

18 May 2020

Industrials | Aerospace & Defence

ST Engineering (STE SP)

Buy (Maintained)

1Q20 Business Update; Keep BUY

Target Price (Return): SGD3.90 (+19%)
 Price: SGD3.27
 Market Cap: USD7,159m
 Avg Daily Turnover (SGD/USD) 26.2m/18.5m

- **Keep BUY with new SGD3.90 TP from SGD4.15 TP, 19% upside and c.5% yield.** In its 1Q20 business update, ST Engineering guided for 5-15% decline in 2020 revenue. It should deliver a profit and positive FCF in 2020 with earnings supported by defence business. Earnings growth will likely resume in 2021 as the global aviation industry gradually recovers. STE, a country Top Pick, should continue to outperform the STI, given its well-diversified business portfolio, record-high orderbook and sustainable DPS payout.
- **1Q20 business update.** STE noted that the COVID-19 pandemic has reduced customer demand, caused supply chain disruptions, and led to workforce disruptions. Its Electronics business has witnessed delays in delivery schedules while there was reduced demand for its Satcom business. For Aerospace, MRO capacity utilisation declined to 80-85% in 1Q20. This is expected to drop to 60%-65% in the coming quarters. Production of aircraft engine nacelle components at Middle River Aerostructure Systems has declined, while passenger to freighter conversions are impacted by supply chain disruptions.
- **Cost reduction and government support.** STE is undertaking a group wide cost reduction initiative, especially for businesses that will see long-term revenue impact from COVID-19. In addition to pay cuts undertaken by its management and directors, government support of c.SGD100m should enable the company in keeping costs in check during 2020.
- **Defence to support 2020 earnings.** Given its long gestation period, the defence business, which spreads across all segments, is expected to remain steady in 2020. Defence accounts for 30-35% of revenue. The company will ramp up the supply of the Hunter Armoured Fighting Vehicle (HAV) under Phase 1 of the contract from Singapore's Ministry of Defence by mid-2020. While the Phase 1 contract is expected to last for 2-3 years, STE has already secured the Phase 2 contract for HAV. Management guided that supply of HAV is a material contract.
- **Strong revenue visibility.** STE reported its highest ever orderbook of SGD16.3bn, which offers >2 years of revenue visibility. Of this orderbook, SGD4.5bn worth of orders are expected to be recognised in 9M20.
- **Earnings recovery in 2021 and resilient yield play.** Although we lower 2020F-2022F earnings by 10-12%, STE should see a return to earnings growth in 2021 amidst gradual recovery of domestic aviation traffic in the US and China and normalisation of supply chain and delivery schedules for most businesses segments. Given its strong FCF generation, we expect it to maintain unchanged DPS payout of 15 SG cents in 2020, or 4.6% yield.

Analyst

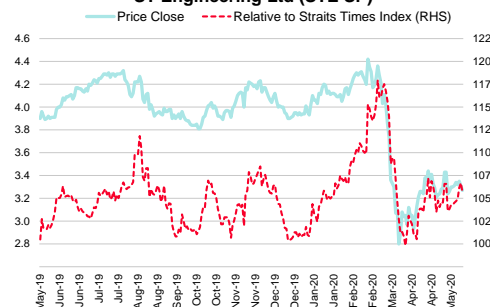
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(17.0)	(2.7)	(24.0)	(22.3)	(16.2)
Relative	4.7	0.5	(2.4)	(0.2)	5.4
52-wk Price low/high (SGD)	2.80 – 4.42				

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	6,980	7,442	8,002
Recurring net profit (SGDm)	527	589	506	568	650
Recurring net profit growth (%)	9.2	11.8	(14.2)	12.3	14.5
Recurring P/E (x)	19.34	17.29	20.19	17.98	15.70
P/B (x)	4.5	4.6	4.5	4.4	4.1
P/CF (x)	15.93	17.27	12.39	9.85	9.09
Dividend Yield (%)	4.6	4.6	4.6	4.7	4.7
EV/EBITDA (x)	12.96	12.07	12.25	11.14	9.88
Return on average equity (%)	22.2	25.9	22.6	24.7	26.8
Net debt to equity (%)	3.2	75.7	72.9	61.6	46.3

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (SGD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Singapore	Recurring EPS	0.17	0.19	0.16	0.18	0.21
Industrials	DPS	0.15	0.15	0.15	0.15	0.15
ST Engineering	BVPS	0.72	0.71	0.72	0.75	0.80
STE SP	Return on average equity (%)	22.2	25.9	22.6	24.7	26.8
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)	19.34	17.29	20.19	17.98	15.70
	P/B (x)	4.5	4.6	4.5	4.4	4.1
	FCF Yield (%)	3.0	4.1	5.4	7.5	8.5
	Dividend Yield (%)	4.6	4.6	4.6	4.7	4.7
	EV/EBITDA (x)	12.96	12.07	12.25	11.14	9.88
	EV/EBIT (x)	18.51	18.86	19.75	17.63	15.20
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	6,980	7,442	8,002
ii. Contributions from MRAS and Newtec acquisitions.	Gross profit	1,406	1,635	1,495	1,616	1,776
	EBITDA	814	1,022	1,007	1,089	1,197
	Depreciation and amortisation	(244)	(368)	(383)	(401)	(419)
	Operating profit	570	654	624	688	778
	Net interest	(34)	(37)	(86)	(78)	(74)
	Pre-tax profit	621	695	608	683	782
	Taxation	(104)	(103)	(90)	(101)	(115)
	Reported net profit	494	578	506	568	650
	Recurring net profit	527	589	506	568	650
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)	(168)	(55)	(71)
ii. Lower than expected contribution from acquisitions;	Cash flow from operations	639	590	824	1,037	1,123
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)	(232)	(225)	(213)
	Dividends paid	(468)	(468)	(468)	(480)	(483)
	Cash flow from financing activities	(1,161)	720	540	(589)	(591)
	Cash at beginning of period	999	416	453	1,586	1,809
	Net change in cash	(587)	37	1,133	223	320
	Ending balance cash	416	453	1,586	1,809	2,129
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	1,586	1,809	2,129
	Tangible fixed assets	1,743	1,805	1,800	1,772	1,716
	Total investments	456	453	410	365	318
	Total assets	7,573	9,521	10,563	10,784	11,107
	Short-term debt	225	1,869	0	0	0
	Total long-term debt	270	469	3,438	3,438	3,438
	Total liabilities	5,038	7,030	8,022	8,140	8,279
	Total equity	2,535	2,491	2,541	2,643	2,827
	Total liabilities & equity	7,573	9,521	10,563	10,784	11,107
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	2.7	17.5	(11.3)	6.6	7.5
	Recurrent EPS growth (%)	9.2	11.8	(14.3)	12.3	14.5
	Gross margin (%)	21.0	20.8	21.4	21.7	22.2
	Operating EBITDA margin (%)	12.2	13.0	14.4	14.6	15.0
	Net profit margin (%)	7.4	7.3	7.2	7.6	8.1
	Dividend payout ratio (%)	94.7	81.0	92.6	84.6	74.2
	Capex/sales (%)	5.0	2.2	3.9	3.6	3.2
	Interest cover (x)	10.2	12.8	6.5	6.0	6.8

Source: Company data, RHB

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Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-04-28	Buy	4.15	3.28
2020-04-17	Buy	4.65	3.36
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

Source: RHB, Bloomberg

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