

17 April 2020

Industrials | Aerospace & Defence

## ST Engineering (STE SP)

**Buy** (Maintained)

### Moderating Aerospace Earnings; Reiterate BUY

Target Price (Return): SGD4.65 (+35%)  
 Price: SGD3.44  
 Market Cap: USD7,528m  
 Avg Daily Turnover (SGD/USD) 24.7m/17.5m

- **Reiterate BUY with new SGD4.65 TP from SGD4.90, 35% upside and 4.3% yield.** Amidst an unprecedented aviation traffic decline, airlines are now in cash-preservation mode: Grounding most of their fleets, accelerating older aircraft retirement, and likely deferring maintenance works on existing fleets. We trim 2020-2022 estimates 4-8% on a weak revenue outlook for aviation MRO. ST Engineering remains our Top Pick, given its relatively resilient and well-diversified business portfolio that offers strong revenue visibility from a record-high orderbook and earnings contributions from recently completed acquisitions.

- **Diverse portfolio of businesses helps mitigate the impact from a weak economic environment.** While STE is not immune to the adverse effects of a weak economic environment, its diverse business portfolio – which covers businesses across the aerospace, electronics, land systems, marine and defence sectors – allows the company to mitigate the overall negative impact on earnings. We believe various government grants and business-supportive measures announced by the Government will also help in offsetting some near-term revenue weakness.

- **No change in operations, as STE's businesses are "essential services".** In its latest press release, STE said its various businesses, including those in aerospace, marine, automotive, and electronics, have been classified as a provider of essential services in Singapore and the US. As such, it will be able to continue operating as normal from the relevant premises during this period of enhanced social distancing. STE's board is taking a 10% cut in fees, while President & CEO Vincent Chong has also taken 10% pay cut. Other senior personnel are taking 5-10% pay cuts. These changes will take effect from 1 May.

- **Long-term growth drivers still intact.** Gradual delivery of its record-high orderbook – which stands at SGD15.3bn and offers >2 years of revenue visibility – along with moderated by positive earnings contributions from the acquisitions of Middle River Aerostructure Systems (MRAS), Newtec, and Glowlink, should continue to drive earnings growth over the forecasted period.

- **Key re-rating catalysts and downside risks.** Continuing strong order wins and new earnings-accretive acquisitions could be the key re-rating catalysts. Key downside risks: A sharper-than-anticipated slowdown in the aerospace MRO business beyond 2020, higher Newtec integration costs, and lower contributions from acquisitions.

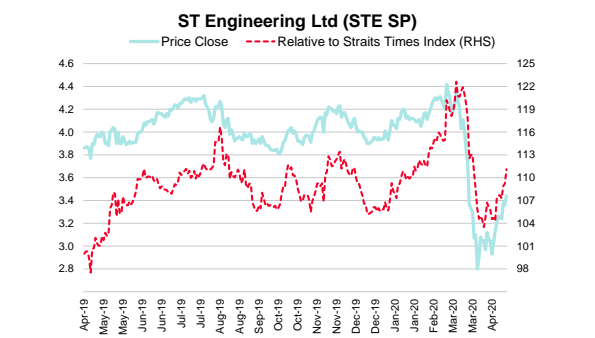
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(12.7)	2.4	(17.5)	(14.2)	(10.7)
Relative	6.3	(2.3)	2.8	2.5	10.9
52-wk Price low/high (SGD)	2.80 – 4.42				



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (SGDm)	6,698	7,868	8,145	8,793	9,501
Recurring net profit (SGDm)	527	589	592	712	773
Recurring net profit growth (%)	9.2	11.8	0.5	20.3	8.5
Recurring P/E (x)	20.34	18.19	18.14	15.08	13.90
P/B (x)	4.8	4.8	4.6	4.2	4.0
P/CF (x)	16.76	18.17	13.64	9.67	8.85
Dividend Yield (%)	4.4	4.4	4.3	4.7	5.6
EV/EBITDA (x)	13.61	12.59	11.93	10.16	9.32
Return on average equity (%)	22.2	25.9	25.9	29.1	29.3
Net debt to equity (%)	3.2	75.7	70.9	54.3	40.3

