

25 February 2020

Industrials | Aerospace & Defence

ST Engineering (STE SP)

Buy (Maintained)

Strong End To 2019; Reiterate BUY

Target Price (Return): SGD4.90 (+17%)
 Price: SGD4.20
 Market Cap: USD9,332m
 Avg Daily Turnover (SGD/USD) 17.6m/12.9m

- **Reiterate BUY, new SGD4.90 TP from SGD4.55, 17% upside with c.4% yield.** ST Engineering – our country Top Pick – is well-positioned to deliver 10% profit growth in 2019-2022, aided by a record-high orderbook, contributions from new acquisitions, and through continuing investments to expand its capabilities in Aerospace and Electronics. The diversified, defensive nature of its business should enable STE to weather the near-term impact of the COVID-19 outbreak. Continuing strong order wins and earnings-accretive acquisitions remain key re-rating catalysts.
- **Strong end to 2019.** 2019 recurring PATMI of SGD589m (+12% YoY) accounted for 106% of our estimate. The earnings surprise for 4Q19 came from lower tax expenses and better profits for Aerospace. STE announced a final DPS of SGD0.10, implying a total 2019 DPS of SGD0.15 (unchanged YoY). Given the long-term nature of its businesses, the group has decided to publish its results on a half-yearly basis.
- **STE does not expect material impact from COVID-19 in the near term,** if the current outbreak remains at current levels until the mid-year. About half of the impact from the outbreak, if any, will be felt by the Aerospace unit – where STE is already working with airlines to rearrange maintenance schedules around changes to the latter's operations. We maintain that STE's business and geographic diversity, as well as the long-term nature of its contracts, ensure that its revenue remains relatively shielded from short-term uncertainties.
- **Focused on long-term growth in Aerospace.** STE will focus on growing its nacelle manufacturing after Middle River Aerostructure Systems (MRAS) aided strong profit growth in 2019. STE also remains focused on building Aerospace capabilities by setting up an airframe MRO capability in Vietnam, and pursuing new passenger-to-freighter conversion contracts. STE has securitised 30 engines that were held under its leasing business. This process will improve the group's capital structure and will ensure that it remains the asset manager for engines, while continuing to receive service fees. Gains from this exercise will be booked in 1Q20.
- **Electronics to benefit from recent acquisitions.** Growth in Electronics will be driven by contributions from its Newtec and Glowlink acquisitions. Revenues for its Smart City business, largely driven by Electronics, has grown 40% YoY in 2019 to SGD1.4bn and remains on track to reach a SGD2bn business by 2022.
- **Downside risks** include failure to sustain its current rate of order wins, slowdown in aerospace business amidst the COVID-19 outbreak, higher Newtec integration costs, and lower contributions from acquisitions.

Analyst

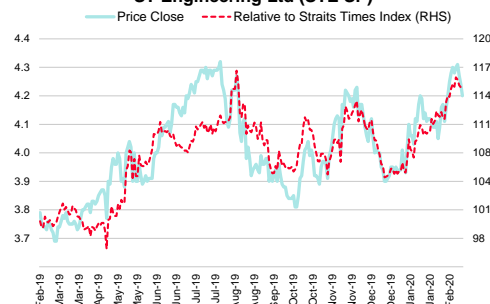
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	6.6	1.9	(0.5)	5.5	12.6
Relative	9.1	4.8	2.1	4.5	16.5
52-wk Price low/high (SGD)				3.69 – 4.32	

ST Engineering Ltd (STE SP)



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (SGDm)	6,698	7,868	8,418	9,082	9,807
Recurring net profit (SGDm)	527	589	647	742	804
Recurring net profit growth (%)	9.2	11.8	9.9	14.6	8.4
Recurring P/E (x)	24.84	22.21	20.26	17.68	16.31
P/B (x)	5.8	5.9	5.5	5.1	4.8
P/CF (x)	20.46	22.18	15.99	11.21	10.38
Dividend Yield (%)	3.6	3.6	3.6	4.2	4.8
EV/EBITDA (x)	16.52	14.90	13.09	11.56	10.63
Return on average equity (%)	22.2	25.9	28.0	29.7	30.0
Net debt to equity (%)	3.2	75.7	68.2	52.0	37.4

