SATS 2Q FY2027 Earnings Call Transcript

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Participants:

- Kerry Mok – President and Chief Executive Officer
- Timothy Tang – Chief Financial Officer
- Derek Ng – Global Head of Communications; moderator

Derek Ng: Good morning, everyone. Welcome to SATS' second quarter results briefing for financial year 2027. I'm Derek Ng, Global Head of Communications at SATS.

Joining us today are Kerry Mok, SATS' President and Chief Executive Officer, and Timothy Tang, SATS' Chief Financial Officer.

Before we begin, I would like to draw your attention to the forward-looking statement on the screen. A recording of this briefing will be made available on our website in due course.

I will now hand over to Kerry to take you through the business update. Kerry, over to you.

Business Update

Kerry Mok: Thank you, Derek, and a very good morning, everyone. Thank you for joining this second quarter results announcement.

I'll briefly go through the key highlights. Revenue continues to grow very well. It's up 9% to S$1.7 billion. We're very pleased that our cargo volume continues to outpace IATA, led by both the Americas and APAC.

On the business front, we have continued to win new business, including Atlas Air in Amsterdam, Turkish Airlines and Singapore Airlines across the US and Europe. We have also recently announced a renewal with American Airlines, with whom we have a 40-year relationship. Renewing the contract across Europe has been a good outcome for us.

The food business also continues to grow, reflecting the increase in meal volumes. That has helped us from a business resilience standpoint despite the ongoing volatility. It's pleasing to see the Food Solutions business growing as well.

On the EBITDA level, as we have highlighted, there is a drop against last year, but last year we were benefiting from front-loading and temporary operating efficiencies. We continue to invest in our technology capability to support the Group's network. The main point is that, on a quarter-on-quarter basis, our EBITDA has improved over the last quarter, despite the full impact of our cost increase. This is because of very focused cost management on our end.

On the PATMI side, you can see it has grown despite the lower EBITDA, supported by lower tax expense. These are some of the actions we've taken to improve our tax efficiency. On a quarter-on-quarter basis, PATMI has also increased, with the margin improving to 4.7%.

On segment performance, you can see cargo growth of 8% year on year. Again, we're very pleased to see that growth. Flights handled have increased, primarily driven by Azul Airlines in Brazil. On the aviation meals side, there is 8.3% growth. China's volume is coming back a little as well. Non-aviation meals have grown primarily through increased utilisation in both our China and India kitchens.

Next slide. I want to highlight the key wins. We have commenced e-commerce handling for Temu at three stations in the Americas. This is helping them manage their e-commerce shipments coming into the US and then sending them on to Latin America. We believe this relationship will continue to grow strongly, and we will look at delivering more value-added services for Temu going forward.

We have expanded our ByteDance business in Singapore on the food side. We've also renewed Malaysia Airlines in Japan. Our Japan kitchen is showing good growth momentum, and many of the customers are happy with what we've done at TFK.

On the infrastructure side, you would have read that we have opened a new terminal at Lyon. It's a fantastic facility where we are targeting high-value items, such as pharmaceutical related products from that region. We believe that, through this infrastructure, a lot more pharmaceutical and high-value items can flow through Lyon. Lyon is right in the middle of France and is an important hub for cargo as well.

On the food side, one of the key strategies we have been working on is to use a network approach, beyond just the location being served. Through our JVs and associates, we are trying to unlock that capability across the network, leveraging what we've invested in central kitchens in China and India, and our factory in Thailand, to see how we can support our network to grow beyond what it has today.

That is a good first start. We have very good relationships with all our JVs and associate partners, and we look forward to continuing that growth momentum with all our network partners.

On the awards side, you can see we've been recognised quite a bit: Global Ground Handler of the Year - Middle East and APAC, and a special award for digitisation and innovation for our AAT business. On the food side, ANA has awarded us Best Caterer for Medium-Haul, and our cruise terminal continues to be recognised as Asia's Best Cruise Terminal by the World Cruise Awards.

