11 October 2018

Technology | Software & Services

CSE Global

Solutions For a Secure Future; Initiate BUY

Buy

Target Price:	SGD0.59
Price:	SGD0.475
Market Cap:	USD174.8m
Bloomberg Ticker:	CSE SP

Initiate with BUY and SGD0.59 TP (24% upside), as CSE is poised to deliver CAGR of 16% over FY17-20F. Dividend yield of 5.8% is also attractive. CSE provides system integration solutions in control, communications and security. We believe elevated oil prices will encourage more system integration activities in the oil & gas space, which makes CSE an excellent proxy as >65% of its revenue is derived from the sector. It is trading at 12.7x FY19F P/E, a 22% discount to the industry.

Elevated oil prices provide potential opportunities. CSE provides process control solutions such as safety shutdown systems and fire & gas detection systems to its oil & gas customers, forming > 65% of its revenue. CSE operates in the Permian and Eagle Ford shale basins, which together with the Bakken field, account for 81% of total shale oil production in the US.

Management is looking to expand (organically or inorganically) its operations in the Permian and Eagle Ford basins, as well as venture into new locations to secure more small greenfield and brownfield projects. The potentially greater presence should underpin higher contract wins and in turn sustain earnings growth momentum, in our view. Further upside includes large greenfield contract wins when the projects pass the final investment decision (FID) stage.

Strong track record allows CSE to ride on Singapore's Smart Nation initiative and Australia's AUD75bn infrastructure investment plan to expand its topline. Notable projects accomplished include involvement in the Singapore Electronic Road Pricing (ERP) system and the Gold Coast Light Railway. CSE is part of the NCS-MHI consortium, which recently won the deal for the next-generation ERP. We understand from management that it is bidding for several infrastructure projects that are worth SGD20-30m.

Potential acquisitions in infrastructure space to fuel growth. Management has expressed interest in looking for acquisition targets to add to its geographical coverage, especially second tier cities in Australia. We expect acquisitions to come in the near term with potential target sizes of USD5-10m (single or collectively), which would boost NPAT by 5-10%.

Strong cash flow generation with solid balance sheet. CSE had a healthy net cash balance of SGD20.9m as at end-June, and forecasted positive cash flows of >SGD25m pa should provide ample resources to execute its growth strategy, and support its dividend payout, which offers attractive yields of 5.8%.

Initiate coverage with BUY. With management eyeing an expansion in the oil & gas segment, coupled with growth opportunities within the infrastructure segment, and synergies via partnering with its new shareholder, Serba Dinamik, we believe the best is yet to come for CSE.

We are projecting a CAGR of 16% for FY17-20F. Despite the YTD share price outperformance of 32%, valuations look compelling at FY19F P/E of 12.7x, below the industry average FY19F P/E of 16.3x. Initiate coverage with BUY and DCF-derived TP of SGD0.59 (WACC of 10%, TG of 0%). Key risks include oil price volatility, foreign currency risks, and execution risks. Under-researched: RHB is one of four brokers covering CSE.

Forecasts and Valuations	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Total turnover (SGDm)	317.8	362.4	368.2	380.6	390.2
Reported net profit (SGDm)	21.2	(46.9)	18.2	19.0	20.6
Recurring net profit (SGDm)	21.2	13.3	16.8	19.0	20.6
Recurring net profit growth (%)	(32.1)	(37.3)	27.4	13.4	8.7
Recurring EPS (SGD)	0.04	0.03	0.03	0.04	0.04
DPS (SGD)	0.03	0.03	0.03	0.03	0.03
Recurring P/E (x)	10.5	16.7	14.5	12.7	11.7
P/B (x)	0.9	1.3	1.4	1.3	1.3
P/CF (x)	3.8	na	8.1	9.7	8.8
Dividend Yield (%)	6.9	8.0	5.8	5.8	5.8
EV/EBITDA (x)	4.4	13.7	6.9	6.4	5.7
Return on average equity (%)	8.4	6.3	9.6	10.7	11.2
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)					

Source: Company data, RHB

Share Data

Avg Daily Turnover (SGD/USD)	1m/0.7m
52-wk Price low/high (SGD)	0.52 - 0.33
Free Float (%)	65
Shares outstanding (m)	509
Estimated Return	24%

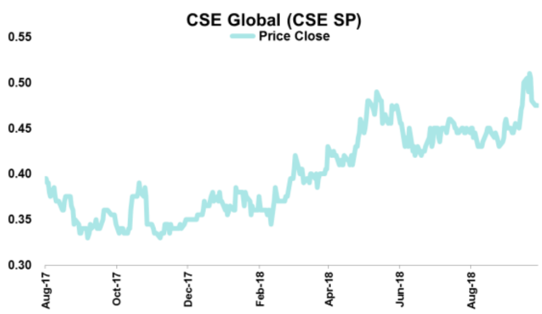
Shareholders (%)

Serba Dinamik	25.2
FMR	10.2
CAM-GTF	6.8

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	31.7	9.2	5.6	20.2	35.5
Relative	39.7	8.8	9.9	29.8	40.2

Source: Bloomberg



Source: Bloomberg

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Financial Exhibits

Financial model updated on: 2018-10-05.

Asia
Singapore
Technology
CSE Global
Bloomberg CSE SP
Buy

Valuation basis

DCF-derived TP of SGD0.59 with WACC of 10%

Key drivers

i. Elevated oil prices provide potential opportunities;
ii. Strong track record;
iii. Potential acquisitions to fuel growth;
iv. Strong cash flow generation with a solid balance sheet.

Key risks

i. Execution risks;
ii. Unsustainable oil price;
iii. Foreign currency risk;
iv. Legislative issues;
v. Credit risk;
vi. Shortage of talent.

Company Profile

CSE Global is a leading systems integrator focusing on the provision and installation of a variety of control systems as well as turnkey telecommunication network and security solutions, targeting the oil & gas, infrastructure and mining industries.

Financial summary	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Recurring EPS (SGD)	0.04	0.03	0.033	0.037	0.04
EPS (SGD)	0.04	(0.09)	0.037	0.036	0.04
DPS (SGD)	0.03	0.03	0.03	0.03	0.03
BVPS (SGD)	0.49	0.34	0.35	0.36	0.37
Weighted avg adjusted shares (m)	516	516	512	509	509

Valuation metrics	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Recurring P/E (x)	10.5	16.7	14.5	12.7	11.7
P/E (x)	10.5	na.	12.9	12.7	11.7
P/B (x)	0.9	1.3	1.4	1.3	1.3
FCF Yield (%)	21.5	(16.3)	10.2	8.3	9.3
Dividend Yield (%)	6.9	8.0	5.8	5.8	5.8
EV/EBITDA (x)	4.4	13.7	6.9	6.4	5.7
EV/EBIT (x)	5.6	26.4	8.9	8.3	7.4

Income statement (SGDm)	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Total turnover	318	362	368	381	390
Gross profit	101	94	99	103	106
EBITDA	35	57	32	33	36
Depreciation and amortisation	(7)	(7)	(7)	(8)	(8)
Operating profit	27	5	23	25	27
Net interest	0	(0)	(1)	(1)	(0)
Income from associates & JVs	0	0	0	0	0
Exceptional income - net	(0)	(46)	1	0	0
Pre-tax profit	28	(37)	24	25	27
Taxation	(7)	(9)	(6)	(6)	(7)
Minority interests	0	(2)	(1)	1	1
Recurring net profit (adj)	21	13	17	19	21

Cash flow (SGDm)	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Change in working capital	24	(33)	5	(2)	(1)
Cash flow from operations	62	(2)	36	32	35
Capex	(7)	(8)	(5)	(5)	(5)
Cash flow from investing activities	(28)	(10)	(5)	(5)	(5)
Dividends paid	(14)	(14)	(14)	(14)	(14)
Cash flow from financing activities	(49)	(4)	(15)	(14)	(14)
Cash at beginning of period	110	91	47	57	63
Net change in cash	(19)	(37)	10	6	9
Ending balance cash	91	47	57	63	72

Balance sheet (SGDm)	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Total cash and equivalents	91	47	57	63	72
Tangible fixed assets	27	28	27	26	25
Intangible assets	65	30	29	27	25
Total investments	8	1	1	1	1
Total other assets	149	177	162	165	168
Total assets	339	284	276	283	291
Short-term debt	21	31	33	33	33
Total long-term debt	0	0	0	0	0
Other liabilities	63	77	66	68	69
Total liabilities	84	108	99	101	102
Shareholders' equity	251	174	176	181	187
Minority interests	3	2	2	2	2
Total equity	255	176	177	182	189
Net debt	(70)	(16)	(24)	(30)	(38)
Total liabilities & equity	339	284	276	283	291

Key metrics	Dec-16	Dec-17	Dec 18F	Dec 19F	Dec 20F
Revenue growth (%)	(22.9)	14.0	1.6	3.4	2.5
Recurrent EPS growth (%)	(32.1)	(37.3)	27.4	13.4	8.7
Gross margin (%)	31.7	26.0	26.8	27.0	27.1
Operating EBITDA margin (%)	10.9	4.2	8.7	8.7	9.2
Net profit margin (%)	6.7	(12.9)	4.9	5.0	5.3
Dividend payout ratio (%)	66.9	106.7	83.7	73.8	67.9
Capex/sales (%)	2.3	2.2	1.4	1.3	1.3
Interest cover (x)	39.4	9.5	28.1	29.3	31.7

Source: Company data, RHB

Investment Merits

High barrier of entry. CSE is a part of the international consortium that developed the technology behind the world's first multi-lane, free-flow ERP system for the Singapore Government. It is also one of the few qualified vendors to provide high-level security solutions to Singapore and Australian Government agencies. Projects include the provision of control, communications and security solutions to the correctional facilities and airports in Australia. A strong track record enables CSE to be in better position to clinch more private and public projects, in our view.

