



Land Transport

UNDERWEIGHT (Unchanged)

Rail transition: Devil's in the details

- Imminent move to a sustainable rail operating model but details on transition terms lacking.
- Treatment of rail assets owned and operators' asset purchase obligations are key obstacles to the transition in our view.
- Maintain SELL on SMRT; retain BUY on ComfortDelGro. SMRT has higher exposure to rail network than ComfortDelGro.

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Imminent transition to a new rail operating model

The new rail financing (NRF) framework, introduced in 2010, is designed to give the Land Transport Authority (LTA) better control over the timing of capacity expansion for the rail network. Currently, only the Downtown Line (DTL) is on the NRF, although all other rail lines are expected to eventually transit to a similar model. But progress has been slow, perhaps due to the complicated process of unwinding contractual agreements under the old regime.

Details on transition lacking, SMRT more exposed

Other than the operating assets of the North South East West Line, which are owned by SMRT, all other rail assets are held on LTA's balance sheet. Under the old regime, rail operators are required to purchase them from the LTA in the future. We estimate these assets to be worth SGD2.4-3.1b as of 31 Mar 2013.

While the transition to a sustainable operating model is a positive move for the industry, the devil is in the details. The lack of clarity on the transition details convinces us that it is highly speculative to conclude that the terms will be favourable to shareholders. In particular, the treatment of rail assets owned and asset purchase obligations of the operators will have a profound impact on their profitability. In our view, the price at which assets are to be sold to LTA and future licensing charges are two key parameters to watch.

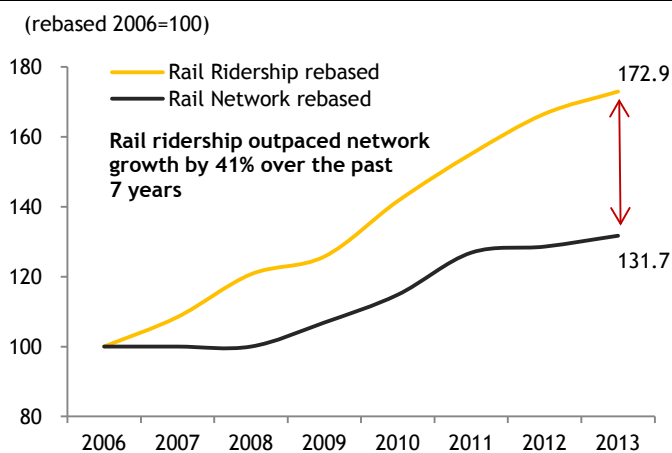
As the largest rail operator, SMRT is highly exposed to the uncertainty surrounding the transition terms. We are less worried about ComfortDelGro (CDG), as its exposure is limited to its stake in SBS Transit or SBST (7% of market cap). Besides, SBST's exposure is smaller because 1) DTL is already on the NRF framework, and 2) its purchase obligations are likely to be lower due to accumulated depreciation since 2003. Maintain SELL on SMRT and BUY on CDG.

Stock	Market Cap. (USD m)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x)			P/BV (x)			Dividend Yield (%)		
						2013E	2014E	2015E	2013E	2014E	2015E	2013E	2014E	2015E
SMRT	1,218	Sell	1.02	0.60	(41.2)	28.6	25.3	20.3	2.0	1.9	1.8	2.0	2.0	2.0
ComfortDelGro	3,198	Buy	1.92	2.40	25.3	15.5	14.6	13.6	1.9	1.8	1.7	3.7	3.8	3.9

Congestion heightens need to increase capacity

Since 2006, Singapore's rail ridership growth has outpaced network expansion by approximately 41%. The upshot: Significant congestion issues and a public outcry to increase capacity on the rail network. But rail operators are also squeezed, grappling with downward pressure on their profitability due to rising costs of inflation and higher maintenance spending. This has reduced their ability, and perhaps willingness, to raise capacity to support demand growth.

Figure 1: Network expansion has lagged behind rail ridership growth since 2006



Source: Maybank KE estimates

Figure 2: Too many people and not enough trains lead to network congestion



Source: Maybank KE

Imminent transition to a new rail operating model

To enable the Land Transport Authority (LTA) to exert better control over the timing of capacity expansion for the rail network, the Rapid Transit Systems Act was amended in 2010 to introduce a new rail financing (NRF) framework. Under the NRF, rail operators are not required to incur capex for operating assets as the LTA will own all these assets. Instead, they will incur "leasing expenses" in the form of licensing fees to the LTA, which comprise fixed and variable components (details undisclosed). Currently, only the Downtown Line (DTL) is contracted under the NRF (Figure 3).

We believe the other rail lines that were under the old financing framework would eventually be switched to an asset-light model similar to the NRF. Mr Desmond Kuek, SMRT's CEO, spoke of an imminent transition to a new rail operating model in April last year and again in January this year. But progress has been slow, perhaps due to the complicated process of unwinding contractual agreements under the old regime.

