30th May 2024

ComfortDelGro

Corporate Monitor Ltd, a newly established not-for-profit entity dedicated to objective and comprehensive research on SGX listed companies, has published a report on ComfortDelGro ("CDG"). This is not investment advice.

CDG is integral to Singapore's transportation system, operating buses, taxis and trains. Despite such a prominent role, CDG's share price has been on a long-term decline, with Total Shareholder Return ("TSR") at a mere 0.4% per annum from 2014 to 2023, helped by its dividends.

The poor share price performance reflects the disappointing operating and financial performance. From 2014-2023, revenue largely stagnated while operating and net profits declined by 39% and 35% respectively. This is despite the company spending more than S$1b on overseas expansion and acquisitions, a sum equal to 1/3 of its market capitalization of S$3b today. It could be asked whether such funds have generated a positive return, and whether the company could have better uses for the funds.

We believe CDG's corporate performance has eroded shareholder value, as its Return on Equity ("ROE") has been on a long-term downward trend. Since 2020, CDG's ROE has been below 9%, which an analyst estimates to be CDG's cost of equity. While it is easy to blame COVID, ROE was only 10.2% in 2019, before COVID hit. This was down from 13.1% in 2014. CDG management confirmed to us that it has no target ROE. Instead, the corporate strategy is focused on scaling up its core business and getting into adjacent businesses, sometimes via acquisitions.

It is hard to see how such strategy can improve ROE. The core issue for CDG is that its main business, public transport, accounted for 76% of revenue, followed by taxis at 15%. Operating margin on public transport has declined from 7.9% in 2019 to 4.1% in 2023. Governments from Singapore to UK to Australia, where CDG operates, are using contract bidding to lower the cost of public transport. Our research shows that operating margins for public transport in developed economies in EU, UK and Australia typically are in the low single digits. Yet CDG has been bidding for bus and metro operations in EU in recent years, for the sake of "scaling up". Including more of the low margin public transport revenue will only lower the overall margin. CDG's past experience does not bode well for such moves. In the UK, where CDG has investments of S$450m on average in the last 5 years, return on investments averaged out at 0.6% per year and were negative in 2 years.

CDG's counter argument is that the public transport business carries little risks and hence lower margins are justified. The volatile performance in UK put paid to this argument. Moreover, there are more than S$160m of foreign exchange translation losses on CDG's books, due to the persistent weakness of UK's and Australia's currencies. Such foreign exchange losses, when recognized, could wipe out the meagre multi-year profits in these markets.

The taxi business has higher margins (operating margin of 18.6% in 2023) but faces a long-term structural trend of disruption and loss of market share to ride sharing firms such as Uber and Grab. Revenue in 2023 was 29% below that of 2019. Yet CDG continued to invest in this sector, via a recent acquisition of A2B in Australia at an equity value of A$182m. CDG does not explain the logic of investing in a business in secular decline. Worse, A2B has been loss making from 2020-2022 and only managed a profit (excluding gain from property sale) of A$4m in 2023. This translates into a P/E ratio of 46x for this acquisition, far higher than the 17x P/E multiple for CDG. CDG management needs to help shareholders understand how such acquisition is value accretive to shareholders. We are not convinced that it is value accretive.

The regulatory environment may also have negative implications for CDG's strategy of global expansion. A new normal is being established globally, where countries tighten regulatory oversight of the Transport sector. For example, the EU, Australia and Singapore have adopted laws to regulate systemically important players in matters such as foreign ownership. Such laws have observers concerned about the risks of protectionism. The political climate must be closely watched, as CDG risks being nudged out of key overseas markets that it had heavily invested in. These exits might not be at fair or favorable terms to CDG.

Despite the poor share price and financial performance, executive remuneration has gone up. We would like CDG to disclose specific KPIs tied to executive remuneration, to better align with shareholders' interest. This is practised by CDG's peers in Australia and UK. However, we were told management only planned to be in line with local benchmarks. It is noteworthy that local benchmarks (e.g. Practice Guidance from MAS) advocate for the same disclosures.

For a business of CDG's scale as measured by revenues and market capitalization, the corporate structure is unwieldy, with three listed entities. The smallest of these is Vicom, which has a revenue of S$110m that has not materially changed for years. Such multiple listings may hurt the valuation of the parent, CDG, since SBS, the larger of the two listed subsidiaries, trades at a lower P/E multiple of 11x.

Accompanying the unwieldy corporate structure are the large boards in the three listed companies, with a total of more than 30 directorships. By contrast, far larger listed entities such as DBS has only 10 directors. SMRT, the most direct comparable to CDG, also had 10 directors when it was a listed entity (it has 14 now as a private firm). There is also a large senior management team across the three listed companies. Ironically, notwithstanding the large senior management team, there is no dedicated CFO.

In conclusion, CDG needs to change course to create shareholder value. It takes a cultural change, with better focus on profitability and returns instead of growing for the sake of keeping revenues from dropping. In particular, CDG should re-consider the logic of bidding for overseas public contracts at razor thin margin that ultimately benefit populations in other countries without benefiting the local shareholders.

The full CDG report can be accessed at https://corporate-monitor.org/research/