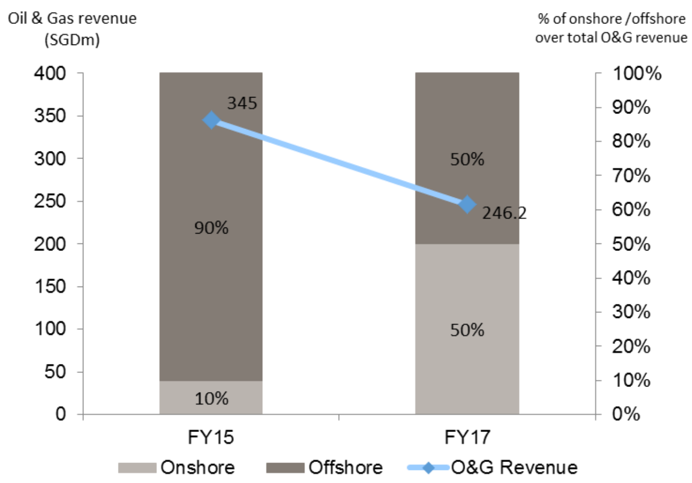
Elevated oil prices provide potential opportunities. CSE provides integrated process control solutions such as safety shutdown systems and fire & gas detection systems to its oil & gas customers, forming > 65% of total revenue. It operates in the Permian and Eagle Ford shale basins, which together with the Bakken field, account for 81% of total shale oil production in the US.

Management is looking to expand (organically or inorganically) its current operations in the Permian and Eagle Ford basins as well as venture into new locations with the focus on getting more small greenfield and brownfield projects. We believe greater presence and potentially higher contract wins will sustain earnings growth momentum. Further upside includes large greenfield contract wins when projects pass the FID stage.

Successful in growing revenue from onshore oil & gas segment. During the downturn in the oil & gas industry, management succeeded in growing its onshore revenue, and achieved a revenue mix of 50% offshore and 50% onshore in FY17, vs 90% offshore and 10% onshore in FY15. Revenue from the onshore oil & gas segment grew to SGD123.1m in FY17 from SGD34.5m in FY15. Even so, it was not enough to offset the significant decline in offshore revenue, which fell to SGD123.1m in FY17 from SGD310.5m in FY15.

Nonetheless, we believe CSE's management has done well, and are optimistic that the strategy will continue to benefit the company in the future. Going forward, management will likely actively pursue smaller greenfield and brownfield projects in the absence of larger greenfield projects.

Figure 1: Breakdown of oil & gas revenue



Source: Company data

Poised to benefit from Australian Government's infrastructure investments. As part of its strategy to strengthen the economy and beat congestion, the Australian Government plans to invest AUD75bn over the next ten years. CSE is in an excellent position to participate in the ongoing/upcoming infrastructure projects given its strong track record. We understand from management that it is currently bidding for large projects in the infrastructure segment in Australia and Singapore.

Potential acquisitions to fuel growth. Acquisitions have always been part of CSE's growth strategy. The company has a track record of executing acquisitions successfully since year 2000. While management is actively engaging and participating in securing large infrastructure projects, it also expressed interest in looking for acquisition targets to add on to its geographical coverage, with potential expansion into second tier cities in Australia via acquisitions. We believe any accretive acquisitions priced at USD5-10m will likely boost NPAT by 5-10%.

Strong earnings recovery in 1H18. 1H18 results affirmed the robust 1Q18 results, and we believe it will follow through for the rest of FY18 and into FY19. 1H18's performance has shown that the company's performance is improving following the decline in recent financial years, impacted by the downturn in the oil & gas sector. Going forward, the management's strategy is to continue looking for smaller green and brownfield projects, as well as bidding for sizeable infrastructure projects to fuel organic growth. It is currently working on two greenfield projects it secured in FY17, with revenue to be recognised in FY18 and 1Q19.

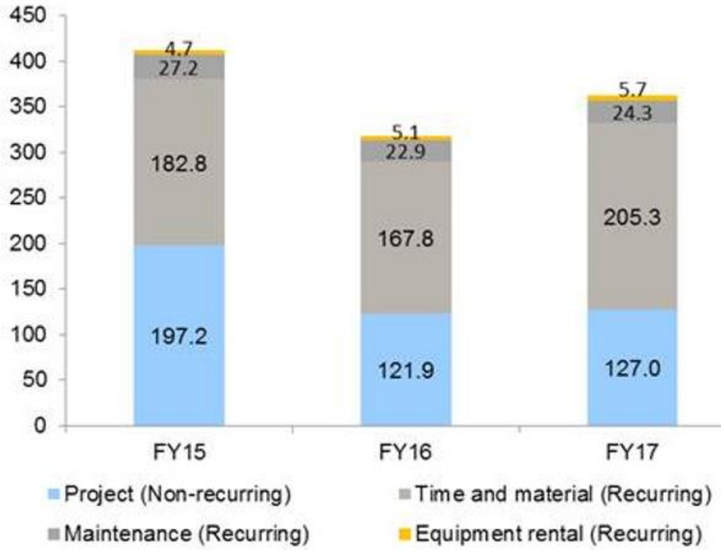
Limited downside. We believe the worst is over for CSE, and that kitchen-sinking has largely been completed. CSE recorded SGD58.5m worth of exceptional items in FY17, which included an impairment of goodwill of SGD27.95m, and an allowance for doubtful trade receivables of SGD11.7m. We think there is minimal downside surprise as we understand from management that the majority of impairment has been completed.

Expanding geographical reach through Serba Dinamik's existing network. In Apr 2018, CSE had a new substantial shareholder in Serba Dinamik, after the latter purchased shares from eight of CSE's shareholders. Around the same time, Serba Dinamik's CEO, Datuk Ir. Mohd Abdul Karim Abdullah was appointed as non-executive, non-independent director. Serba Dinamik is ranked third in terms of market share for maintenance, repair and overhaul (MRO) services related to rotating equipment in Malaysia, and its client base includes national oil companies such as Petronas and Saudi Aramco. We believe CSE would be able to tap on Serba Dinamik's strong network and extend its services in the region.

Asset-light business model with solid balance sheet. CSE operates on an asset-light business model, unlike its competitors, which are also manufacturers. Most of the projects are made-to-order, and therefore, do not require CSE to incur a huge amount of capex or carry substantial inventory. With a healthy net cash balance of SGD20.9m (as at 30 Jun 2018), and forecasted positive cash flows of over SGD25m pa, CSE has ample resources to execute its growth strategy as well as support its dividend payout, which offers an attractive yield of 5.8%.

Strong recurring revenue model. Approximately 60-65% of CSE's revenue in FY17 was recurring in nature, which we believe gives high earnings visibility. Under normal circumstances, maintenance contracts are valid for 1-2 years, and on auto renewal basis. In addition, being the project owner helps CSE to create a sticky relationship with its customers. The majority of its recurring revenue is derived from monthly maintenance services, which are accounted for and billed to clients on a monthly basis.

Figure 2: Recurring and non-recurring revenue (SGDm)



Source: RHB

Momentum in order intake is maintaining. 2Q18's order intake has gained momentum and reverted to SGD89.1m from SGD68.9m in 1Q18. We understand from management that CSE's strategy going forward is to bid for smaller greenfield and brownfield projects to mitigate the lull in large greenfield projects from the oil & gas sector. It is also actively pursuing large infrastructure projects to grow its infrastructure segment in both Singapore and Australia. Management is hopeful of maintaining the order intake of SGD70-90m every quarter.

Figure 3: Quarterly order intake (SGD m)

SGDm	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18
Oil & Gas	86.4	57.8	54.8	59.1	49.4	60.5
Mining	2.4	6.0	4.0	6.5	3.2	4.4
Infrastructure	29.0	27.0	27.6	21.2	16.3	24.2
Total	**117.8**	**90.8**	**86.4**	**86.8**	**68.9**	**89.1**

Source: Company data

Share buyback mandate. The company implemented a performance share plan in 2017. The objective is to align the interests of its senior management with shareholders' interests. We deem this as a positive step to create long-term shareholders' value. With the share buybacks, the incentive structure will shift to part cash, part shares, from 100% cash. The share buyback mandate does not exceeding 5% of the total issued shares of the company. As at 30 Aug 2018, the company bought back 7.18m ordinary shares, which constitute 1.4% of total shares.

Attractive dividend yield. Although CSE does not have a fixed dividend policy in place, it has all this while been consistent in paying out dividends to shareholders. Even in its worst performing financial year (FY17's core operating profit: SGD13.3m), CSE continued to reward its shareholders with SGD0.0275 of dividend per share, which translated to a 107% dividend payout ratio. With a more positive outlook, coupled with contracts reaching its billable milestone, we are optimistic that it is able to sustain its dividend payment. In its results release for 1H18, the company announced its intention to maintain its full-year dividend of SGD0.0275 per share. At the current price level, this translates to an attractive yield of 5.8%.

