AIRFINANCE GLOBAL

The reluctant borrower

01/11/2005

It is one of the most bankable names in aviation, but Singapore Airlines is also one of the least likely to seek external financing. Financiers are hoping for a change. The Asian airline will need to make a heavy capital expenditure commitment over the next three years, and a changing market environment may encourage it to seek an increased volume of funding from banks or debt capital markets.

Few other carriers are able to emulate Singapore Airlines' ability to deliver consistently strong profitability. Despite rising fuel costs and increasing low-cost competition, it achieved a record operating profit of S$1.356 billion ($830 million) in the 12 months to March 2005. Even during the 2003/04 financial year, when passenger traffic was hit by the severe acute respiratory syndrome (Sars) outbreak, Singapore Airlines reported a net profit of S$849 million.

Over the past decade, this industry-beating operational performance has allowed Singapore Airlines to rely almost exclusively on its own cash reserves to meet capital expenditure commitments. The only external aircraft-backed financings closed by the airline in recent decades have been leveraged leases or operating leases employed for residual value management purposes. This track record sets Singapore Airlines apart from Cathay Pacific and Qantas, its closest peers in the region, as both have tapped the bank market to fund aircraft deliveries.

Singapore Airlines' most recent leveraged lease financing was a tax-based Japanese operating lease (JOL) transaction on a 777-300, which closed in 2004. Citigroup arranged the deal, which was the airline's first tax-based JOL. The 2001-vintage 777 was placed on a 10-year lease, although the deal did not feature a residual value guarantee. HSBC provided the debt.

Financial institutions involved in operating leasing have had the opportunity to do business with Singapore Airlines. SIA Group has about 20% of its fleet on operating lease – a proportion that has been relatively stable in recent years. "We do not have a fleet-wide target [for the proportion of the fleet placed on operating lease]," says a Singapore Airlines spokesman. "From time to time we review the proportion of each aircraft type that is on operating lease."

All parts of the Singapore Airlines group have used operating leases, including SilkAir, Singapore Airlines' regional subsidiary, which sold and leased back two A319-100s in 2004. The airline also continues to pursue leasing primarily to manage its exposure to the residual values of different aircraft types.

Singapore Airlines mandated a further JOL to Citigroup and another to Tombo Airfinance in the first quarter of this year. Both deals were for 777-200ERs and used a sale/leaseback structure. Unlike the 2004 deal, these transactions were real operating lease arrangements with real residual risk transfer to the investors.

In the Citigroup transaction, a Japanese special purpose company owned by Citilease Company, a wholly owned subsidiary of Citibank, bought the aircraft. HSBC again acted as lender to the lessor through its Tokyo branch. Neither the Citigroup nor Tombo JOLs are believed to have included a purchase option.

The chief target of Singapore Airlines' residual value management activities has been its 747 fleet. In 2003 Singapore Airlines completed a sale/leaseback of a 747-400. The deal was the 16th 747-400 sold and leased back by the carrier. The aircraft was sold to Caspian Leasing Limited and is being leased back for six years.

The previous year, IEM Airfinance, an Amsterdam-based aircraft-operating lessor, purchased a 747-400 and a 777-200 from the airline and leased the jets back for a period of 10 years.

Going forward, Singapore Airlines' 777 fleet will be the main focus of its residual value management and lease programme. "The 777 fleet is Singapore Airlines' largest, and there are relatively few of these aircraft on lease," says the spokesman.

Capital structure

The investment community has previously criticized the level of cash on Singapore Airlines' balance sheet as excessively high, thereby diluting return on assets. The airline has taken certain measures to deflect that criticism, for instance by buying back shares.

All content © Copyright 2026 AFG, all rights reserved.

Five years ago, the airline launched a budgeted S$1 billion multiphase programme buy-back programme equal to about 5% of the company's share capital on issue.

Singapore Airlines says it does not have a high level of cash resources any longer compared to its peers in the industry, and that it is, like other airlines, obliged to have a large cash reserve because of a combination of a potentially volatile environment and high fixed costs.

In addition to its strategy to return surplus cash to shareholders, Singapore Airlines has also sought to establish a modest gearing in its capital structure. A bond issue by Singapore Airlines in 2001 was the culmination of that exercise. Singapore Airport Terminal Services (Sats), a listed subsidiary that is 87% owned by Singapore Airlines, has also issued corporate bonds.