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (SGD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Regional	Recurring EPS	0.17	0.19	0.21	0.24	0.26
Industrials	DPS	0.15	0.15	0.15	0.18	0.20
ST Engineering	BVPS	0.72	0.71	0.76	0.83	0.88
STE SP	Return on average equity (%)	22.2	25.9	28.0	29.7	30.0
Buy						
Valuation basis	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Our TP is derived by using an average of forward P/E, P/BV, EV/EBITDA and DCF of adjusted free cash flows.	Recurring P/E (x)	24.84	22.21	20.26	17.68	16.31
	P/B (x)	5.8	5.9	5.5	5.1	4.8
	FCF Yield (%)	2.3	3.2	4.2	6.9	7.7
	Dividend Yield (%)	3.6	3.6	3.6	4.2	4.8
	EV/EBITDA (x)	16.52	14.90	13.09	11.56	10.63
	EV/EBIT (x)	23.59	23.29	19.98	17.14	15.63
Key drivers	Income statement (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
i. Strong order wins;	Total turnover	6,698	7,868	8,418	9,082	9,807
ii. Contributions from MRAS and Newtec acquisitions.	Gross profit	1,406	1,635	1,812	2,003	2,157
	EBITDA	814	1,022	1,163	1,290	1,372
	Depreciation and amortisation	(244)	(368)	(401)	(420)	(438)
	Operating profit	570	654	762	870	933
	Net interest	(34)	(37)	(65)	(64)	(57)
	Pre-tax profit	621	695	778	892	967
	Taxation	(104)	(103)	(115)	(132)	(143)
	Reported net profit	494	578	647	742	804
	Recurring net profit	527	589	647	742	804
Key risks	Cash flow (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
i. Poor execution of diversification in the aerospace sector;	Change in working capital	(166)	(439)	(318)	(85)	(73)
ii. Lower-than-expected contributions from acquisitions;	Cash flow from operations	639	590	820	1,169	1,263
iii. Delay in the implementation of Singapore's Smart Nation initiative	Capex	(332)	(172)	(275)	(270)	(260)
	Cash flow from investing activities	(65)	(1,273)	(226)	(220)	(208)
	Dividends paid	(468)	(468)	(468)	(550)	(630)
	Cash flow from financing activities	(1,161)	720	(542)	(624)	(704)
	Cash at beginning of period	999	416	453	505	831
	Net change in cash	(587)	37	52	326	351
	Ending balance cash	416	453	505	831	1,181
Company Profile	Balance sheet (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
ST Engineering (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	416	453	505	831	1,181
	Tangible fixed assets	1,743	1,805	1,777	1,725	1,644
	Total investments	456	453	404	354	303
	Total assets	7,573	9,521	9,998	10,372	10,765
	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	7,311	7,475	7,674
	Total equity	2,535	2,491	2,686	2,897	3,091
	Total liabilities & equity	7,573	9,521	9,998	10,372	10,765
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	2.7	17.5	7.0	7.9	8.0
	Recurrent EPS growth (%)	9.2	11.8	9.6	14.6	8.4
	Gross margin (%)	21.0	20.8	21.5	22.1	22.0
	Operating EBITDA margin (%)	12.2	13.0	13.8	14.2	14.0
	Net profit margin (%)	7.4	7.3	7.7	8.2	8.2
	Dividend payout ratio (%)	94.7	81.0	72.4	74.2	78.4
	Capex/sales (%)	5.0	2.2	3.3	3.0	2.7
	Interest cover (x)	10.2	12.8	9.5	10.7	11.5

