SECTOR UPDATE

Aviation – Singapore

China's Reopening Injects New Momentum To The Sector's Recovery In 2023

The swift reopening of China to international travellers starting from 8 Jan 23 is expected to inject new momentum to the Singapore aviation sector's recovery, lifting the FY23-24 earnings outlook for respective Singapore aviation plays. We maintain our MARKET WEIGHT rating on the Singapore aviation sector. We recommend BUY on SIA Engineering (New Target: S$2.70) and SATS (New Target: S$3.10), and HOLD on Singapore Airlines (New Target: S$5.40). SIA Engineering is our top pick.

WHAT'S NEW

- **Reopening of China.** In a largely unexpected manner, China has had an abrupt pivot in its stance towards treating COVID-19 in the past month. From 8 Jan 23 onwards, inbound travellers to China would no longer need to serve any quarantine period. No on-arrival test is required as well. Travellers only need to obtain negative PCR test results within 48 hours before travelling. Measures that limit the number and frequency of international passenger flights, such as the "Five One" policy, will also be scrapped.

- **Singapore among the top tourism destinations.** According to Trip.com, Singapore is among the top 10 destinations of mainland China travellers based on search volume. Other top destinations include Japan, South Korea, Thailand, Malaysia, the US, the UK, Australia, Hong Kong and Macau.

- **No additional restriction on Chinese travellers entering Singapore.** Unlike some other popular destinations which have announced to impose additional restrictions (pre-departure/on-arrival tests, possible quarantines, etc) on travellers coming from China, Singapore has maintained relatively flexible entry requirements for all inbound travellers, including those from China. To enter Singapore, travellers aged 12 and below are exempted from COVID-19 border measures; travellers aged 13 and above are only required to take minimum WHO-approved vaccine dosage (eg two doses of Sinovac vaccine) at least two weeks before arrival in Singapore.

STOCK IMPACT

- **Injecting new momentum to sector recovery.** Before the pandemic, air travel between Singapore and Mainland China was the second largest contributor to Changi airport's passenger volume, forming 10.9% of the total throughput in 2019 (second to Indonesia's 12.2%). Due to the previous restrictive international travel policy of China, as of Oct 22, the air travel volume between Singapore and China was only at 4.6% of the pre-pandemic level, significantly lagging behind the air travel recovery between Singapore and other regions which have reached 72.6% in Oct 22. Given China's faster-than-expected reopening and Singapore's accommodative entry policies, we now expect a steeper recovery trajectory of the Singapore aviation sector than we have previously projected.

- **Singapore Airlines** (SIA) is a key beneficiary from the recovery of flight activities between Singapore and China. While the supply of pax capacity is likely a limiting factor of the air travel volume recovery in the remaining FY23 (as it may take time for airlines to liaise with the Chinese authorities for approval to raise the flight frequencies and for SIA to train up its newly-recruited cabin crew), we expect the influx of fresh demand travelling from/to China should to bolster SIA's airfare and sustain high load factors of its pre-scheduled flights. FY24 should be the year when SIA see more meaningful recovery of air travel volume from/to China as flight frequencies continue to increase. To reflect these expectations, we have raised our FY23 and FY24 earnings forecasts for SIA by 1.3% and 4.6% respectively while keeping FY25 forecast intact.

- **SIA Engineering.** As the leading line maintenance and MRO services provider at Changi airport, SIA Engineering stands to benefit from increasing landing/taking-off activities and engineering service demand of flights connecting Singapore and China. To reflect a faster business volume recovery in FY24, we have raised our FY24 earnings forecast for SIA Engineering by 5.0% while keeping the FY23 and FY25 earnings forecasts.

MARKET WEIGHT

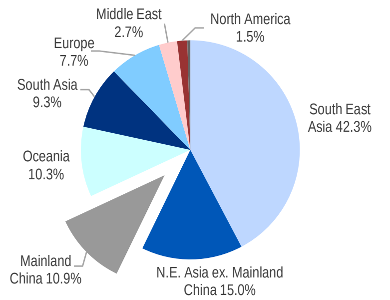
(Maintained)

SECTOR PICKS

Company	Rec	Current Price	Target Price New (Old)	Upside
SIA Engineering	BUY	S$2.40	S$2.70 (S$2.60)	+12.5%
SATS	BUY	S$2.83	S$3.10 (S$3.08)	+9.5%
Singapore Airlines	HOLD	S$5.54	S$5.40 (S$5.35)	-2.5%

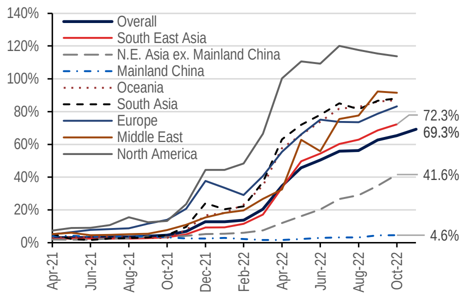
Source: UOB Kay Hian

PAX VOLUME FROM AND TO MAINLAND CHINA FORMED 10.9% OF PAX VOLUME OF CHANGI AIRPORT IN 2019



Source: Civil Aviation Authority of Singapore, UOB Kay Hian

AIR TRAVEL FROM/TO CHINA WAS A KEY DRAG TO SINGAPORE'S AVIATION SECTOR RECOVERY, WITH PAX VOLUME AT ONLY 4.6% OF THE PRE-PANDEMIC LEVELS AS OF OCT 22



Source: Civil Aviation Authority of Singapore, UOB Kay Hian

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- **SATS.** As a leading inflight catering and gateway service provider in Asia, SATS is set to benefit from the returning of Chinese travellers, not only to Singapore but also to other key destinations where SATS has a presence (eg Japan, Hong Kong, Malaysia, Indonesia, etc). Based on our rough estimate, the total direct and indirect revenue exposure to China could be in the range of 15-20% before the pandemic. To reflect a faster business volume recovery in FY24, we have raised our FY24 earnings for SATS by 4.0%, while keeping our FY23 and FY25 earnings forecasts.