Singapore Airlines sources state that the carrier does not have an optimal capital structure that is set in stone. "The optimal capital structure must take into account the ever-changing business environment, as well as the cost of capital from different funding options. We constantly benchmark ourselves against the best-run airlines and other companies, and generally expect to maintain a strong balance sheet when compared with our peers," says the airline. "In this context, while we believe the group has room to take on more debt, we would exercise that decision prudently."

Because of its rarity, the Singapore Airlines bond was the most noteworthy bond issue by an Asian airline in 2001. HSBC and Oversea Chinese Banking Corp led the S$800 million fixed-rate issue, which met with a strong market response despite being launched only two months after the terrorist attacks on the US in September 2001. As a result of the initial success, the issue was increased to S$900 million. The original transaction was priced with a coupon of 4.15% to offer a spread of about 92 basis points over swaps – a more generous price than seen with other Singapore government-supported issues in the same period because of the perceived risk in the airline industry.

This renewed interest in the bond market (it was Singapore Airlines' first bond issue for 25 years) came just when many banks were reigning in lending to the airline sector. Singapore Airlines officials said at the time that the issue was also part of the planned restructuring of its capital base.

A corporate bond deal appeared to make a lot of sense with or without the Sars crisis. Investor demand was dampened at the time by the slump in ticket sales across the Asian airline market, but the airline was still able to raise funds at very low spreads, because of the historic low in interest rates. An analyst remembers that Singapore Airlines' borrowing cost at the time was significantly lower than its cost of equity. The bond financing therefore made a big difference to Singapore Airlines' average weighted cost of capital.

Because of other similar efforts to revise its capital structure, Singapore Airlines was in a net debt position of S$277 million at the end of the 2003/04 financial year. The group returned to a net liquid asset position (defined as cash, bank balance, investments in financial instruments and loans to third parties minus finance lease commitments, loans and fixed-rate bonds in issue) during the last financial year. As at March 31, 2005 its net liquid asset position was S$923 million. "We must ensure adequate resources are available to meet future commitments. Thus, liquidity is important," says a Singapore Airlines spokesman.

Singapore Airlines Cargo

Singapore Airlines Cargo's (SIA Cargo) financing strategy contrasts with that of Singapore Airlines.

Singapore Airlines states that SIA Cargo was established as an independent entity only in July 2001. Neither the financings of SIA Cargo nor Singapore Airlines' low-cost subsidiary, Tiger Airways, are supported by guarantees from the Singapore Airlines Group.

Singapore Airlines explains that the cargo operator's funding approach is different because of its fairly rapid increase in capacity after being established could not be entirely financed from internally generated cash flow. Indeed, less than half of SIA Cargo's fleet of 14 747-400 freighters has been financed from cash flow.

Instead, SIA Cargo has five (out of 16) 747-400Fs, about 30% of its capacity, on finance leases. As of March 31, 2005 Singapore Airlines had no aircraft on finance leases.

Moreover, unlike Singapore Airlines, the cargo operator has tapped export credit-backed loans to fund aircraft orders. In 2003 and 2004 SIA Cargo used US Export-Import Bank-guaranteed loans to purchase two 747-400F deliveries. The deal was arranged by BNP Paribas and included a tax optimization structure. The nature of the structure was never revealed, although it is not thought to have involved a lease.

The two airlines do share a similar residual value management strategy, however. Like Singapore Airlines, the cargo operator is anxious to manage residual value exposure to the aircraft it operates.

All content © Copyright 2026 AFG, all rights reserved.

As SIA Cargo is a new unit, this programme has only just begun. It completed its first sale/leaseback transaction for a 747-400F in June 2004. The aircraft was sold to AFS Investments 61, a subsidiary of Aviation Financial Services, and is being leased back for 10 years. Babcock & Brown has been advising SIA Cargo on its sale/leaseback programme since it began.

Unfortunately for the aircraft finance community, SIA Cargo does not have a heavy orderbook; financing opportunities with the operator therefore will be relatively thin over the next few years. SIA cargo has only one 747-400F to deliver in 2006, thereafter there will be three more deliveries up until 2009 (one in 2008 and two in 2009).

