

13 January 2020

## ST Engineering (STE SP)

**Expecting a Strong 2020; Maintain BUY**

Capital Goods | Aerospace & Defence

**Buy** (Maintained)

Target Price (Return) SGD4.55 (+12%)  
Price: SGD4.06  
Market Cap: USD9,372  
Avg Daily Turnover (SGD/USD) 17.3m/12.8m

- **Reiterate BUY and SGD4.55 TP, 12% upside plus c.4% yield.** ST Engineering – our sector and country Top Picks – should deliver double-digit profit growth in 2020-2021, aided by contributions from earnings-accretive acquisitions and record-high orderbook, which offers more than two years of revenue visibility. Its strong FCF-generation capability should enable it to deliver high dividend yields. We expect its share price to outperform the STI. Earnings contribution from the Newtec and Glowlink acquisitions and continuing strong order wins should remain key re-rating catalysts.

- **Record high orderbook.** STE reported an all-time high outstanding orderbook of SGD15.9bn, of which SGD2.2bn will be delivered in 4Q19 (4Q18 revenue was SGD1.8bn). The outstanding orderbook provides revenue visibility of about 2.5 years. Excluding the SGD1bn contract for the design and construction of the first Polar Security Cutter, the company reported order wins worth SGD5.4bn in 9M19. This has already exceeded the reported order wins worth SGD5.2bn in 2018.

- **Acquisitions to drive near-term earnings growth.** Profit growth has been strong in the last two quarters, aided by contributions from the Middle River Aerostructure Systems (MRAS), a US-based original equipment manufacturer engine nacelle manufacturer that it acquired early this year. We expect this profit contribution to increase, in line with the ramp-up in output at MRAS. We maintain that the recently completed Newtec and Glowlink acquisitions should remain earnings accretive despite the SGD20m in integration costs that will be spread over 4Q19 and 2020.

- **Valuation basis.** We value STE on blended valuations, ie FY20F 22x P/E, 5.8x P/BV, and 11x EV/EBITDA, as well as DCF (WACC: 6.3%, LTG: 1.5%). The WACC is based on a risk-free rate of 2.2%. We use the Monetary Authority of Singapore 10-Year (MASB10Y) bond yield as a proxy for the risk-free rate. The MASB10Y is yielding 1.76%. If we use this as a risk-free rate in our DCF valuation, our blended TP will increase to SGD4.68.

- **Key downside risks** include failure to sustain its current rate of strong order wins, slowdown in its aerospace business, an increase in MRAS and Newtec integration costs, and lower-than-estimated contributions from recently completed acquisitions.

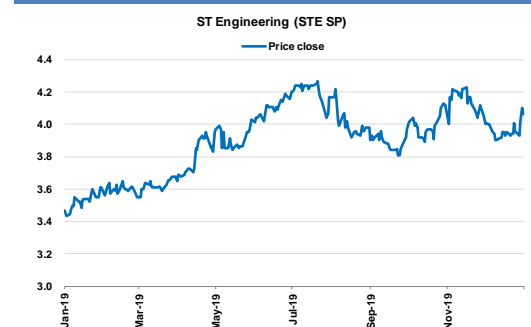
### Analyst

Shekhar Jaiswal  
+65 6232 3894  
[shekhar.jaiswal@rhbgroup.com](mailto:shekhar.jaiswal@rhbgroup.com)



### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	3.0	1.5	1.2	(4.5)	12.8
Relative	2.0	(1.4)	(4.1)	(1.9)	10.5
52-wk Price low/high (SGD)	3.54 - 4.35				



Source: Bloomberg

Forecasts and Valuations	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (SGDm)	6,521	6,698	7,616	8,084	8,632
Recurring net profit (SGDm)	482	527	556	611	688
Recurring net profit growth (%)	(0.5)	9.2	5.4	10.0	12.5
Recurring P/E (x)	25.0	23.1	22.1	20.1	17.8
P/BV (x)	5.7	5.6	5.6	5.3	4.9
P/CF (x)	15.3	17.7	16.1	13.7	10.1
Dividend Yield (%)	3.7	3.7	3.7	3.7	4.1
EV/EBITDA (x)	17.2	16.0	14.9	13.1	11.7
ROE (%)	21.9	23.6	24.7	26.3	27.7
Net debt to equity (%)	5.3	3.6	84.3	76.9	59.3
Interest coverage (x)	12.7	12.7	13.8	9.5	10.7