Figure 4: Dividends

	FY15	FY16	FY17	FY18F	FY19F	FY20F
Dividend per share (SGD cents)	2.75	2.75	2.75	2.75	2.75	2.75
Profit after tax before exceptional items (SGD m)	31.2	21.2	13.3	16.8	19.0	20.6
Dividend payout ratio (%)	46	67	107	84	74	68

Source: Company data, RHB

Valuation

Initiating coverage with BUY and TP of SGD0.59

DCF-derived TP of SGD0.59, with WACC of 10%. We initiate coverage on CSE with a DCF-derived TP of SGD0.59, and recommend BUY. Our TP implies a 15.7x FY19F P/E. The stock is now trading at about 12.7x FY19F P/E, with an attractive dividend yield of 5.8%.

Our DCF assumptions are:

i. WACC of 10%;

ii. Terminal growth rate of 0%.

Figure 5: CSE's DCF valuation

	Total (SGDm)	FY18F	FY19F	FY20F	FY21F	FY22F	FY23F	Terminal Value
EBIT		24.6	25.6	27.8	29.0	30.0	32.0	
EBIT(1-T)		**18.6**	**19.4**	**21.0**	**21.9**	**22.6**	**24.1**	
Less: Capex		(5.0)	(5.0)	(5.0)	(5.0)	(5.0)	(5.0)	
Add: Depreciation & Amortisation		7.2	7.6	8.1	8.5	8.9	9.3	
Less: Change in Non-cash WC		4.5	(1.6)	(1.2)	(1.5)	(1.4)	1.0	
FCFF		**25.3**	**20.4**	**22.9**	**23.9**	**25.2**	**29.5**	**296.6**
Present Value of FCFF		-	18.6	18.9	18.0	17.2	18.4	184.6
Total FCFF	**275.7**							
Add: Cash	57.0							
Less: Value of Debt	(33.2)							
Less: Minority Interest	(1.8)							
Target Equity Value	**297.7**							
No. of shares (basic)	509							
Intrinsic Share Price (SGD)	**0.59**							

Source: RHB

Figure 6: Underlying assumptions for WACC

Cost of Equity		**Cost of Debt**	
Expected market return	11%	Pre-Tax Cost of Debt	3%
Risk free	3%	1 - Effective Tax Rate	75%
Beta	1.07	Weight	13%
Weight	87%		
WACC (Estimated)	**10%**		

Source: RHB

Figure 7: Additional forecast assumptions

	O&G	Infrastructure	Mining
Revenue contribution	69% - 70 %	27% - 29%	1% - 3%
Revenue growth	2% - 5%	4% - 5%	n.a.
EBIT margin	3% - 5%	12% - 14%	11%
EBIT contribution	42% - 45%	52% - 55%	2% - 5%

Source: RHB

Best case scenario

We believe there is a possibility that we may see FID pass through sooner than expected, with more deepwater projects coming through. Together with the growing flow of business at the onshore segment and potential accretive acquisitions, we have factored in a 6-10% growth within the oil & gas sector in our best case scenario.

We also think that the infrastructure space could see further upside, which includes winning more contracts, especially higher valued contracts from the Australian and Singapore government agencies. Through strengthening its presence especially in New South Wales, Australia via accretive acquisitions, we believe there is a likelihood of a robust 7-10% growth in this segment. Given the above, we think that there is a possibility of a 50% upside to its current stock price in our best case scenario.

Figure 8: CSE's best case scenario; DCF valuation

	Total (SGDm)	FY18F	FY19F	FY20F	FY21F	FY22F	FY23F	Terminal Value
EBIT		-	26.7	30.4	33.0	35.5	38.5	-
EBIT(1-T)		-	**20.2**	**23.0**	**24.9**	**26.8**	**29.0**	-
Less: Capex		-	(5.0)	(5.0)	(5.0)	(5.0)	(5.0)	-
Add: Depreciation & Amortisation		-	7.6	8.1	8.5	8.9	9.3	-
Less: Change in Non-cash WC		-	(1.7)	(1.3)	(1.7)	(1.6)	1.2	-
FCFF		-	**21.2**	**24.8**	**26.7**	**29.1**	**34.6**	**390.7**
Present Value of FCFF		-	19.2	20.5	20.1	19.9	21.5	243.3
Total FCFF	344.5							
Target Equity Value	**366.6**							
No.of shares (basic)	509							
Intrinsic Share Price (SGD)	**0.72**							
WACC	10%							
Terminal growth	1%							

Source: RHB

Worst case scenario

On the flipside, if oil prices are unsustainable, we expect CSE's clients to implement more stringent cost control measures and this would translate into significantly lower order flows and a lack of greenfield projects. Based on this worst case scenario, we cut our forecast for the oil & gas segment by 30-40% for FY19F-23F (based on FY18F's revenue).

Similarly, we used an aggressive discount on the forecasted revenue from the infrastructure segment of 30-40%, on the assumption that the company is unable to renew its contracts with the risk of losing its recurring revenue, in addition to losing out on project revenues. In this worst case scenario, our forecast shows that there is a chance of a 28% downside risk to the current stock price.

Figure 9: CSE's worst case scenario; DCF valuation

	Total (SGDm)	FY19F	FY20F	FY21F	FY22F	FY23F	Terminal Value
EBIT		15.1	14.9	14.9	14.9	14.9	-
EBIT(1-T)		**11.4**	**11.3**	**11.3**	**11.3**	**11.3**	-
Less: Capex		(5.0)	(5.0)	(5.0)	(5.0)	(5.0)	-
Add: Depreciation & Amortisation		7.6	8.1	8.5	8.9	9.3	-
Less: Change in Non-cash WC		(0.9)	(0.6)	(0.8)	(0.7)	0.5	-
FCFF		**13.1**	**13.7**	**14.0**	**14.5**	**16.1**	**161.9**
Present Value of FCFF		11.9	11.3	10.5	9.9	10.0	100.8
Total FCFF	154.5						
Target Equity Value	**176.6**						
No.of shares (basic)	509						
Intrinsic Share Price (SGD)	**0.35**						
WACC	10%						
Terminal growth	0%						

Source: RHB

Key Risks

Execution risks. As a system integration solutions provider, the company is subject to risks such as delays in the implementation of projects, delays in the completion of projects, and cost overruns due to improper budgeting or resources planning. If this happens, CSE may face financial losses or its working relationship with its client may be affected which may in turn impact the bidding for future contracts.

Unsustainable oil price. CSE generates 60-70% of its revenue from the oil & gas industry. If the oil price is unsustainable, there is no incentive for oil companies to produce and activity levels may slow sharply. Consequently, there would not be any projects up for bidding.

Foreign currency risk. CSE is exposed to foreign currency risk on transactions and balances from sales or purchases that are dominated in foreign currencies (mostly USD, AUD, GBP and EUR). More than 90% (FY17) of CSE's sales and 80% of the costs are denominated in the respective functional currencies of its entities.

The weakening of foreign currencies against the SGD may impact the company's performance. Based on our estimation, the recent weakness in the AUD (-3%; 1H18:1.0253 vs 1H17:1.0574) has affected its revenue by 1-2% on a translation basis.

The company mitigates its foreign currency risk by building a buffer in its quotations to its clients and making back-to-back purchases once sales are confirmed to avoid exchange rate fluctuations.

Legislative issues. Sanctions have been put in place against certain countries in which CSE has business dealings with. CSE has to be extra careful when dealing with such companies. Potential civil liability may arise for any alleged violations of the Sanctions Act.

Credit risk. CSE's exposure to credit risk primarily arises from trade receivables should its customers default on their obligations. As at 31 Mar 2018, CSE had approximately SGD91.3m worth of trade receivables on its balance sheet.

Shortage of talent. The company relies heavily on its engineers to run projects and service its customers. Currently, about 90% of its headcount are engineers and salary costs are one of the most significant components in its P&L. The risk of losing its talents or not hiring enough staff to meet demand may result in a loss of projects and a decrease in revenue.

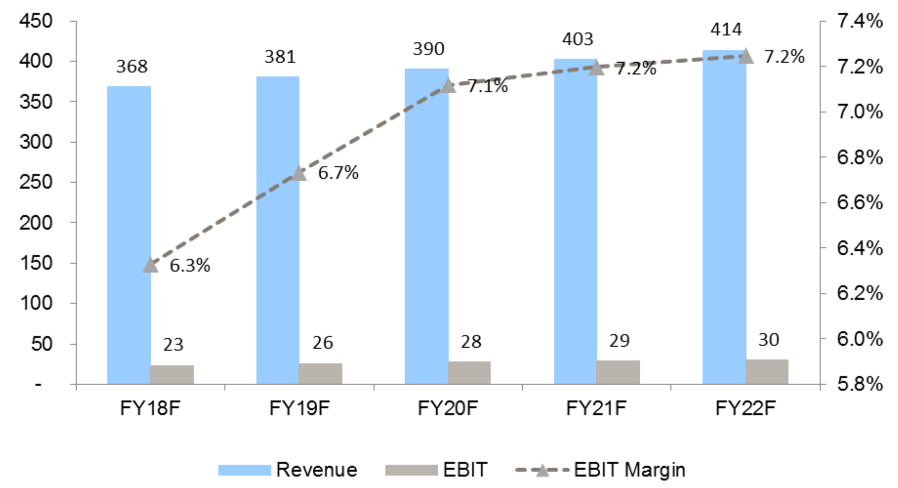
Financial Forecasts

Revenue to be back on track. We saw a dip in revenue over the past few FYs due to the oil price crisis, which saw oil prices tumble below USD30 per bbl in Jan 2016. YTD, oil prices have remained relatively stable, and gaining upward momentum. Riding on this trend, we expect CSE's revenue to follow suit and be on an upward trajectory. Coupled with its growing infrastructure segment, we are optimistic of its near-term performance.