Future financing strategy

Singapore Airlines' funding needs are far more substantial. The airline has 10 A380s to be delivered from the end of 2006 to mid-2008, and 19 777-300ERs from late 2006 to late 2008. With this delivery programme, aircraft-related capital expenditure for Singapore Airlines over the next five years will peak at $5 billion in the 2007 to 2008 financial year, more than double the $2.3 billion expenditure in the current fiscal year.

Will this high capital expenditure commitment prompt a change in funding approach? Perhaps not. There has been no major change in the airline's financing approach in the past decade, despite the changing operating conditions and a capital expenditure requirement that has fluctuated significantly. Singapore Airlines says that it will keep all options regarding future funding approaches constantly under review.

It is Singapore Airlines' operational excellence and competitive edge that underpins the carrier's ability to fund its capital expenditure from internal reserves. External funding will be more likely if its ability to generate a solid profit margin comes under threat.

But over the past three years, and despite the increasing competition in South-East Asia, the Singapore Airlines Group has continued to flourish. Revenue for the group (comprising Singapore Airlines, SilkAir, SIA Cargo, Sats and SIA Engineering) in the last financial year was the highest ever, at S$12 billion, up S$2.3 billion, or 23.1%, from last year.

Effective control of costs saw expenditure in the same period rise by only 17.3%, to $10.7 billion.

Singapore Airlines reveals that its unit cost (excluding fuel cost) has reduced by more than 8% in the first quarter of the current financial year. Analysts attribute this to a more streamlined organizational structure, a rationalization of staff functions, the outsourcing of IT infrastructure functions to IBM and the outsourcing of certain revenue accounting functions in the finance division.

The competitive threat has certainly increased in the past three years. There are four low-cost and start-up carriers operating from Singapore alone, including Tiger Airways, backed by Singapore Airlines. The competitors are: Jetstar Asia, backed by Qantas, AirAsia and ValuAir, the homegrown Singaporean operator. There are other budget operators, such as Lion Airways, also flying Singapore routes from Thailand, Indonesia and Australia.

Singapore Airlines says it competes with these new entrants on about 10% of its market in the south-east Asian region. Although the new carriers targeting Singapore are focused on providing regional services rather than longer-haul services, the competitive threat continues to ramp up. One analyst calculates that low-cost carriers will be competing on 12% of Singapore Airlines Group's routes (the percentage of its total capacity operating within four hours of Singapore) by the end of this year.

In view of this threat, Singapore Airlines' chief executive officer, Chew Choon Seng, has stated that the airline needs to deliver cost savings of 10%, or S$800 million, annually in order to maintain a competitive edge. Some doubt whether the airline can continue to generate cost savings of this magnitude, particularly as major cost-saving outsourcing measures have already been made.

Even if Singapore Airlines is able to fend off the competition, profitability is under pressure because of increasing fuel costs. As with most carriers, fuel is the largest cost component for Singapore Airlines. It accounted for more than one-quarter of Singapore Airlines Group's expenditure (25.3%), up from just under one-fifth (19.9%) last year.

Fuel hedging has reduced some of the impact. In the last financial year, fuel costs were reduced by S$380 million and totalled S$589 million, because of hedging tactics.

For the current financial year, Singapore Airlines has closed out positions that cover 32% of forecast fuel requirements, at a weighted average hedge price of close to $54 per barrel.

Singapore Airlines says: "Our existing fuel-hedging policy, which we keep under review, is to hedge between 30% and 60% of our requirements up to 18 months using a combination of hedging instruments, namely swaps, collars and call options."

Several financiers note that Singapore has adopted several new and revised financial reporting standards (FRSs), governing all Singapore-

All content © Copyright 2026 AFG, all rights reserved.

based companies, including Singapore Airlines Group. For the Singapore Airlines Group, some of the main changes are in the treatment of aircraft maintenance and overhaul costs, the recognition and fair value measurement of financial instruments, and the expensing of employee share options.

The adoption of these FRSs resulted in a net positive impact of S$61 million after tax. Singapore Airlines says that these reporting standards changes are not going to lead to any material change in financing strategy.

Thank you for printing this article from Airfinance Global, your essential intelligence resource for aviation finance. If you have been given this article by a subscriber, you can contact us through email at accountmanager@airfinanceglobal.com or call us on +44 (0)20 7779 8015 to discuss our subscription options.

All content © Copyright 2026 AFG, all rights reserved.