SMRT's escalating staff costs detrimental to group margins

Find out what is really derailing SMRT's track to profit

Revenues of Singapore's multi-modal public transport operator continue to rise, but an unhealthy mix of high operating costs and lack of a fare hike continue to put the company in a losing battle for profitability.

CIMB Analyst Gary Ng blames the misalignment to relentlessly high operating costs, which effectively neutralized the effect of a 5.3% year-on-year rise in revenue. According to OSK DMG's Edison Chen,

> **Bus operations will likely extend its run of 11 consecutive quarter losses.**

ballooning staff costs, depreciation and maintenance cost are to blame, and payment of bonuses don't assist either. A lack of a fare increase adds to the problem, but even a fare hike isn't enough to increase fare income, says Chen: "Even with an anticipated fare hike, its escalating staff costs may be detrimental to group margins."

Whilst the company's fare revenue segments (train, LRT, bus) continue to post weak results, its non-fare revenue segments present a glimmer of hope, after recording a 10.9% EBIT growth in 2Q14, says DBS Group Research analyst Andy Sim.

The non-fare segments which include rental, advertising, taxi and engineering and others, are growing domestically and overseas.

The transport operator's rental business benefited from a price increment as well as growth in rental space, owing to improvements done at the Woodlands Xchange station, says OSK DMG.

OSK DMG says the company's advertising division similarly reported a 15% year-on-year EBIT, while taxi operations' EBIT increased 55.1% to SGD2.1 million due to higher rentals from a newer fleet. However this was offset by lower diesel sales.

Higher engineering projects also contribute positively to the non-fare segment.

OCBC's Lim Siyi says that on a segmental basis, bus operations will likely extend its run of 11 consecutive quarter losses, assuming there are no asset impairments. Rail profitability is predicted to be lower as well.

"The taxi, rental and advertising segments should stay positive and provide some consolation to SMRT," Lim adds.

In terms of valuation, there is a consensus among analysts that the stock will continue to underperform until the company finds ways to properly align costs with its revenues.

Ng confirms: "We believe that SMRT is making inroads with regulators regarding the accounting of asset transfers." Lim adds that the lower frequency of bad publicity has definitely aided the company, and he believes that the street has already factored in the majority of the negative expectations for FY14 as well as concerns over capex requirements.

THE ANALYSTS' CALL

What are SMRT's silver linings?

CIMB- Gary Ng

The only positives are that the risk of significant dividend cuts is lower now and management is proactive in growing its non-fare business domestically and overseas. We believe the risk of further dividend cuts is now less of a concern given the more robust cash flow structure.

OCBC - Lim Siyi

The free MRT ride scheme introduced on 24 Jun has seen rail ridership figures for July and August exceed 60m rides for the first time in SMRT's history. The incentive to promote travel to 16 designated MRT stations in the city area before 8am has also aided in the alleviation of a congested rail system during the morning peak periods. SMRT will bear the cost of free travel up to S$5m and the relevant authorities will compensate the company for the remainder.

Since the end of August, SMRT's share price has stabilised between a tight band of 1.29-1.30, which has helped to arrest its slide of 10% following its 1Q14 results.

OSK DMG - Edison Chen

During the quarter, SMRT Corp (MRT)'s revenue increased by 5% year-on-year to SGD296.3m, underpinned by healthy ridership growth in both its rail and bus operations. Its average daily rail ridership grew 3.7% year-on-year to 2.0m/day, while that of its bus service unit increased by 4.0% to 971k/day.

MRT's taxi operation reported a 2QFY14 EBIT of SGD2.1m (+55.1% year-on-year). The stronger performance was due to higher rental from a newer fleet.