Benefiting from recovery in the oil & gas industry. The oil & gas segment's revenue growth is likely to come from smaller greenfield and brownfield projects in both onshore and offshore sectors. We are forecasting revenue growth of 2-4% from FY18F onwards, with EBIT expected to grow by 100% in FY18F, followed by growth in the low teens over the subsequent two FYs. Factors contributing to the revenue increase include recognition of revenue from two major contracts won in FY17, higher production volume that may result in higher capex requirement & maintenance from its clients, smaller greenfield and brownfield projects wins, and EBIT margin improvements due to better pricing, cost rationalisation, and the absence of impairment of receivables.

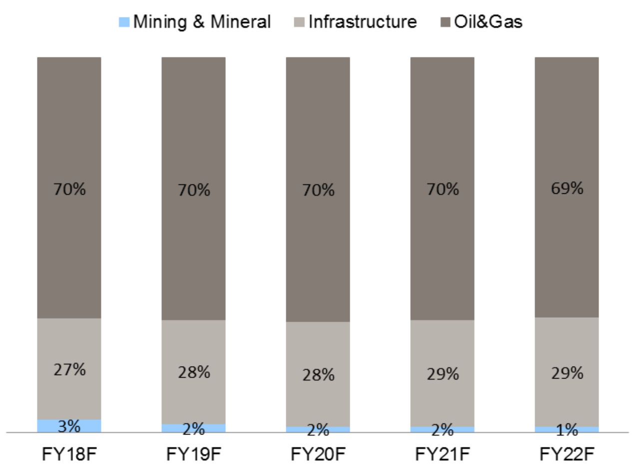
We are also positive on the infrastructure sector as the Australian Government is planning to boost infrastructure spending, and given opportunities in Singapore's Smart City initiatives. For the infrastructure sector, we are forecasting revenue growth of 10% in FY18F and between 4-6% in the subsequent FYs. The basis of our projection includes expanding into second tier cities in Australia, smaller green and brownfield projects contract wins, the Australian Government's plan to boost spending on infrastructure, and Singapore's Smart City initiatives.

Figure 10: FY18F-22F estimates



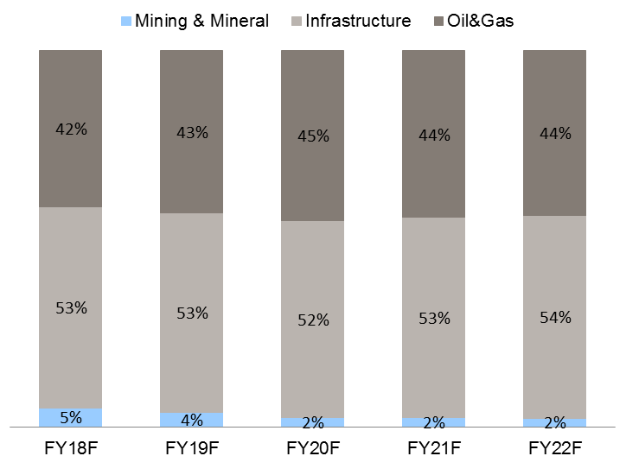
Source: RHB

Figure 11: Revenue forecasts by industry



Source: RHB

Figure 12: EBIT margin forecasts by industry



Source: RHB

Company Background

CSE is a global systems integrator, focusing on the provision and installation of control systems, as well as communications and security solutions targeting the oil & gas, infrastructure and mining industries.

It has an international presence spanning the Americas, Asia Pacific, Europe, Middle East and Africa regions. Currently, the company operates a network of 39 offices in 17 countries with a team of 1,036 employees.

CSE commenced operations in 1985 as the engineering projects division of Chartered Electronics Industries, the electronics arm of Singapore Technologies (ST). In 1995, the Singapore Government spun off some of the business units to list by itself and be independent. Hence, the Government encouraged employees to buy over the shares. Tan Mok Koon, the founder, together with six of his employees bought out the majority stake in the company in 1997. The company was listed on the SGX in Feb 1999. Lim Boon Kheng was appointed as the group CEO in 2013. Prior to his promotion, he was the group CFO since 2002 and is concurrently the managing director for CSE's Asian business.

Figure 13: CSE's management team

Name	Position	Profile
Lim Ming Seong	Chairman and Non-Executive Director	Mr Lim was appointed as the Chairman and Non-Executive Director of the Company on 17 January 1997. He was last re-elected as a Director of the Company on 20 April 2016. Mr Lim holds a Bachelor of Applied Science (Honours) with a major in Mechanical Engineering from the University of Toronto and a Diploma in Business Administration from the former University of Singapore. He has also participated in the Advanced Management Programmes conducted by INSEAD and the Harvard Business School.
Lim Boon Kheng	Chief Executive Officer	Mr Lim is the Group Managing Director/Chief Executive Officer of CSE Global Limited, was appointed as an Executive Director on 13 August 2013 and was last re-elected as Director of the Company on 20 April 2017. Mr Lim holds a Bachelor of Accountancy from the National University of Singapore.
Eddie Foo	Chief Financial Officer	Mr Eddie Foo is the Group Chief Financial Officer of the Company. Mr Foo is responsible for the Group's overall financial strategy and management, corporate finance and treasury management, tax and investor relations. Mr Foo holds a Bachelor degree in Accountancy from the Nanyang Technological University and is a member of the Institute of Chartered Accountants of Singapore.
Leong Say Haur	Chief Operating Officer	Mr Leong is the Chief Operating Officer of the Company, with overall strategic and business operational responsibility for CSE-ITS, CSE-IAP, CSE-EIS and CSE Transtel. Mr Leong joined CSE Transtel as Managing Director in July 2013. He holds a Bachelor of Arts (Economic & Finance) from University of Western Ontario, Canada.

Source: Company data

Process control

CSE provides process control solutions that utilise supervisory control and data acquisition systems (SCADA), distributed control systems (DCS), programmable logic controllers (PLCs), motors, drives and plant transducers. Many of its mission critical solutions are used in high integrity environments such as oil & gas, power and nuclear installations, with client processes being wholly dependent on the control systems.

Example of control systems:

i. Intelligent transport system (ITS): ERP system, electronic toll collection system and electronic information display system;
ii. Safety shutdown system: emergency shutdown systems, process shutdown systems and integrated control & safety systems.

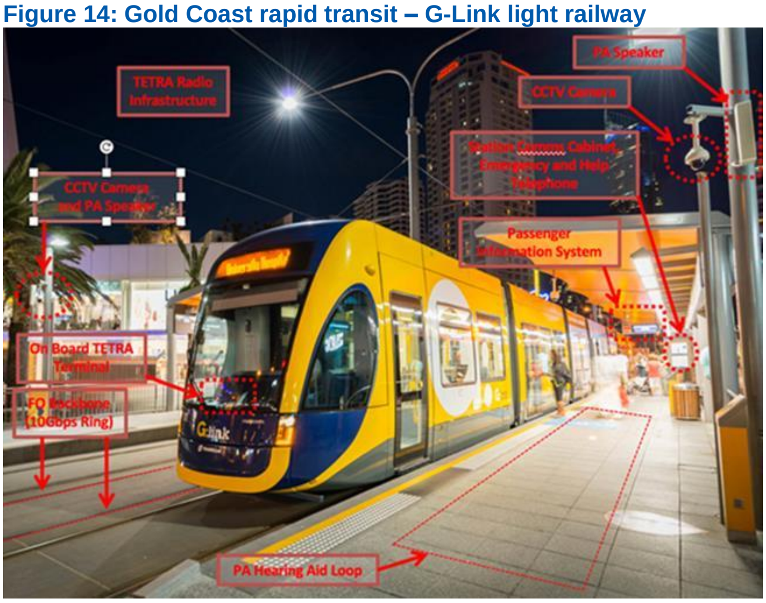
Communications and security

CSE designs, installs and maintains 2-way radio communications for both permanent and temporary locations. CSE offers turnkey packaged solutions or will provide rental and managed systems. CSE's 2-way radio systems offer the latest in personnel safety management and personnel tracking, location and "man down" alert systems.

Example of communications and security solutions:
i. Fibre optic systems;
ii. VSAT satellite communications networks;
iii. CCTV, access control & FIDS systems.

Example of communications project involvement**:** CSE Transtel scope of work – Design, supply & interfacing of fibre optic IP backbone network for signalling and data communications, for security CCTV systems, TETRA Radio communications, emergency telephone systems, station PA systems, and passenger information systems serving 16 stations and depots.

Figure 14: Gold Coast rapid transit – G-Link light railway



Source: http://cse-transtel.com/wp-content/uploads/2016/07/gold-coast-rapid-transit2.jpg

Renowned list of clients. CSE's top three customers contributed about 10-20% of total revenue. The list of clients includes blue chip companies like Shell, BP, Exxon and Chevron, which have market capitalisations of USD100bn-350bn. CSE is also working closely with national oil companies like Petronas. For the infrastructure segment, CSE mainly deals with the Singapore and Australian Government agencies such as the land Transport Authority of Singapore and MINDEF.