Here is the tonnage breakdown. Year to date, it is 5.16 million tonnes, representing 8.3% growth year on year. Including our associates, it is now 7 million tonnes. You can see there has been good growth momentum for us on the cargo side.

Flights have also increased, mainly due to Azul in Brazil. Aviation meals continue to grow well. In our JVs and associates, we have some weakness affecting domestic airlines in China, as well as other airlines that have cancelled some flights, affecting meal volumes. Overall, though, there is still very good growth in our own business.

Non-aviation meals have all grown. We have also had higher in-camp training volume on the military side and new contract wins in China with Starbucks. That is helping us with utilisation.

On employees, you can see we are trying to manage that growth as well. Headcount is almost flat, with a slight decline in the second quarter. There is a big focus on managing our cost baseline and improving productivity across the network.

Here we show like-for-like versus non-like-for-like growth. Against IATA's numbers, we have 8% year-on-year growth versus IATA's 5.3%. On a like-for-like basis, APAC and the Americas are leading that, offset by weaker growth in EMEA. That is due to the Middle East conflict and the start of the de minimis impact affecting some e-commerce shipments.

On a non-like-for-like basis, new wins are mainly in EMEA and the Americas, showing good growth as we continue to take market share from our competitors. We are in 14 of the top 30 air cargo stations globally, and the airside access has helped us continue to work closely with customers to win more business on the cargo side.

I'll hand over to Tim, who will take us through the financials.

Financial Summary

Timothy Tang: Thanks, Kerry. Good morning, everyone. Great to be here again for our Q2 earnings announcement. I'll go into a bit more detail and provide more colour on what Kerry has already noted.

He has said it, but I think it's worth repeating. To start us off, we do have a weaker comparison against last year. Most of you will recall that last year's results benefited from pull-forward volume, post-Liberation Day. In particular, the efficiency gain came from the rerouting of a lot of cargo out of some US locations into our European and Asia-Pacific locations. There was significant labour efficiency in that movement.

It took us some time to catch back up on service delivery quality in those regions, which was reflected in more normalised margins in Q3 last year, more consistent with Q1 last year as well. That is the backdrop to our comparison.

Within that backdrop, we have the Middle East impact, and, in particular, in the second quarter, the de minimis impact in our EMEA market as well. Within all of that, we are very pleased with revenue growth, driven by volume growth.

As we continue to work through and improve our efficiencies, and as the market has continued to settle down, you can see sequential improvements in our margins. We're pleased with that because we did say that higher costs and the full quarter of higher input costs would affect us worse in the second quarter than in the first quarter.

In that context, improving margins really shows the strength of the network. Our business model continues to offset some of the high input cost challenges, both through price revisions and working with our customers, as well as through the volume mechanism that offsets that.

A few words on the segments; I've got more detail on the next slide. We're seeing good growth in both Gateway Services and Food Solutions. Within Gateway, the higher performer continues to be the Americas market, with which we're very pleased. That has rebounded well from the lows of last year.

It is helped by speciality charters we are processing that were flying into the Middle East, in particular into Saudi Arabia. We've noted that in the past, and it has been a bit of an upside in the Americas market. Outside of that, we're very pleased with both the Singapore and APAC markets as well.

The European market is definitely the weakest, given the Middle East impact, not to mention de minimis, but it is still growing and therefore very resilient. The portfolio continues to support the overall network approach we've been taking on the Gateway side.

Likewise, on the food side, aviation has been performing very well, particularly out of Singapore. Our non-aviation business continues to ramp up, particularly in our Tianjin and India facilities.

A word on SoAJV. The weakness we're seeing there, with Q on Q, continuing to be flattish, reflects continued exposure to low-cost carriers within the SoAJV line, where they represent a greater weighting of the business.