"...discussions are ongoing with the government on more sustainable models for both the train and bus businesses."
- SMRT CEO Desmond Kuek,
30 Apr 2013

"We are engaging the authorities on a timely transition to a viable and sustainable model for the train and bus businesses."
- SMRT CEO Desmond Kuek,
28 Jan 2014

Figure 3: Singapore's rail network at a glance

Rail lines	North South East West Line (NSEWL)	Circle Line (CCL)	Bukit Panjang Light Rail Transit (BPLRT)	North East Line (NEL)	Sengkang-Punggol Light Rail Transit (SPLRT)	Downtown Line (DTL)
Operator	SMRT	SMRT	SMRT	SBST	SBST	SBST
Network details						
Rail type	MRT	MRT	LRT	MRT	LRT	MRT
2013 rail length (km)	93	36	8	20	21	4
Future expansion (km)	9	4	0	2	0	40
2030E rail length (km)	102	40	8	22	21	44
Licensing						
Licensing regime	Old	Old	Old	Old	Old	New
Start of concession	1987	2009	1999	2003	2003	2013
End of concession	2028	2019	2028	2033	2033	2032
Assets						
Estimated rail operating asset value (SGD b)	0.7	< ----- Up to 3.1 ----- >				
Train fleet value* (SGD b)	0.5	< ----- 0.8 ----- >				
Other operating asset value^ (SGD b)	0.2	< ----- Up to 2.3 ----- >				
Location of operating assets	SMRT PPE	LTA PPE	LTA PPE	LTA PPE	LTA PPE	LTA PPE
Asset purchase date from LTA	1998	2019	2015	To be agreed	To be agreed	Not required
Asset purchase value	SGD1.2b	At book value	At book value	At book value	At book value	n.a.

*Train fleet book value as of 31 Mar 2013.

^Refers to signalling, communication, automatic fare collection systems, other operating equipment & power supply equipment on SMRT PPE. Operating equipment on LTA PPE includes other non-rail assets. Value as of 31 Mar 2013.

Source: LTA, SMRT, SBST, Maybank KE estimates

Two key obstacles to transition

The treatment of rail assets owned and asset purchase obligations of the operators are the key obstacles to the transition, in our view. Other than the operating assets of the North South East West Line (NSEWL), which are owned by SMRT, all other rail assets are currently held on LTA's balance sheet (Figure 3). Under the old regime, rail operators are required to purchase them from the LTA in the future.

Over the years, as the rail network expanded, the value of the train fleet and operating equipment on LTA's balance sheet similarly increased. Assuming that 70-100% of the operating equipment is related to rail operations, we estimate that LTA holds SGD2.4-3.1b worth of rail assets on its balance sheet as of 31 Mar 2013 (Figure 4). In the absence of detailed disclosures, we estimate that more than half of these purchase obligations are due to Circle Line (CCL) related assets. Unlike other rail lines that were in operation more than a decade ago, the CCL was only fully opened from October 2011.

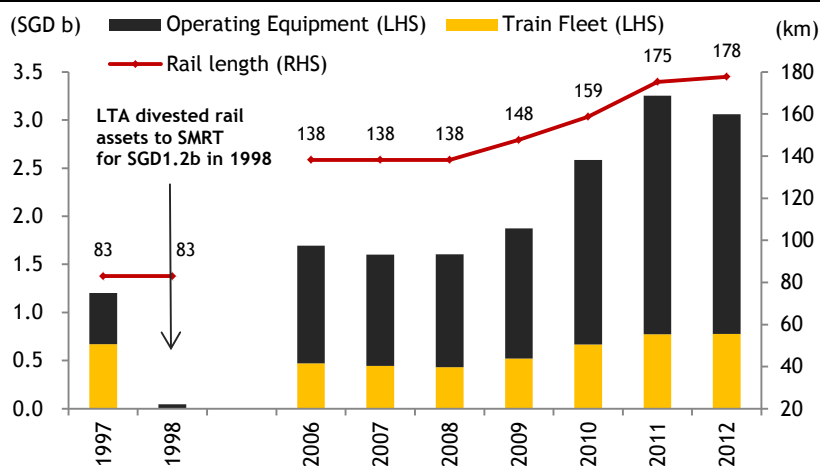
Figure 4: Rail assets held on LTA's balance sheet estimated to be worth SGD2.4-3.1b*...

Off-balance-sheet liabilities of rail operators (SGD b)				
Sensitivity to rail share of LTA's operating equipment	70	80	90	100
Rail fleet value (1)	0.8	0.8	0.8	0.8
Rail operating equipment value (4)=(2)x(3)	1.6	1.8	2.1	2.3
Total operating equipment value on LTA's PPE (2)	2.3	2.3	2.3	2.3
Rail share of LTA's operating equipment (%) (3)	70	80	90	100
Total rail operating assets on LTA books (5)=(1)+(4)	2.4	2.6	2.8	3.1

*As of 31 Mar 2013.

Source: LTA, Maybank KE estimates

Figure 5: ...which are asset purchase obligations of the rail operators



Note: 2012 refers to 31 Mar 2013 for LTA assets. Operating equipment includes other non-rail assets.