Figure 15: CSE's global clients

Source: RHB

Serba Dinamik emerged as a substantial shareholder in an exchange filing dated 13 Apr 2018. Serba Dinamik acquired a 24.84% stake in CSE from eight shareholders at SGD0.45 a share, or approximately 20% premium to the market price traded during that time. This acquisition opens up new possibilities for CSE to further its reach to the Middle East and Malaysia where Serba Dinamik has a strong presence. Following the acquisition, Serba Dinamik's CEO, Datuk Ir. Mohd Abdul Karim Abdullah was appointed as the non-executive, non-independent director and deputy chairman of CSE. Mr Syed, group CFO of Serba Dinamik was appointed as the non-executive, non-independent director.

Figure 16: Insider shareholding

Insider:	%
Lim Boon Kheng	1.4
Lim Ming Seong	0.63
Abdullah Abdul Karim Bin	0.39
Lee Soo Hoon	0.09

Source: Bloomberg

Business Analysis

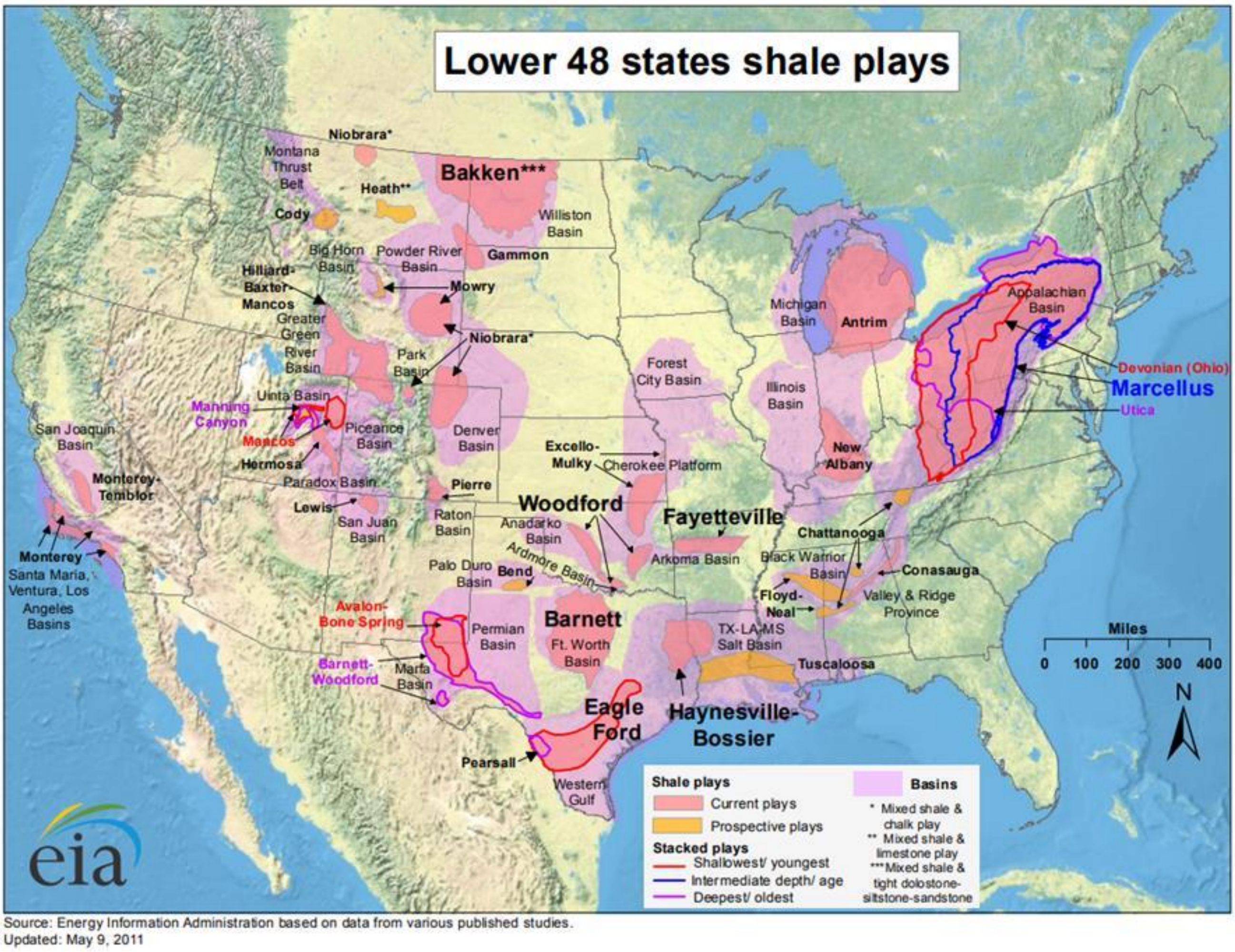
CSE's turnover was impacted in recent years due to the oil price crisis, which saw oil prices tumble to below USD30 per barrel in Jan 2016. CSE serves the oil & gas industry predominantly in the US and Middle East, offering system integration solutions focusing on the provision and installation of a variety of control systems.

Due to contracts secured prior to the crisis, CSE managed to maintain its revenue in FY14. However, as a result of lower activities, revenue declined from SGD345m in FY15 to a low of SGD236.8m in FY16 before rising slightly to SGD246.2m in FY17.

There are three dominant basins for shale oil – the Permian Basin, the Eagle Ford, and the Bakken fields. These three basins account for 81% of total shale oil production. The company currently operates on two oil shale formations, Permian Basin and Eagle Ford Basin.

CSE will continue to strengthen its presence in these two formations while looking to set up offices in new territories to explore opportunities. Offshore revenue should come from smaller platforms in the Gulf of Mexico.

Figure 17: Shale gas in the United States



Source: https://upload.wikimedia.org/wikipedia/commons/2/22/United_States_Shale_gas_plays%2C_May_2011.pdf

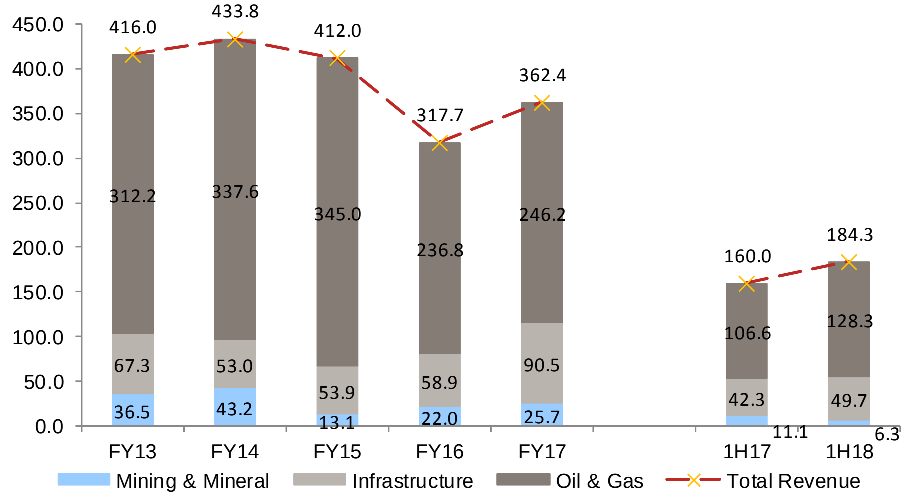
Infrastructure revenue on the rising trend. The group derived its revenue from the infrastructure segment mainly from Australia and Singapore. This sector registered a YoY revenue growth of 53.6% to SGD90.5m in FY17, due to higher spending on public infrastructure in Australia and Singapore, as well as from the addition of a new radio communications business in Australia. In 1Q18, revenue grew by 24% to SGD23.7m from SGD19.1m in 1Q17.

Figure 18: Past acquisitions

No.	Year	Company & Business Nature
1	2000	- United States based W-Industries & Control Concept Technologies, - British systems integrator, Servelec, telecommunications provider ranstel Engineering, and - ttc s.r.o. in Slovakia
2	2004	- Uniserve Corporation, an electrical engineering solutions company for the power & water utility, and mining industries in Australia, and - RTUnet, a manufacturer and distributor of the Kingfi sher remote telemetry units for industrial application, also in Australia
3	2006	- CSE-Semaphore, a Belgium-based company that develops and sells telemetry and telecontrol solutions for various industries, including oil & gas, irrigation, utilities, railways and building automation, and - CSE-Controls Ltd, a Scotland-based company that provides system integration services for customers in the oil, gas and power sector
4	2008	- W Arthur Fisher (WAF), a New Zealand-based company that provides control and electrical engineering services, and - Hankin Acquisition Corp, a US based company that designs and installs high temperature thermal process and incineration systems for the industrial and environmental markets
5	2011	- Astib Group, one of Australia's leading communications providers. The Astib Group provides a range of systems integration services for the development and delivery of sophisticated communications.
6	2012	- Acquired 66% controlling interest in Power Diesel Engineering Pte Limited, a recognised leader in engine servicing focusing on the oil & gas sector.
7	2013	- Acquired 75% share of S3ID Group Limited. S3ID designs and manufactures computer programmable safety systems for electronic mustering, principally for the oil and gas sector.
8	2015	- CC American Oilfield, manufacturing and repairing pressure vessels for wellhead oil and gas production in Corpus Christie, Texas, USA, and - Mobile Masters, delivering Two-way radio communication systems and infrastructures in Western Australia, and - Tetracom, delivering two-way radio communication systems and infrastructures in South Australia and, - Ezi Communications, Provision of two-way radio communication systems in Queensland, Australia.
9	2017	- Gulf Coast Power & Control of Louisiana, Provision of equipment and services for the midstream and ownstream oil and gas industry, mainly in the Lake Charles city on the Gulf Coast of USA - Combined Communication Solutions, Provision of two-way radio communication systems in Darwin, Australia - Comm8, radio communications experience in the Northern Territory (Australia)
10	2018	Genesis Communications, Providing Motorola communications products, solutions and services in New Zealand