EARNINGS REVISION

UPDATED EARNINGS FORECASTS FOR SIA, SIA ENGINEERING AND SATS

Company	---- Earnings forecast (old) ----			--- Earnings forecast (new) ---			-------------- Change --------------		
(S$m)	FY23F	FY24F	FY25F	FY23F	FY24F	FY25F	FY23F	FY24F	FY25F
SIA	2,300	2,486*	803	2,330	2,600*	803	+1.3%	+4.6%	-
SIA Engineering	84	131	174	84	137	174	-	+5.0%	-
SATS**	16	154	266	16	160	266	-	+4.0%	-

** FY24F earnings forecasts for SIA have included a significant one-off non-cash accounting gain of about S$1.11b from the merger of Vistara to Air India. Excluding the one-off accounting gain, our updated FY24 earnings forecast for SIA is S$1.39b.*
*** Our earnings forecasts for SATS has yet to reflected the potential contribution from WFS, the acquisition of which is subject to shareholder approval in an EGM scheduled on 18 Jan 23.*
Source: UOB Kay Hian.

RECOMMENDATION

- **Maintain MARKET WEIGHT on the Singapore aviation sector.** We have also retained the respective ratings for the three individual stocks while raising their respective target prices slightly.

- **SIA (HOLD/Target: S$5.40).** Our updated target price of S$5.40 for SIA is based on 1.06x FY24F P/B, equivalent to 1SD above SIA's historical mean P/B of 0.97x. We deem SIA's current valuation slightly stretched (at 1.3SD above historical mean) though we think near-term sentiment on SIA is likely to remain buoyant. We believe consensus FY23F earnings forecast of S$1.67b (28% lower than our forecast of S$2.33b) is conservative and due for positive surprises in the upcoming 3QFY23 result release.

- **SIA Engineering (BUY/Target: S$2.70; top pick).** We like SIA Engineering for its market leadership in line maintenance business at Changi Airport (about 80% of Changi Airport's line maintenance service volume), good cash generating capability (asset-light business model) and benign valuation (current price implying 15.6x FY25 PE, or 12.0x if excluding net cash). SIA Engineering has been proactively conducting share buyback in the recent months. Since Jul 22, it has bought back over 1.6m shares from the open market at a price range of S$2.12-2.47, with the most recent purchase on 4 Jan 23 at S$2.40.

- **SATS (BUY/Target: S$3.10).** While SATS' existing business remains on the recovery trajectory, we expect its share price performance to stay subdued in the near term due to the market's concern over its large-size acquisition of Worldwide Flight Services (WFS), a globally leading air cargo handler, whose business is prone to slowing air cargo volume amid a global recession. According to IATA, global air cargo volume is forecasted to decline by 4% yoy in 2023. Investors in SATS need to adopt a medium- to long-term view.

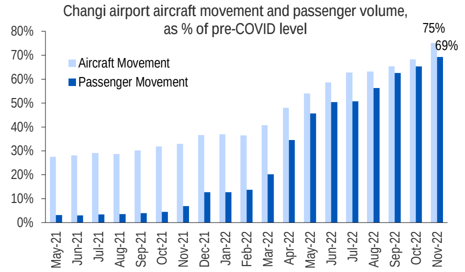
SECTOR CATALYSTS

- Delivery of earnings recovery.

RISKS

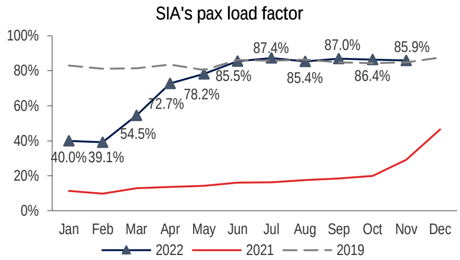
- a) Potential recession dampening air travel and air cargo demand, and b) competition catching up faster than expected.

FLIGHT ACTIVITIES AND PAX VOLUME AT CHANGI AIRPORT RECOVERED TO 75%/69% OF THE PRE-PANDEMIC LEVLES IN NOV 22



Source: Changi Airport

SIA'S UPBEAT LOAD FACTORS, ALREADY AT OR EVEN ABOVE PREPANDMIC LEVLES.



Source: SIA

GLOBAL NEW EXPORT ORDERS PMI, A LEADING INDICATOR OF GLOBAL TRADE AND AIR CARGO VOLUME, REMAINING IN THE CONTRACTION TERRITORY

Source: IATA, Markit

UPDATED VALUATION

Company	-------- Target price --------		Valuation
	new	old	basis
SIA	S$5.40	S$5.35	P/B
SIA Engineering	S$2.70	S$2.60	DCF
SATS	S$3.10	S$3.08	DCF

Source: UOB Kay Hian

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