 2022 Revenue



Source: SATS

PROFIT & LOSS

Year to 31 Mar (\$m)	2022	2023F	2024F	2025F
Net turnover	1,176.8	1,812.1	2,163.3	2,453.2
EBITDA	77.1	190.2	325.0	465.2
Deprec. & amort.	119.7	165.0	165.0	166.8
EBIT	(42.6)	25.2	160.0	298.3
Total other non-operating income	12.2	18.4	0.0	0.0
Associate contributions	17.1	23.5	31.5	38.2
Net interest income/(expense)	(13.8)	(10.7)	(7.0)	(6.7)
Pre-tax profit	(27.1)	56.4	184.5	329.9
Tax	31.4	1.1	(30.6)	(58.3)
Minorities	16.1	7.0	0.0	(6.0)
Net profit	20.4	64.5	153.9	265.6

BALANCE SHEET

Year to 31 Mar (\$m)	2022	2023F	2024F	2025F
Fixed assets	902.4	998.9	1,095.5	1,192.4
Other LT assets	1,093.9	1,085.6	1,080.0	1,076.6
Cash/ST investment	786.0	578.1	493.9	460.7
Other current assets	510.0	591.7	682.6	759.6
Total assets	3,292.3	3,254.4	3,351.9	3,489.3
ST debt	143.1	101.4	101.4	101.4
Other current liabilities	487.5	502.9	513.9	525.6
LT debt	694.8	625.7	625.7	625.7
Other LT liabilities	133.2	133.2	133.2	133.2
Shareholders' equity	1,602.6	1,667.1	1,753.6	1,873.3
Minority interest	231.1	224.1	224.1	230.1
Total liabilities & equity	3,292.3	3,254.4	3,351.9	3,489.3

CASH FLOW

Year to 31 Mar (\$m)	2022	2023F	2024F	2025F
Operating	62.3	129.7	204.5	331.5
Pre-tax profit	(27.1)	56.4	184.5	329.9
Tax	(17.0)	1.1	(30.6)	(58.3)
Deprec. & amort.	119.7	165.0	165.0	166.8
Associates	(17.1)	(23.5)	(31.5)	(38.2)
Working capital changes	(0.3)	(66.3)	(79.9)	(65.4)
Non-cash items	19.5	18.4	0.0	0.0
Other operating cashflows	(15.4)	(21.4)	(3.0)	(3.4)
Investing	31.1	(199.5)	(194.1)	(191.5)
Capex (maintenance)	(77.9)	(218.2)	(218.2)	(220.4)
Investments	80.6	0.0	0.0	0.0
Proceeds from sale of assets	0.7	0.0	0.0	0.0
Others	27.7	18.7	24.1	29.0
Financing	(189.3)	(138.1)	(94.6)	(173.2)
Dividend payments	0.0	0.0	(67.3)	(145.9)
Issue of shares	0.0	0.0	0.0	0.0
Proceeds from borrowings	21.1	0.0	0.0	0.0
Loan repayment	(182.0)	(110.8)	0.0	0.0
Others/interest paid	(28.4)	(27.3)	(27.3)	(27.3)
Net cash inflow (outflow)	(95.9)	(207.9)	(84.2)	(33.2)
Beginning cash & cash equivalent	879.8	786.0	578.1	493.9
Changes due to forex impact	2.1	0.0	0.0	0.0
Ending cash & cash equivalent	786.0	578.1	493.9	460.7

KEY METRICS

Year to 31 Mar (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	6.5	10.5	15.0	19.0
Pre-tax margin	(2.3)	3.1	8.5	13.4
Net margin	1.7	3.6	7.1	10.8
ROA	0.6	2.0	4.7	7.8
ROE	1.3	3.9	9.0	14.6
Growth				
Turnover	21.3	54.0	19.4	13.4
EBITDA	(36.0)	146.8	70.9	43.1
Pre-tax profit	n.a.	n.a.	227.2	78.8
Net profit	n.a.	216.1	138.7	72.6
Net profit (adj.)	n.a.	216.1	138.7	72.6
EPS	n.a.	215.8	138.7	72.6
Leverage				
Debt to total capital	31.4	27.8	26.9	25.7
Debt to equity	27.9	21.2	20.2	19.0
Net debt/(cash) to equity	(15.0)	(9.4)	(4.7)	(2.9)

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