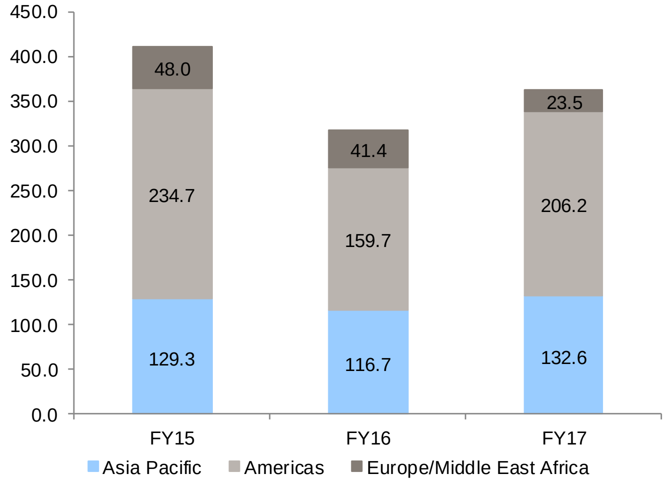
Source: Company data

Figure 19: Revenue by industry



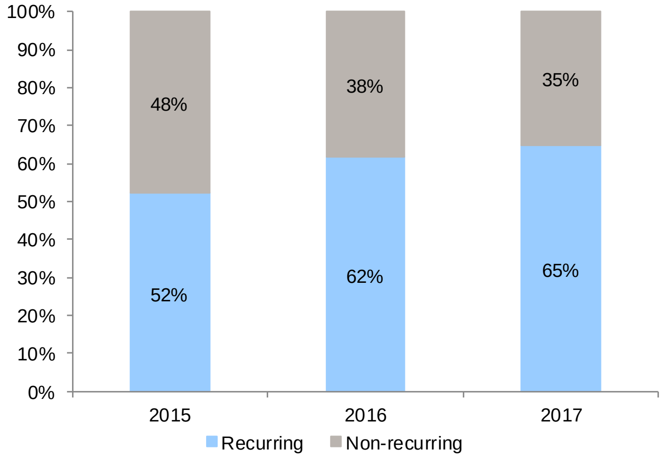
Source: Company data

Figure 20: Geographical location



Source: RHB

Figure 21: Recurring and non-recurring revenue



Source: RHB

Good earnings visibility. CSE's revenue component consists of:

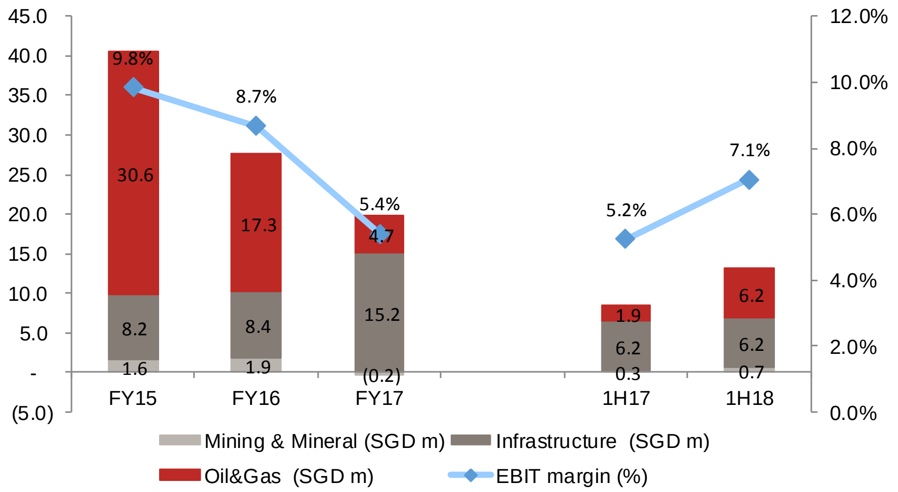
i. Time and materials;

ii. Maintenance;

iii. Equipment rental, which are recurring in nature.

These three components made up 65% of FY17 revenue, which suggests high earnings visibility going forward.

Figure 22: EBIT by industry and EBIT margins



Source: Company data

FY17 – a year of one-offs. CSE recorded SGD58.5m worth of exceptional items in FY17. This comprised:

i. One-off settlement cost of SGD16.8m;

ii. Impairment of receivables of SGD11.7m;

iii. Impairment of goodwill net of NCI SGD26.2m;

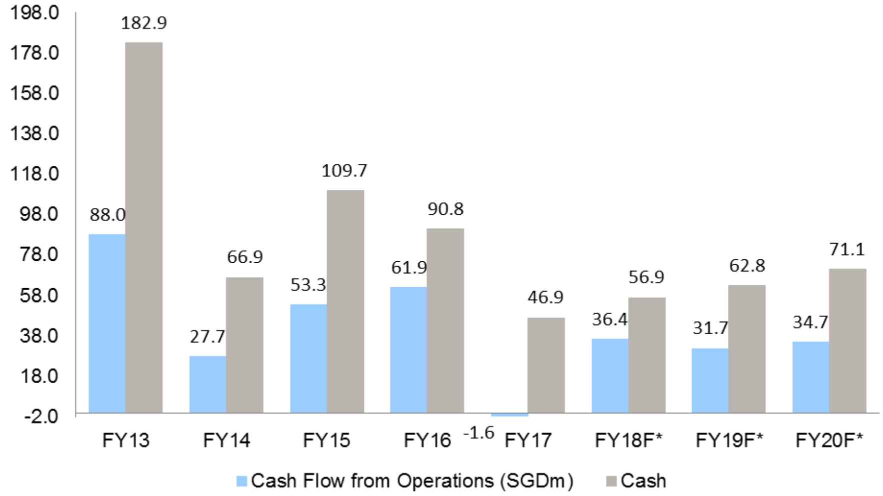
iv. Impairment of other investments of SGD0.2m;

v. Write down of deferred tax assets of SGD3.5m.

We believe that kitchen sinking has been completed and we do not expect any extraordinary write-offs in the near term.

Cash generative business. The company has generated positive cash from operations except in FY17 (due to the one-off settlement cost and movement in trade receivables). We expect CSE to continue generating positive cash from operations of between SGD21-26m during FY18F-19F. Coupled with a war chest of SGD52.6m, this gives CSE ample cash to expand both organically and inorganically, in our view.

Figure 23: Cash generated from operations and cash position

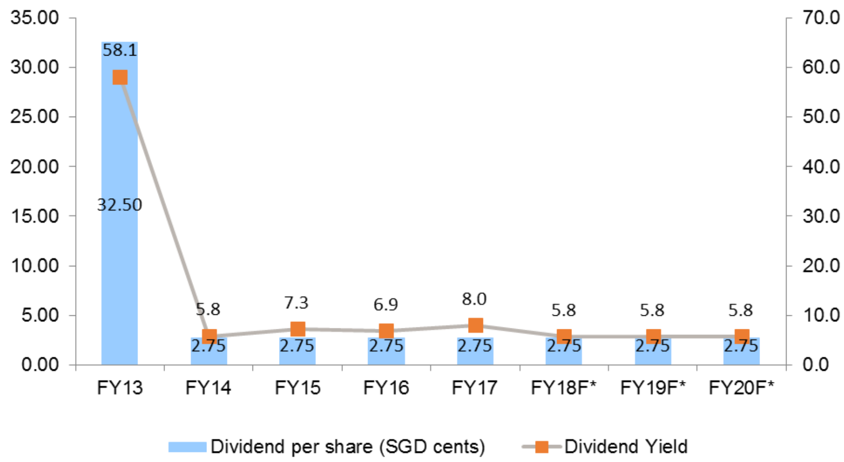


Source: RHB

Attractive dividend yield of 5.8%. The company does not have any dividend policy in place. However, CSE believes in rewarding shareholders that have been with the company through the severe downturns in the oil & gas and mining & mineral markets, by maintaining the absolute dividend amount.

As such, it intends to maintain the dividend amount for FY18. In its results release for 1HFY18, the company announced its intention to maintain its full-year dividend payout of SGD0.0275 per share, translating into an attractive dividend yield of about 5.8%.