We see that as a temporary headwind as things continue to settle down. Some of our partners and airlines exposed to low-cost carriers are starting to revise their flight schedules back up. As that market continues to stabilise, we will see improving results on the SoAJV front as well.

Next slide, please. A little more detail. In the first quarter, many of you will recall, we said we wanted to continue driving quarter-on-quarter improvements. We see that path because the overall impact has been very volatile, especially when it comes to rerouting.

Having said that, we expected Q2 input costs to be significantly higher than in the first quarter because we had a full quarter of input costs in Q2. We saw that come through, and it is reflected in the food business. In particular, you can see the margin continues to be lower than in the first quarter. However, the gap has closed.

We are also seeing the offsetting impact of our price revisions, as part of the contractual arrangements, that goes towards offsetting some of the margin weakness from higher input costs. Volume is helping as well, driving operational efficiency. As Kerry mentioned, we continue to strengthen our network approach on that side. Some of that is already helping, and some will continue to bear fruit as we move forward.

Encouragingly on the Gateway side, the initial disruption, particularly significant rerouting of flights, played the biggest role in our margin weakness. Sequentially, as the market and rerouting stabilise, we're getting good labour utilisation out of our European markets in particular.

It is a very difficult market in which to make major, one-off workforce changes. Our methodology has been to work through natural attrition and very targeted actions, to make sure that we address both the stability of our workforce and the service our customers, while driving efficiency back up. That has shown in our sequential quarter-on-quarter performance.

One last word on Others. We noted that, in the first quarter, we were impacted by higher professional fees due to the lumpiness of that type of work. That has reduced in the second quarter. Overall, our run rate is somewhere between the first and second quarters on an average basis. The year-to-date number is quite representative of where we are, and we see that continuing.

We have made investments in technology that supports the long-term growth of the business. We have also made investments on the commercial side to support long-term growth. We are disciplined in that approach, but we see these investments bearing fruit in growth and delivering efficiency over the long term. That is where we focus, particularly on those global projects.

Over to the next slide. A little deeper by business and segment. The numbers speak for themselves here. We are encouraged across all lines of business. It sometimes doesn't show up, but there is a huge amount of disruption underneath these numbers. We've spoken about de minimis and the Middle East. Within the region, you've got the low-cost carrier impact and rerouting inefficiencies.

Amongst all of that, the fact that we have positive numbers across the board on a year-on-year basis really shows the resilience of the market. As these things move around the world, while that brings inefficiency, being able to capture this revenue allows us to offset some of that inefficiency and continues to prove the strength of our network. That will become even more evident on the food side, as Kerry has mentioned.

Singapore has also been very strong. We've been pleased with that. We continue to serve the hub here. In Singapore, we're seeing technology flows through here overseas, and that

plays a role, alongside the overall attractiveness of the hub. You can also see how the Americas have stood out, particularly with the benefit of the charters I've mentioned.

As Kerry noted, we have delivered growth above IATA for 12 consecutive quarters.

Next slide, please. Diving into the metrics, not surprisingly, they look weaker against last year, but that doesn't tell the full story. We've already mentioned that the year-on-year comparison is a bit tricky. I'll highlight two points.

For the majority of the metrics, we continue to be pleased and confident that they are well within our safety range and our target capital allocation range overall. I'll touch on cash on the next slide.

The first metric I'll point to is lease liabilities. We've had a significant increase on our balance sheet. Almost all of it is driven by the starting recognition of our Hong Kong AAT 15-year concession with Hong Kong International Airport. We have announced this in the past, but, from a balance sheet standpoint, this is the beginning of that recognition.

That creates great stability for our Hong Kong market, which is a vital market and connector in our network. While it has a negative balance sheet impact and weighs on our P&L because of the IFRS 16 impact, which we take on a straight-line basis across the 15 years, it creates significant stability and growth opportunities, allowing us to reinvest in that market for future growth.

It also secures profitability over the years as IFRS 16 works through the P&L. That's one component.