Source: Company data, RHB

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## Financial Exhibits

Singapore	Financial summary	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Industrials	Recurring EPS (SGD)	0.16	0.18	0.18	0.20	0.23
ST Engineering	DPS (SGD)	0.15	0.15	0.15	0.15	0.17
STE SP Equity	BVPS (SGD)	0.71	0.72	0.72	0.77	0.82
Buy	ROE (%)	21.9	23.6	24.7	26.3	27.7
Valuation basis	Valuation metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Our TP is derived by using an average of forward P/E, P/BV, EV/EBITDA and DCF of adjusted free cash flow.	Recurring P/E (x)	25.0	23.1	22.1	20.1	17.8
	P/B (x)	5.7	5.6	5.6	5.3	4.9
	FCF Yield (%)	22.7	33.0	24.6	19.5	12.8
	Dividend yield (%)	3.7	3.7	3.7	3.7	4.1
	EV/EBITDA (x)	17.2	16.0	14.9	13.1	11.7
	EV/EBIT (x)	24.1	22.9	23.8	20.5	17.8
Key drivers	Income statement (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
i. Strong order wins; ii. Contributions from MRAS and Newtec acquisitions.	Total turnover	6,521	6,698	7,616	8,084	8,632
	Gross profit	1,313	1,406	1,583	1,743	1,901
	EBITDA	760	814	995	1,128	1,236
	Depreciation & amortisation	184	195	280	308	327
	Operating profit	543	570	622	723	812
	Net interest	(19)	(34)	(27)	(49)	(47)
	Pre-tax profit	612	621	672	754	849
	Taxation	(86)	(104)	(109)	(123)	(138)
	Net profit	503	494	544	611	688
	Recurring net profit	482	527	556	611	688
Key risks	Cash flow (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
i. Poor execution of diversification in the aerospace sector; ii. Long term slowdown in the ship building industry; iii. Delay in the completion of Newtec acquisition; iv. Delay in the implementation of Singapore's smart nation initiative.	Change in working capital	2	(166)	(309)	(294)	(70)
	Cash flow from operations	764	639	660	820	1,141
	Capex	(271)	(332)	(274)	(275)	(270)
	Cash flow from investing activities	(246)	(65)	(1,412)	(230)	(224)
	Dividends paid	(468)	(468)	(468)	(463)	(520)
	Cash flow from financing activities	(390)	(1,161)	1,062	(539)	(596)
	Cash at beginning of period	904	998	414	727	778
	Net change in cash	(643)	(1,200)	(336)	(748)	(798)
	Ending balance cash	998	414	727	778	1,100
Company Profile	Balance Sheet (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
STE is an integrated engineering group in the aerospace, electronics, land systems and marine sectors. The company has over the years, diversified its businesses and geographical coverage.	Total cash and equivalents	999	416	728	779	1,101
	Tangible fixed assets	1,719	1,743	1,871	1,838	1,781
	Total investments	-	-	-	-	-
	Total assets	8,024	7,573	10,016	10,321	10,648
	Short-term debt	222	225	-	-	-
	Total long-term debt	894	270	2,635	2,635	2,635
	Total liabilities	1,941	1,187	3,733	3,733	3,733
	Total equity	2,215	2,246	2,249	2,397	2,565
	Total liabilities & equity	8,024	7,573	10,016	10,321	10,648
	Key metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Revenue growth (%)	(2.4)	2.7	13.7	6.1	6.8
	Recurrent EPS growth (%)	6.7	8.3	25.8	15.5	11.1
	Gross margin (%)	20.1	21.0	20.8	21.6	22.0
	Operating EBITDA margin (%)	11.7	12.2	13.1	14.0	14.3
	Net profit margin (%)	7.4	7.9	7.3	7.6	8.0
	Capex/sales (%)	4.1	5.0	3.6	3.4	3.1
	Interest cover (x)	12.7	12.7	13.7	9.5	10.6

Source: RHB, Company data

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Capital Goods | Aerospace &amp; Defence

Figure 1: TP derivation

FYE Dec	x	Based on 2020 estimates
P/E-based valuation	22.00	4.31
P/BV-based valuation	5.80	4.45
EV/EBITDA-based valuation	11.00	4.48
DCF-based valuation		4.98
<b>RHB's TP</b>		<b>4.55</b>