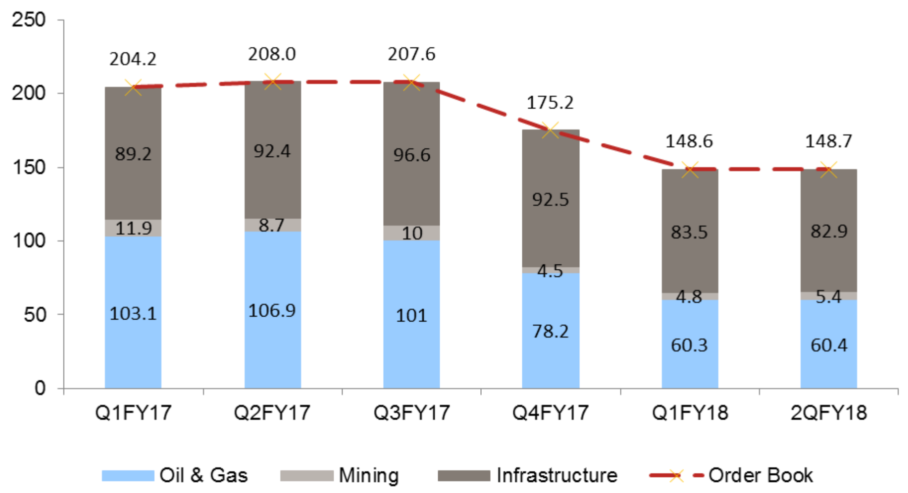
Figure 24: Dividends



Source: Company data, RHB

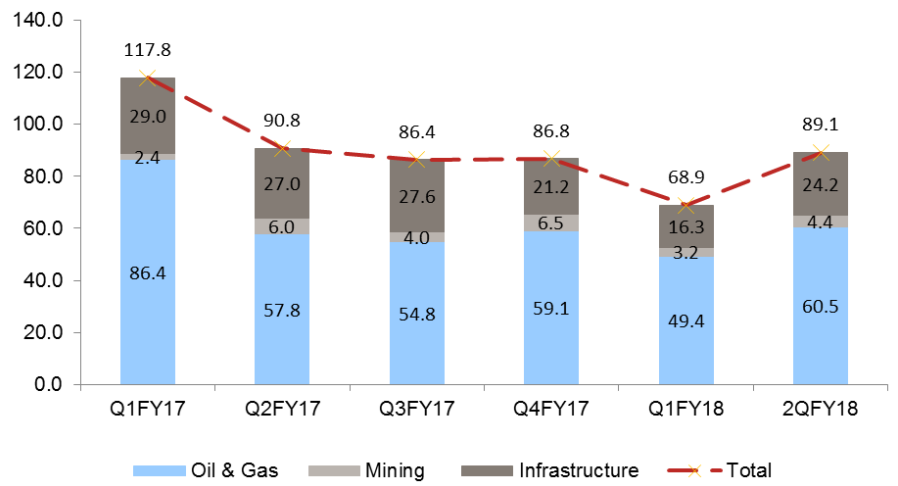
Orderbook maintaining its momentum. Order intake in 2Q18 decreased marginally by 1.8% as compared to 2Q17, and 5.1% on a half-yearly basis (excluding two large greenfield projects). Comparing on a QoQ basis, order intake increased by 29.2% to SGD89.1m as a result of more small greenfield and brownfield projects especially in the oil & gas and infrastructure sectors.

Figure 25: Order backlog by industry (SGDm)



Source: Company data

Figure 26: Quarterly order intakes (SGDm)



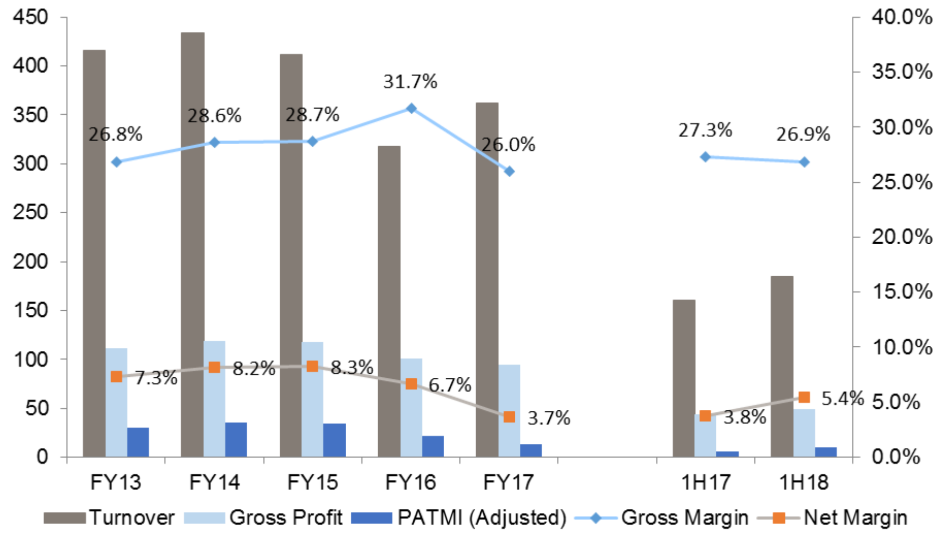
Source: Company data

Margin improvements. The spike in FY16's gross margin to 31.7% was due to the increased sale of higher margin infrastructure projects and the completion of some projects. It fell to 26% the following financial year despite a pickup in revenue to SGD362.4m from SGD317.2m, on higher revenue generated at a lower gross margin in the oil & gas segment outside of the US.

In the latest 2Q18 results, gross margin for 1H18 improved 0.9% to 26.9% vs 26% in FY17 as the company carried out some smaller greenfield and brownfield projects.

Gross margin for CSE is largely influenced by the sales mix – broadly, different margins between the infrastructure and oil & gas sector, greenfield and brownfield projects, and the various geographical regions.

Figure 27: Turnover, gross profit, GP margin, PATMI and net margin (SGDm, adjusted)



Source: Company data

Signs of recovery as shown by improvement in 1H18 PATMI. In the past, CSE's profitability was hit by a series of unfortunate events such as the freezing of mining projects in Australia and declining oil prices, which resulted in cost-cutting measures implemented by the oil players.

A snapshot of events that impacted CSE's profitability over last three financial years:

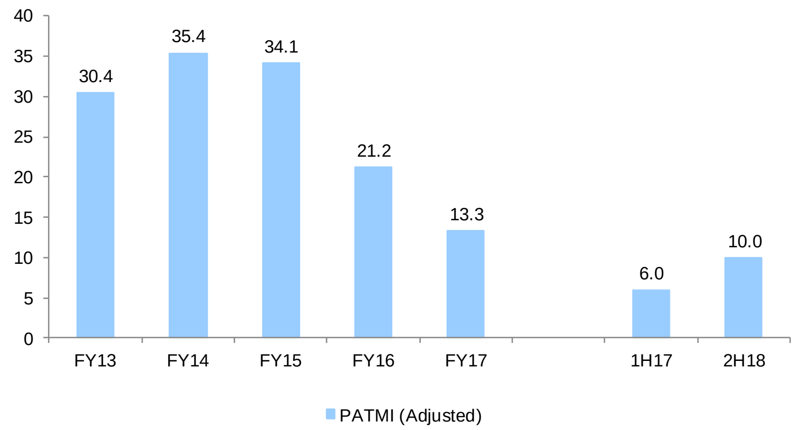
i. FY17 – Higher revenue secured at lower gross margins for oil & gas projects, and impairment of receivables and additional operating expenses from new acquisitions;

ii. FY16 – Revenue dropped by 22.9% YoY on lack of large greenfield projects in the oil & gas industry. Additionally, operating expenses increased as a result of acquisition expense, consolidate expenses of newly acquired businesses, and higher amortisation expenses on intangibles for new acquisitions. Excluding these, normalised expenses dropped 15.1% YoY. PATMI decreased by c.SGD10m in FY16;

iii. FY15 – Large greenfield mining projects were frozen, coupled with the inclusion of expenses of newly acquired Crosscom, and higher provision for doubtful debt. These were offset by better profitability for the Middle Eastern projects.

The latest 1H18 earnings grew to SGD10m vs SGD6m (excluding exceptional items) in 1H17 on 15.1% revenue growth.

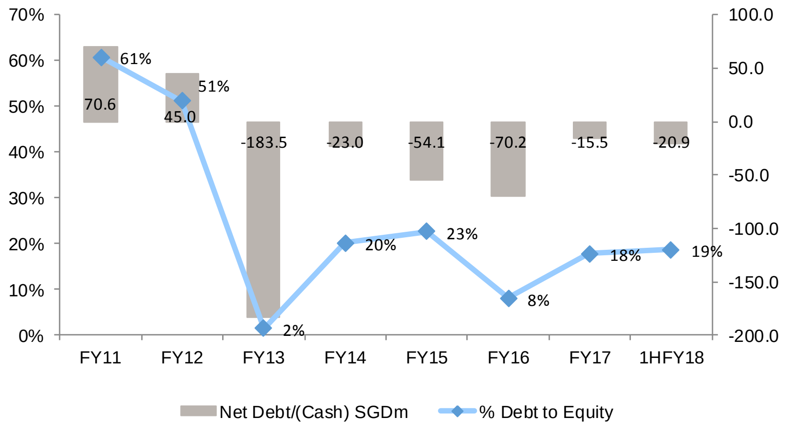
Figure 28: PATMI (SGDm, adjusted)



Source: Company data

Net cash position. In FY13, following the divestment of CSE's wholly-owned subsidiaries in the UK through the Servelec Group's initial public offering, it had utilised SGD75.1m of the proceeds for the repayment of bank borrowings and distributed an interim special dividend of SGD144.5m. The company has since maintained its net cash position even during the downturn in the oil & gas sector. In 2QFY18, it generated a strong cash inflow from operations of SGD27.9m, giving the company a comfortable net cash of SGD20.9m as at 1HFY18.

Figure 29: Debt/equity, net debt/(cash)



Source: Company data

Peer Comparison

We have included global peer comparison in our peer analysis as more than 90% of CSE's revenue is derived from overseas. The Asia Pacific, Americas and EMEA contributed 32%, 65% and 2% respectively to 1HFY18 revenue.

Within the oil & gas scene, Hiap Seng Engineering (HSE SP, NR) is considered the closest listed peer as it does compete for certain projects locally. As for the US region, its competitors are usually small local players.