Source: Company data, RHB

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Results Summary

Figure 1: STE – 4Q19 results review

	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	QoQ %	YoY %	4Q % of est.	2019 % est.
Income statement (SGDm)												
Revenue	1,646.6	1,651.1	1,626.2	1,774.0	1,731.3	1,780.0	2,068.6	2,288.3	11%	29%	112%	103%
Cost of sales	(1,320.7)	(1,301.2)	(1,283.6)	(1,387.0)	(1,382.5)	(1,398.6)	(1,635.5)	(1,816.2)	11%	31%	113%	103%
Gross profit	325.9	349.9	342.6	387.1	348.8	381.4	433.2	472.1	9%	22%	112%	103%
Operating Profit	122.1	144.5	143.6	160.0	141.9	157.9	163.1	191.1	17%	19%	119%	105%
Finance costs	(2.2)	(25.8)	0.7	(6.3)	(0.9)	(8.4)	(10.5)	(16.8)	60%	169%	224%	134%
Net other income / (expense)	8.6	19.2	11.9	(4.8)	10.2	7.3	7.2	14.2	97%	-399%	116%	105%
Associates and JVs	15.4	12.5	9.6	11.6	8.8	12.9	7.0	10.3	47%	-11%	87%	96%
Profit before tax	144.0	150.4	165.8	160.5	159.9	169.7	166.8	198.8	19%	24%	112%	103%
Income tax	(23.9)	(29.3)	(23.8)	(27.3)	(26.0)	(28.2)	(25.1)	(23.2)	-7%	-15%	73%	92%
Profit after tax	120.0	121.1	142.0	133.3	133.9	141.5	141.7	175.5	24%	32%	121%	105%
Minority Interest	(2.3)	(3.6)	(7.4)	(8.8)	(2.8)	(3.3)	(2.6)	(6.0)	131%	-32%	63%	80%
Profit for equity holders	117.7	117.5	134.6	124.5	131.1	138.2	139.1	169.5	22%	36%	125%	106%
PATMI (recurring)	117.7	121.7	138.4	149.1	131.1	138.2	150.3	169.5	13%	14%	125%	106%
Depreciation & amortisation	(57.2)	(58.2)	(65.4)	(63.3)	(75.4)	(96.2)	(99.0)	(97.7)	-1%	54%	95%	99%
EBITDA	179.3	202.8	209.0	223.2	217.3	254.1	262.1	288.7	10%	29%	109%	102%
Margins (%)												
Gross margin	19.8%	21.2%	21.1%	21.8%	20.1%	21.4%	20.9%	20.6%				
Operating margin	7.4%	8.8%	8.8%	9.0%	8.2%	8.9%	7.9%	8.3%				
EBITDA margin	10.9%	12.3%	12.9%	12.6%	12.6%	14.3%	12.7%	12.6%				
Net margin	7.1%	7.1%	8.3%	7.0%	7.6%	7.8%	6.7%	7.4%				

Source: Company data, RHB

Figure 2: STE – 4Q19 segmental results

	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	QoQ %	YoY %	4Q % of est.	2019 % of est.
Revenue (SGDm)												
Aerospace	599.6	716.5	689.4	648.6	623.5	837.3	1,052.6	941.5	-11%	45%	106%	102%
Electronics	609.1	515.6	497.8	544.0	570.3	500.8	545.9	692.9	27%	27%	119%	105%
Land Systems	285.8	273.8	301.8	441.5	387.7	300.7	313.1	456.1	46%	3%	102%	101%
Marine	150.0	148.2	137.5	138.7	149.1	139.3	154.6	204.1	32%	47%	147%	111%
Net profit (SGDm)												
Aerospace	59.2	66.6	55.4	63.5	62.7	64.2	65.0	76.9	18%	21%	148%	110%
Electronics	40.3	46.7	55.5	44.1	43.4	44.3	51.5	51.6	0%	17%	109%	102%
Land Systems	15.6	20.4	17.6	(0.7)	15.2	20.3	15.1	26.7	77%	-3788%	102%	101%
Marine	8.7	9.3	12.8	14.5	12.0	14.3	3.4	21.8	547%	51%	208%	128%
Net profit margin (%)												
Aerospace	9.9%	9.3%	8.0%	9.8%	10.1%	7.7%	6.2%	8.2%				
Electronics	6.6%	9.1%	11.1%	8.1%	7.6%	8.8%	9.4%	7.4%				
Land Systems	5.5%	7.5%	5.8%	-0.2%	3.9%	6.8%	4.8%	5.8%				
Marine	5.8%	6.2%	9.3%	10.5%	8.1%	10.3%	2.2%	10.7%				

Note: Net profit is not adjusted for exceptional items

Source: Company data, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2019-04-25	Buy	4.10	3.89

Source: RHB, Bloomberg

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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Not Rated:	Stock is not within regular research coverage

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