Source: Company data, RHB

## Financial Exhibits

Asia	Financial summary (SGD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Singapore	Recurring EPS	0.17	0.19	0.19	0.23	0.25
Industrials	DPS	0.15	0.15	0.15	0.16	0.19
<b>ST Engineering</b>	BVPS	0.72	0.71	0.75	0.81	0.87
STE SP	Return on average equity (%)	22.2	25.9	25.9	29.1	29.3
Buy						
	<b>Valuation metrics</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
	Recurring P/E (x)	20.34	18.19	18.14	15.08	13.90
	P/B (x)	4.8	4.8	4.6	4.2	4.0
	FCF Yield (%)	2.9	3.9	4.8	7.8	8.9
	Dividend Yield (%)	4.4	4.4	4.3	4.7	5.6
	EV/EBITDA (x)	13.61	12.59	11.93	10.16	9.32
	EV/EBIT (x)	19.44	19.67	18.48	15.03	13.67
	<b>Income statement (SGDm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
	Total turnover	6,698	7,868	8,145	8,793	9,501
	Gross profit	1,406	1,635	1,713	1,934	2,084
	EBITDA	814	1,022	1,080	1,238	1,317
	Depreciation and amortisation	(244)	(368)	(383)	(401)	(419)
	Operating profit	570	654	697	837	898
	Net interest	(34)	(37)	(65)	(65)	(58)
	Pre-tax profit	621	695	712	857	930
	Taxation	(104)	(103)	(105)	(126)	(137)
	Reported net profit	494	578	592	712	773
	Recurring net profit	527	589	592	712	773
	<b>Cash flow (SGDm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
	Change in working capital	(166)	(439)	(276)	(95)	(72)
	Cash flow from operations	639	590	787	1,111	1,214
	Capex	(332)	(172)	(275)	(270)	(260)
	Cash flow from investing activities	(65)	(1,273)	(226)	(220)	(208)
	Dividends paid	(468)	(468)	(468)	(503)	(606)
	Cash flow from financing activities	(1,161)	720	(542)	(577)	(679)
	Cash at beginning of period	999	416	453	472	786
	Net change in cash	(587)	37	19	314	326
	Ending balance cash	416	453	472	786	1,112
	<b>Balance sheet (SGDm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
	Total cash and equivalents	416	453	472	786	1,112
	Tangible fixed assets	1,743	1,805	1,800	1,772	1,716
	Total investments	456	453	404	354	303
	Total assets	7,573	9,521	9,881	10,256	10,637
	Short-term debt	225	1,869	0	0	0
	Total long-term debt	270	469	2,338	2,338	2,338
	Total liabilities	5,038	7,030	7,251	7,399	7,593
	Total equity	2,535	2,491	2,630	2,857	3,044
	Total liabilities & equity	7,573	9,521	9,881	10,256	10,637
	<b>Key metrics</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
	Revenue growth (%)	2.7	17.5	3.5	8.0	8.1
	Recurrent EPS growth (%)	9.2	11.8	0.3	20.3	8.5
	Gross margin (%)	21.0	20.8	21.0	22.0	21.9
	Operating EBITDA margin (%)	12.2	13.0	13.3	14.1	13.9
	Net profit margin (%)	7.4	7.3	7.3	8.1	8.1
	Dividend payout ratio (%)	94.7	81.0	79.1	70.7	78.3
	Capex/sales (%)	5.0	2.2	3.4	3.1	2.7
	Interest cover (x)	10.2	12.8	8.7	10.4	11.1

Source: Company data, RHB

## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-02-25	Buy	4.90	4.42
2020-01-13	Buy	4.55	4.03
2019-11-29	Buy	4.55	4.13
2019-11-12	Buy	4.55	4.17
2019-11-11	Buy	4.70	4.00
2019-10-14	Buy	4.70	4.04
2019-08-15	Buy	4.70	4.07
2019-07-05	Buy	4.45	4.23
2019-05-22	Buy	4.45	3.92

Source: RHB, Bloomberg

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