

First Read

SMRT Corporation Ltd

Transformation into an asset light operator

Capital discipline to support ROE

Amidst a backdrop of slowing growth, our [APAC Strategists](#) believe that capital discipline will be critical to help drive higher asset turns and ROEs. We believe that SMRT Corporation (SMRT) is a good example of effective capital discipline and should benefit from this theme. Historically stocks exhibiting these characteristics, driving higher asset turns and ROEs, have persistently outperformed.

Why this stock fits the capital discipline theme

The Singapore public transport industry is moving in a direction whereby the government will own all public transport related operating assets such as buses and train rolling stock. Operators such as SMRT will subsequently be responsible for only operating bus and train routes. Currently, SMRT owns its own buses, and the rail operating assets of the North-South and East-West MRT Lines (NSEWL). We estimate that the company has spent c.\$300m over the last five years investing in rail and bus assets. Under the new bus and rail business models, SMRT will be relieved of bus and rail capex, and we estimate that annual capex will decline 80% to c.\$80m vs \$400m previously.

What evidence is there?

We believe that rail reform could occur in CY2016. During the latest Q416 results briefing (on 29 April 2016), management expressed reticence in providing guidance for its annual *rail-only* capex for FY17E, citing ongoing negotiations with the authorities on rail reform. In addition, the company indicated in its media and results release that SMRT Trains would become asset light as it transitions to the NRFF, its first ever comment since Q412. In addition, the bus business is set to transition to the cost-plus Government Contracting Model in September 2016, when existing Bus Services Operator Licences expire on 31 August 2016.

Other reasons we like this stock:

We believe that when public transport operating assets have transferred to the government ownership model, SMRT's bus and rail EBIT margins will improve from previous loss making positions. Coupled with lower capex, this will improve free cash flow, providing SMRT with flexibility to improve ROE by raising its payout ratio. In our view the market has not given sufficient attention to the transformation of SMRT's business model, and the read-through to its ROE and P/BV multiple. We have a BUY rating on the stock, with a DCF-back price target of S\$1.81.

Equities

Singapore
Railroads

12-month rating

Buy

12m price target

S\$1.81

Price

S\$1.51

RIC: SMRT.SI BBG: MRT SP

Trading data and key metrics

52-wk range	S\$1.66-1.14
Market cap.	S\$2.29bn/US\$1.67bn
Shares o/s	1,524m (ORD)
Free float	46%
Avg. daily volume ('000)	2,093
Avg. daily value (m)	S\$3.3
Common s/h equity (03/17E)	S\$0.97bn
P/BV (03/17E)	2.4x
Net debt / EBITDA (03/17E)	NM

EPS (UBS, diluted) (\$)

	UBS	Cons.
03/17E	0.08	0.06
03/18E	0.09	0.07
03/19E	0.09	0.09

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Highlights (\$m)	03/14	03/15	03/16	03/17E	03/18E	03/19E	03/20E	03/21E
Revenues	1,164	1,236	1,297	1,253	1,278	1,312	1,332	1,355
EBIT (UBS)	84	121	138	144	161	167	177	180
Net earnings (UBS)	62	91	109	116	136	142	150	153
EPS (UBS, diluted) (\$)	0.04	0.06	0.07	0.08	0.09	0.09	0.10	0.10
DPS (\$)	0.02	0.03	0.04	0.04	0.05	0.05	0.05	0.06
Net (debt) / cash	(481)	(665)	(589)	119	229	329	431	528
Profitability/valuation	03/14	03/15	03/16	03/17E	03/18E	03/19E	03/20E	03/21E
EBIT margin %	7.2	9.8	10.7	11.5	12.6	12.7	13.3	13.3
ROIC (EBIT) %	8.4	9.0	9.5	12.8	20.5	22.3	24.6	26.0
EV/EBITDA (core) x	8.6	9.1	8.1	9.5	7.6	7.2	7.0	6.3
P/E (UBS, diluted) x	31.9	25.6	20.6	19.8	16.9	16.2	15.3	15.0
Equity FCF (UBS) yield %	(21.0)	(7.7)	3.6	(16.6)	7.6	7.6	7.8	7.8
Net dividend yield %	1.7	2.1	2.7	2.8	3.3	3.4	3.7	3.7

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of S\$1.51 on 18 May 2016 17:28 HKT

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Forecast returns

Forecast price appreciation	+20.3%
Forecast dividend yield	2.8%
Forecast stock return	+23.1%
Market return assumption	7.1%
Forecast excess return	+16.0%

Valuation Method and Risk Statement

Our valuation is based on DCF methodology based on 7.0% cost of equity, and 3% terminal growth. Our earnings forecasts could be at risk if oil prices spike and wage pressure impacts margins, as these are two major cost items. Our ridership assumptions could be negatively affected in the case of an epidemic, as was the case during SARS. Major policy changes, including the implementation of a cost plus model for buses, a transition to the new rail financing framework on terms differing from our base assumptions, or nationalisation could result in material differences from our estimates.

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12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2016.

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

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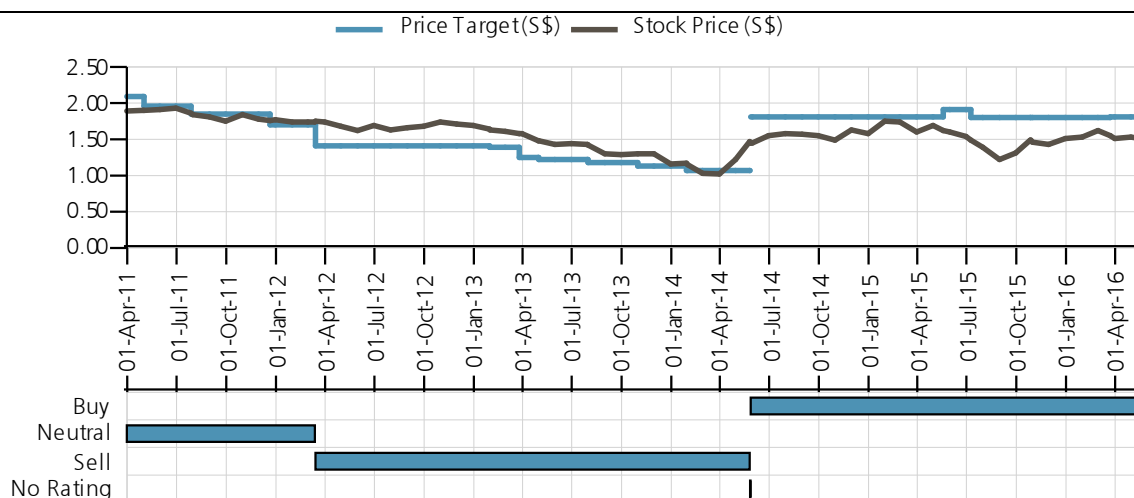
Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
SMRT Corporation Ltd	SMRT.SI	Buy	N/A	S\$1.51	17 May 2016

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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SMRT Corporation Ltd (S\$)



Source: UBS; as of 17 May 2016

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