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Research Update:

SMRT Corp. Ltd. 'AAA' Rating Affirmed; Outlook Remains Negative On Uncertain Timing And Scope Of Government Support

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Overview

- On Sept. 27, 2013, we revised the rating outlook on SMRT to negative because of the company's weakening financial metrics and the uncertainty about the timing and form of government support.
- While affirming the rating on SMRT at 'AAA', we also maintain our negative outlook because the timing and scope of government support remain open as of today.
- We are adjusting the trigger points for a potential rating change for low-volatility industries, such as transportation structure. This is line with our revised corporate ratings criteria of Nov. 19, 2013.

Rating Action

On March 31, 2014, Standard & Poor's Ratings Services affirmed its 'AAA' long-term corporate credit rating and 'axAAA' long-term ASEAN regional scale rating on Singapore-based rail operator SMRT Corp. Ltd. The outlook remains negative. We also affirmed our 'AAA' issue rating and 'axAAA' ASEAN regional scale rating on the senior unsecured notes that SMRT guarantees.

Rationale

The rating affirmation reflects our view that SMRT will maintain its dominant market position in Singapore's public transport sector and that passenger growth will remain steady. We assess SMRT's business risk profile as "strong" and its financial risk profile as "minimal". We then use a comparable rating analysis modifier to lower the rating by one notch to reach a stand-alone credit profile (SACP) of 'aa-'. The rating incorporates our view of an "extremely high" likelihood of extraordinary government support for the company.

On the other hand, rising operating expenses have significantly tightened SMRT's margins, intensifying downward rating pressure on the company. In addition, the government has yet to outline the new financing and operating frameworks for SMRT to ensure the long-term sustainability of its train and bus businesses.

However, our current base case assumes that government support will come through. It also assumes that the company's annual maintenance capital

spending burden will ease in the fiscal year ending March 31, 2015, to about Singapore dollar (S\$) 100 million, with the implementation of a new rail financing framework for SMRT's operating infrastructure. Under this base case, we forecast that SMRT's ratio of funds from operations (FFO) to debt could improve to more than 40% in fiscal 2015, after declining to about 30% in fiscal 2014. However, if SMRT spends about S\$300 million in 2015-2016, the prospects of its FFO-to-debt ratio recovering to the "minimal" category, at more than 35%, are remote. We will reexamine our base-case projection once details on the government support are available.

Nevertheless, the lack of clarity of government support continues to weigh on the ratings. This is particularly because we expect the company to continue a large capital investment program over the near term. Our adjustment of an "unfavorable" comparable rating analysis modifier reflects the uncertainty regarding the government support.

The final rating of 'AAA' reflects a three-notch uplift due to our view of an "extremely high" likelihood of extraordinary government support, which is based on the following factors:

- SMRT's critical role as a key provider of essential public transport services in Singapore.
- Its very strong link with its majority owner, the government of Singapore (unsolicited rating AAA/Stable/A-1+; axAAA/axA-1+), through Temasek Holdings (Private) Limited (AAA/Stable/A-1+), which owns 54.3% of SMRT.

Our base case assumes:

- Steady revenue growth at about 3% in fiscal 2015 and fiscal 2016.
- EBITDA margin recovers steadily to 22%-23% in 2015-2016 from 20% in fiscal 2014.
- Annual maintenance capital spending will ease to S\$100 million level in fiscal 2015 and onward.

Based on these assumptions, we arrive at the following credit measures over the next two years:

- Ratio of FFO to debt to recover to more than 35%; and
- Ratio of debt to EBITDA to recover to less than 2.0x.

Liquidity

SMRT has "adequate" liquidity, as our criteria define the term. We also believe SMRT has steady bank relationships and stable access to capital market.

Liquidity sources include:

- Cash and cash equivalents of about S\$127.8 million as of Dec. 31, 2013;
- Undrawn bank lines of S\$200 million; and
- Annual FFO that we estimate at S\$230 million-S\$250 million.

Uses of liquidity primarily include:

- Debt repayment that we estimate at about S\$150 million;
- Estimated maintenance capital spending at S\$100 million; and
- Estimated dividend payment of S\$40 million.

Outlook

The negative outlook reflects the uncertainty about the timing and details of support from the Singapore government for SMRT. It also reflects our expectation that SMRT's future financial performance continues to rely on a new rail financing framework for SMRT's operating infrastructure for its recovery to a level in line with the current rating.

We may lower the rating if SMRT's stand-alone credit profile weakens to 'a+' from 'aa-'. This could happen if the company's cash flow metrics remain depressed due to high capital expenditure and if the timing and scope of future government support cause us to believe that SMRT's financial metrics will ultimately not recover to at least 35% within the next 12-18 months.

A downgrade could also occur if there is a material change in the regulatory and transport policy framework, negatively affecting SMRT's role as an essential public service provider. Such an adverse change may lead us to lower our expectation of extraordinary government support to "very high" from "extremely high." We may also downgrade SMRT if the sovereign rating on Singapore is lowered.

We may revise the outlook to stable once the timing and scope of future government support lead us to believe that SMRT can sustain its ratio of FFO to debt to more than 35%.

Ratings Score Snapshot

Corporate Credit Rating: AAA/Negative/---

Business risk: Strong

- Industry risk: Low risk
- Country risk: Very Low risk
- Competitive position: Strong
- Financial risk: Minimal
- Cash flow/leverage: Minimal

Anchor: aa

Modifiers:

- Diversification: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and Governance: Satisfactory (no impact)
- Comparable Rating Analysis: Unfavorable (-1 notch)

Stand-alone credit profile: aa-

- Sovereign rating: AAA
- Likelihood of government support: Extremely high (+3 notches from SACP)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Key Credit Factors For The Transportation Infrastructure Industry, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- Research Update: Outlook On SMRT Corp. Ltd. Revised To Negative On Weak Financials; 'AAA' Rating Affirmed; Sept. 27, 2013

Ratings List

Ratings Affirmed

SMRT Corp. Ltd.

Corporate Credit Rating

AAA/Negative/--

ASEAN Regional Scale

axAAA/--/--

SMRT Capital Pte. Ltd.

Senior Unsecured

AAA

Senior Unsecured

axAAA

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