On the infrastructure front, CSE is one of few qualified service providers of high-level security solutions to the Government in the home market. Among its peers in this space are ST Engineering (STE SP, BUY, TP: SGD3.97) and NCS, a subsidiary of Singtel (ST SP, BUY, TP: SGD3.70). We estimate that approximately 5-10% of CSE's FY17 revenue was derived locally.

Under its control business segment, the closest peers would be Yokogawa (6841 JT, NR), which manufactures products such as IT controllers. Siemens (SIE GR, NR) and ABB (ABB SS, NR) are also considered its competitors in Australia.

Our DCF-backed TP of SGD0.59 implies FY19F P/E of 15.7x, which is comparable to the industry's average of 16.3x. At the current price level, CSE offers an attractive dividend yield of 5.8%, higher than the industry average of 2.5%. Its P/BV ratio of 1.4x is also compares favourably vs the 4.7x industry average.

Figure 30: Peer comparison

Name	Price 28 Sep (Local Cur)	Market Cap (USDm)	P/E Ratio (x)	FY18F P/E Ratio (x)	FY19F P/E Ratio (x)	FY18F ROE (%)	P/B Ratio (x)	EV/EBITDA (x)	Dividend Yield (%)
CSE GLOBAL LTD	0.50	186	n.a.	15.1	13.4	9.6	1.4	7.3	5.5
HIAP SENG ENGINEERING LTD	0.07	15	n.a.	n.a.	n.a.	n.a.	0.5	n.a.	n.a.
SINGAPORE TECH ENGINEERING	3.56	8121	20.9	20.5	17.5	24.2	5.2	13.7	4.2
YOKOGAWA ELECTRIC CORP	2403	5673	29.8	24.0	20.6	9.6	2.4	10.7	1.2
ABB LTD-REG	23.19	51232	22.7	17.3	15.1	17.9	3.7	12.4	3.4
SIEMENS AG-REG	110.10	108605	14.0	15.0	14.0	13.0	2.1	11.6	3.4
SYSTEM INTEGRATOR CORP	2229	109	51.1	n.a.	n.a.	n.a.	8.7	8.2	1.3
SERBA DINAMIK HOLDINGS BHD	3.81	1353	16.2	14.1	11.8	23.1	7.7	20.9	1.9
HONEYWELL INTERNATIONAL INC	166.40	123570	19.2	20.5	19.0	33.2	7.0	13.0	2.0
Average			**24.9**	**18.6**	**16.3**	**20.2**	**4.7**	**13.0**	**2.5**

Source: Bloomberg, RHB

Industry Overview

Australia to increase spending on infrastructure projects. During the 2018 budget, the Australian Government announced that it would invest more than AUD75bn in nationally significant transport infrastructure projects over the next ten years. With several acquisitions (Mobile Masters, Testracom, Ezi Communications, Comm8 and Genesis Communications) made over the past three years, CSE is able to enjoy nationwide coverage and has the ability to bid for infrastructure projects as and when the Government calls for tenders.

Figure 31: Australia's infrastructure commitments

$70 billion in infrastructure commitments

Major projects underway

- $3.6 billion for the joint Australian Government and NSW Western Sydney Infrastructure Plan
- $1.6 billion to North-South Corridor in Adelaide
- $1.5 billion of funding and a $2.0 billion concessional loan for the WestConnex project in Sydney
- $500 million towards the $1 billion Monash Freeway upgrade
- $500 million for the M80 Ring Road in Melbourne
- $412 million for NorthConnex in Sydney
- $914 million for the Gateway Upgrade North in Queensland
- $833 million for NorthLink in Western Australia

New initiatives

- $1.6 billion towards a $2.3 billion Federal-State WA package. The package includes $1.2 billion for the METRONET rail project and $237 million for the Kwinana Freeway
- $1 billion infrastructure package for Victoria, including:
  - $500 million for regional passenger rail
  - $20.2 million for Murray Basin Rail
  - $30 million towards a Melbourne Airport Rail Link business case
- $844 million Bruce Highway upgrades, including Pine River to Caloundra

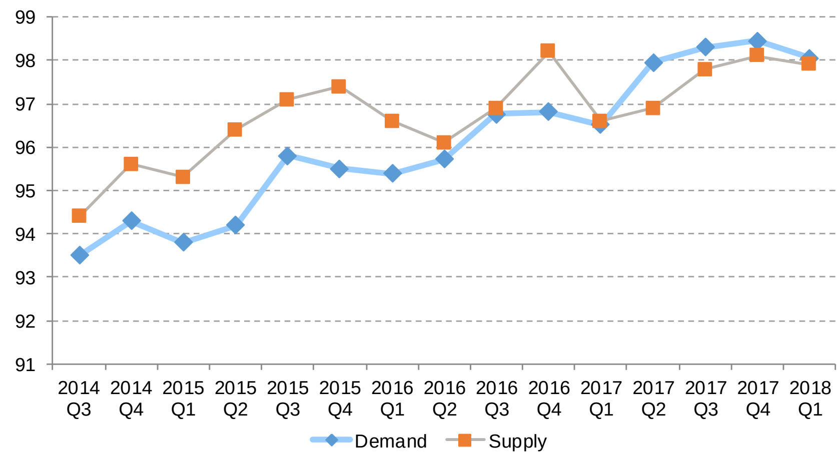
Source: https://budget.gov.au/2017-18/content/glossies/jobs-growth/html/jobs-growth-01.htm

Crude oil prices now flirting with USD80 per bbl levels. Since the Dec 2016 oil production cut agreement came into effect, crude oil prices have more than doubled, and it has since held steady at above USD60 per bbl from a year ago.

The upcoming sanction on Iranian crude oil exports, drawdown of inventories coupled with higher demand, and oil production decline in Venezuela, have driven crude oil prices even higher, hitting USD 80 per bbl.

The US Energy Information Association (EIA) forecasted that world production would reach 99.67mbpd in 2018, below the estimated consumption of 100.10mbpd. Global supply reached a historic high of 100mbpd in Aug 2018, while demand is at about 99.4mbpd.

Figure 32: World crude oil supply and demand (MMBPD)



Source: International Energy Agency

Figure 33: Oil Prices

Source: www.macrotrends.net

Capex set to increase but prudently over the next 6-12 months. With market conditions looking brighter this year, the forecast for FIDs is looking a wee bit better. Wood Mackenzie, the global natural resources consultancy firm has forecasted at least 30 major projects FIDs are expected this year, and 15 projects have already been sanctioned.

We expect to see overall improvement in capex spending by the oil players but do not expect the return of large greenfield projects at least over the next 6-12 months. New projects are now smaller with a shorter payback period

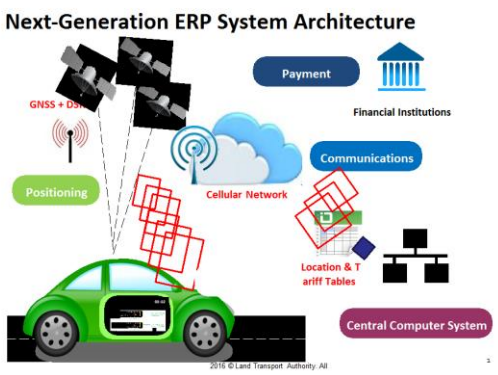
.Figure 34: Capex spend by integrated oil companies

Integrated Oil Companies	2010A CAPEX	2011A CAPEX	2012A CAPEX	2013A CAPEX	2014A CAPEX	2015A CAPEX	2016A CAPEX	2017A CAPEX	2018 Guidance CAPEX
BP PLC	18,421	17,845	23,222	24,520	22,546	18,648	16,701	16,562	15,500
Cenovus Energy Inc	2,138	2,824	3,451	3,174	2,770	1,342	781	1,287	1,247
Chevron Corp	19,612	26,500	30,938	37,985	35,407	29,504	18,109	13,404	19,500
Eni SpA	16,328	16,233	14,430	14,496	14,195	12,407	10,036	9,591	9,337
Husky Energy Inc	3,282	4,855	4,704	4,883	4,550	2,353	1,288	1,711	2,331
Repsol SA	6,445	4,946	4,384	2,646	3,462	3,320	2,217	2,598	4,076
Royal Dutch Shell PLC	26,940	26,301	32,576	40,145	31,854	26,131	22,116	20,845	27,500
Statoil ASA	11,335	15,196	16,302	19,562	19,506	15,485	12,191	10,755	11,000
Suncor Energy Inc	5,837	6,929	6,962	6,581	6,305	5,221	4,972	5,050	3,704
Total SA	18,323	24,994	25,595	29,754	26,320	25,132	18,106	13,767	16,000

Source: Bloomberg

ERP 2.0 to replace existing ERP system in Singapore. ERP is an electronic road pricing system used in managing road congestion in Singapore. Motorists are charged a flat fee once they enter an ERP zone. The fee varies for different roads and time periods. The next generation satellite-based ERP system costing SGD556m will replace the existing ERP system from 2020. CSE is part of the NCS-MHI led consortium that won the tender for ERP 2.0. Under ERP 2.0, motorists will be charged according to the distance travelled on congested roads instead of a flat fee. The new system will rely on satellite navigation technology instead of gantries. On 26 Mar 2018, the LTA announced that it is testing the equipment for satellite-based ERP. Dedicated Short Range Communications (DSRC) beacons and Automatic Number Plate Recognition (ANPR) camera systems will be mounted along the expressways and highways in Singapore.

Figure 35: New ERP system



Source: An illustration of the new ERP system, LTA

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