Source: LTA, Maybank KE

Two key parameters to watch

In our view, the transition to a sustainable rail operating model is akin to a sale-and-leaseback arrangement. To adopt an asset-light model similar to the NRF framework, SMRT is required to sell its assets pertaining to the NSEWL to the LTA and lease them back from the regulator. We also believe the licensing fees to be paid by both SMRT and SBST in the future would need to be raised substantially in order to offset the asset purchase obligations.

This means the future profitability of the rail operators will hinge on two key parameters:

- Price at which assets are to be sold, and
- Future licensing charge.

While the transition is a positive move for the industry, the devil is in the details. The lack of clarity on the transition details convinces us that it is highly speculative to conclude that the terms will be favourable to shareholders. The recent spate of rail disruptions and public displeasure over service standards certainly do not bode well for the operators. As such, there would be political pressure not to be seen as granting any favourable terms to the operators. We believe the authorities are trading a fine line between assuring the public of a safe and reliable service and ensuring a viable business model for the operators. With respect to the latter, we think the noose will tighten.

Stock view: SMRT more exposed than CDG

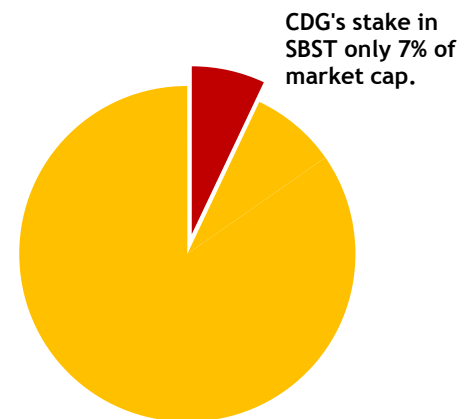
We maintain our SELL call on SMRT with a TP of SGD0.60. As the largest rail operator, the risk it faces from the uncertainty surrounding the transition terms is naturally greater.

We are less worried about CDG as its exposure is limited to its stake in SBST (7% of market cap). As for SBST, its exposure is smaller than SMRT's because:

- 1) DTL is already on the NRF framework, which has no exposure to the uncertain transition terms, and
- 2) Its purchase obligations for assets for North East Line and Sengkang-Punggol LRT could be lower as the book value on LTA's balance sheet may have fallen significantly due to accumulated depreciation over the years (approximately 5% pa since 2003).

We reiterate our BUY call on CDG with a TP of SGD2.40.

Figure 6: Value of CDG's stake in SBST



Source: Maybank KE estimates

Figure 7: Rail network expansion

Rail Length	2008	2009	2010	2011	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2025E	2030E									
MRT (km)	109	119	130	147	149	153	154	154	178	199	199	204	240	250	276	328									
NSEWL	83	87	87	87	87	87	88	88	95	95	95	95	95	95	95	95									
Changi Airport Line	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6									
CCL	0	6	17	33	36	36	36	36	36	36	36	36	36	36	40	40									
NEL	20	20	20	20	20	20	20	20	20	20	20	20	20	20	20	22									
DTL	0	0	0	0	0	4	4	4	21	42	42	42	42	42	44	44									
Thomson Line	0	0	0	0	0	0	0	0	0	0	0	5	20	30	30	30									
Eastern Region Line	0	0	0	0	0	0	0	0	0	0	0	0	21	21	21	21									
Jurong Region Line	0	0	0	0	0	0	0	0	0	0	0	0	0	0	20	20									
Cross Island Line	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	50									
LRT (km)	29	29	29	29	29	29	29	29	29	29	29	29	29	29	29	29									
BPLRT	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8									
Sengkang LRT	11	11	11	11	11	11	11	11	11	11	11	11	11	11	11	11									
Punggol LRT	10	10	10	10	10	10	10	10	10	10	10	10	10	10	10	10									
Total Rail (km)	138	148	159	175	178	182	183	183	207	228	228	233	269	279	305	357									
SMRT	97	107	118	134	137	137	138	138	145	145	145	145	145	145	149	149									
SBST	41	41	41	41	41	45	45	45	62	83	83	83	83	83	85	87									
Unallocated	0	0	0	0	0	0	0	0	0	0	0	5	41	51	71	121									
Network share (%)																									
SMRT	70	72	74	77	77	75	75	75	70	64	64	62	54	52	49	42									
SBST	30	28	26	23	23	25	25	25	30	36	36	36	31	30	28	24									
Unallocated	0	0	0	0	0	0	0	0	0	0	0	2	15	18	23	34									
Train Capacity Increase	Planned vs 2013 (%)		2013		2014E		2015E		2016E		2017E		2018E		2019E		2020E		2021E		2025E		2030E		
MRT																									
NSEWL*		30%			128		+13		+28																
Changi Airport Line																									
CCL		60%			40			+24																	
NEL		70%			25			+18																	
DTL					10																				
Thomson Line																									
Eastern Region Line																									
Jurong Region Line																									
Cross Island Line																									
LRT																									
BPLRT		70%			19		+13																		
Sengkang LRT*		40%			41			+16																	
Punggol LRT																									

*NSEWL includes Changi Airport Line, Sengkang LRT includes Punggol LRT.

Source: LTA, Maybank KE estimates

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