Secondly, the net current liability position has changed since the last quarter, but we do see that being managed quite cleanly towards the end of this financial year. The primary component is a EUR500 million loan that we are well on our way to refinancing and extending that term in the market. That should be concluded in Q4 this year.

Over to the next slide. Lastly, on cash, we continue to be hit by significant working capital changes. We have published our detailed balance sheet results on SGX, but I've extracted some of that from the SGX announcement into this slide to show how working capital has impacted cash flow on a year-on-year basis.

There are two main points. Q2 cash flows are seasonally negative because of the annual incentive payments to the global team. The delta versus last year is caused by working capital changes.

We see this normalising over the next two quarter - over the remainder of the year. We have relatively clear visibility on those movements. Some are much shorter term, already into Q3. We see some of that reversing, particularly in the second half, and we'll provide more updates as we announce our Q3 and Q4 results. The remainder of the cash movements are largely as you would expect or as previously explained.

One thing we continue to be disciplined on, given market volatility and continuing margin pressure, is taking a very hard look at our CAPEX trajectory. In our overall capital deployment, projects are being prioritised. We continue to look at how to direct that capital towards the highest returns for the business.

Non-critical projects are being rephased and reviewed as part of our overall approach to managing cash, in line with the operations of the business.

Before I pass back to Kerry, on the next slide, we take the view that, given our Q2 performance compared with Q1, we see the cost implications we can work through as transient, in light of the trajectory of the business.

At this stage, no one can predict when the Middle East impact may end. There are definitely continuing headwinds into Q3, with the KSA conflict escalating in early October, and additional de minimis measures starting on 1 November in Europe, on top of the one implemented in July. Both continue to be headwinds.

On the food side, the opening of our Thailand factory will most likely start to hit our P&L from 1 December. Even within that context, we see Q2 progress as very encouraging. Revenue continues to grow, and we see that momentum largely continuing.

While we have these near-term headwinds, we recognise them in our progress towards our FY29 targets. We see that path of recovery. As the Middle East conflict settles down, where we are hopefully seeing some potential, that could allow us to accelerate growth and margin improvement towards FY28 and FY29. It is uncertain, but, if that goes well, our eyes remain firmly on our FY29 targets at this stage.

With that, I'll pass over to Kerry.

FY29 Targets and Outlook

Kerry Mok: Thank you. Tim, you've covered quite a bit of the outlook on the cargo side.

Next slide. I want to highlight that we believe our cargo performance continues to be solid and firm. The freighter and charter business continues to have a big impact on our P&L. We are getting a lot of charters, not just in and out of the US but also in Asia, where charter activity is heavy. We continue to get a lot of those charter volumes coming through.

We are rolling out AI-enabled cargo planning, starting with London. We believe this is the start of a tool that can help us manage manpower a lot better. If it works in London, we can roll it out across the network, helping us manage some of the cost pressures.

Likewise, we're rolling this out in Changi. This is beyond manpower, we are also looking at using it for our equipment. Whatever we learn in Changi can then be scaled across our network.

We continue to win business, and that's helping us maintain volume. Even with the weakness in Europe, we believe contract wins will help mitigate volume losses from cancelled flights. This is important. Our commercial teams are working very hard, for both

ground and cargo, to continue winning business that gives us scale and leverage in the locations where we operate.

On the food side, as Tim alluded to, we are going to start phase two and are ramping it up now. There is a lot of work with the commercial team to bring in demand. We continue to make good progress in China and India. Those kitchens are being utilised more.

As we develop new products for Starbucks and others, we can roll them out across our network. The aim for the food team is to utilise our innovation and expand it across the network.

The third quarter is usually our best quarter. Having seen what we've seen to date, we believe that momentum continues, and we look forward to a good third quarter as well. Thank you.

Derek Ng: Thank you very much, Kerry and Tim. We've come to the end of the presentation.

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