Source: RHB

Figure 2: DCF valuation

FYE Dec Quarter ended		Mar-19	Jun-19	Sep-19	Dec-19	2019 Dec-19	2020 Dec-20	2021 Dec-21	2022 Dec-22	2023 Dec-23
EBITDA	SGDm	217.3	254.1	262.1		997.4	1,130.3	1,238.0	1,303.1	1,371.6
Depreciation & amortisation	SGDm	(75.4)	(96.2)	(99.0)		(373.7)	(405.6)	(424.3)	(442.5)	(460.3)
EBIT	SGDm	141.9	157.9	163.1		623.7	724.7	813.7	860.6	911.3
Tax rate (%)	%	16%	17%	15%		16%	16%	16%	16%	16%
<b>EBIT (1 - tax rate)</b>	<b>SGDm</b>	<b>118.8</b>	<b>131.6</b>	<b>138.6</b>		<b>520.8</b>	<b>605.1</b>	<b>679.5</b>	<b>718.6</b>	<b>760.9</b>
Change in net working capital	SGDm	145.7	(170.0)	(262.7)		(311.1)	(291.9)	(70.1)	(58.5)	(63.1)
Net capex	SGDm	28.5	34.9	11.2		97.6	130.6	154.3	182.5	200.3
<b>Free cash flow</b>	<b>SGDm</b>	<b>293.0</b>	<b>(3.4)</b>	<b>(112.9)</b>		<b>307.4</b>	<b>443.8</b>	<b>763.6</b>	<b>842.6</b>	<b>898.2</b>
<b>Terminal value</b>	<b>SGDm</b>									<b>18,992.2</b>
Discount factor (nominal)	x	1.0	1.0	1.0		1.0	0.9	0.9	0.8	0.8
<b>PV of nominal cash flow</b>	<b>SGDm</b>	<b>293</b>	<b>(3)</b>	<b>(113)</b>		<b>307</b>	<b>417</b>	<b>676</b>	<b>701</b>	<b>15,575</b>
<b>PV of cash flows</b>	<b>SGDm</b>	<b>17,500.5</b>								
<b>Cash</b>	<b>SGDm</b>	<b>760.9</b>	<b>3Q19</b>							
Total debt	SGDm	2,435.4	3Q19							
Net debt / (net cash)	SGDm	1,674.5								
Minority interest	SGDm	270.7	3Q19							
Equity value	SGDm	15,555.4								
Shares outstanding (basic)	m	3,122.5	3Q19							
<b>Equity value</b>	<b>SGDm</b>	<b>4.98</b>								

Note: DCF value is adjusted for reported quarters

Source: RHB

Figure 3: DCF assumptions

Key assumptions	
beta	1.00
risk free rate	2.20%
market risk premium	4.50%
tax	17.50%
cost of debt	10.00%
cost of equity	3.00%
LT growth	6.70%
<b>WACC used</b>	<b>1.50%</b>

Source: RHB

Figure 4: DCF sensitivity analysis

		WACC				
		5.3%	5.8%	6.3%	6.8%	7.3%
Long term growth	0.5%	5.14	4.58	4.12	3.74	3.41
	1.0%	5.73	5.06	4.51	4.06	3.68
	1.5%	6.49	5.65	4.98	4.44	4.00
	2.0%	7.47	6.39	5.56	4.91	4.37
	2.5%	8.80	7.36	6.29	5.48	4.83

Source: RHB

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**KUALA LUMPUR**

**RHB Investment Bank Bhd**  
Level 3A, Tower One, RHB Centre  
Jalan Tun Razak  
Kuala Lumpur 50400  
Malaysia  
Tel : +603 9280 8888  
Fax : +603 9200 2216

**JAKARTA**

**PT RHB Sekuritas Indonesia**  
Revenue Tower, 11th Floor, District 8 - SCBD  
Jl. Jendral Sudirman Kav 52-53  
Jakarta 12190  
Indonesia  
Tel : +6221 509 39 888  
Fax : +6221 509 39 777

**HONG KONG**

**RHB Securities Hong Kong Ltd.**  
12<sup>th</sup> Floor, World-Wide House  
19 Des Voeux Road  
Central  
Hong Kong  
Tel : +852 2525 1118  
Fax : +852 2810 0908

**BANGKOK**

**RHB Securities (Thailand) PCL**  
10th Floor, Sathorn Square Office Tower  
98, North Sathorn Road, Silom  
Bangrak, Bangkok 10500  
Thailand  
Tel: +66 2088 9999  
Fax :+66 2088 9799

**SINGAPORE**

**RHB Securities Singapore Pte Ltd.**  
10 Collyer Quay  
#09-08 Ocean Financial Centre  
Singapore 049315  
Tel : +65 6533 1818  
Fax : +65 6532 6211