22 May 2019

Industrials | Aerospace & Defence

ST Engineering (STE SP)

Buy (Maintained)

Defensive Growth Story; Keep BUY

Target Price (Return)	SGD4.45 (+12%)
Price:	SGD3.96
Market Cap:	USD8,966m
Avg Daily Turnover (SGD/USD)	14.6m/10.6m

- **Keep BUY, with a higher SGD4.45 TP** from SGD4.10, 12% upside with 4% FY20F yield. ST Engineering (STE) offers strong visibility on double-digit profit CAGR over FY19-21, aided by the execution of its record-high SGD14.1bn orderbook, and inorganic growth from the acquisition of MRAS and Newtec. This, along with its strong FCF generation capability and dividend yield, makes the stock a defensive Top Pick. Timely completion of the Newtec acquisition and continuing order wins could be key re-rating catalysts.
- **Strong revenue visibility from record-high orderbook.** Amidst strong order wins by its Aerospace and Electronics businesses during 1Q19, STE reported an outstanding orderbook of SGD14.1bn (+5.2% YoY, +6.8% QoQ) as at end-Mar 2019. This is a record high and offers two years of revenue visibility. STE expects to recognise SGD4.2bn of its orderbook as revenue over the next three quarters. This provides scope for organic revenue growth and accounts for 76% of our estimated revenue for the rest of 2019.
- **Acquisitions to support growth from 2H19.** STE expects the Middle River Aerostructure Systems (MRAS) acquisition, completed in Apr 2019, to be earnings-accretive from 2H19. Management also remains confident of completing the Newtec acquisition by 2H19. The transaction expense (1% of purchase consideration) related to this acquisition will be recognised in 2H19. We expect Newtec to start contributing to earnings growth from FY20.
- **Diversified business makes it relatively less prone to near-term risks from the trade war.** Although STE's growth remains exposed to global economic cycles, its 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 created by the escalation in trade tensions between the US and China.
- **Raise estimates; TP based on blended valuation.** We incorporate potential earnings contributions from the Newtec acquisition and increase FY20-21F profit by 5-9%. We continue to value STE on blended valuations (Figure 1), ie 20.5x FY20F P/E, 5.5x FY20F P/BV, 11.0x FY20F EV/EBITDA and DCF (WACC: 6.8%, LTG:1.5%). Our TP is based on FY20 estimates, as it fully captures profit contributions from recent acquisitions.
- **Key downside risks are** weakness in aviation maintenance, repair and overhaul (MRO) demand and delays in Smart Nation initiatives amidst decelerating global economic growth. Lower-than-estimated contributions from MRAS and Newtec acquisitions could also derail earnings growth.

Forecasts and Valuations	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (SGDm)	6,521	6,698	7,196	7,916	8,779
Recurring net profit (SGDm)	482	527	596	669	745
Recurring net profit growth (%)	(0.5)	9.2	13.1	12.3	11.4
Recurring P/E (x)	24.4	22.5	19.8	17.7	15.9
P/BV (x)	5.6	5.5	5.3	5.0	4.7
P/CF (x)	15.0	17.3	10.7	13.1	10.0
Dividend Yield (%)	3.8	3.8	3.8	4.1	4.6
EV/EBITDA (x)	16.8	15.6	14.2	12.6	11.3
ROE (%)	21.9	23.6	26.1	27.9	29.0
Net debt to equity (%)	5.3	3.6	54.9	49.8	36.3
Interest coverage (x)	12.7	12.7	11.8	8.8	9.7

Source: Company data, RHB

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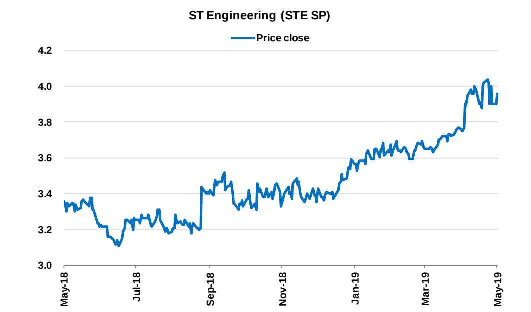
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	13.5	2.3	6.7	14.8	13.1
Relative	9.7	7.2	9.6	9.6	22.9
52-wk Price low/high (SGD)					3.21 – 4.05



Source: Bloomberg

Figure 1: Target price derivation

Financial year ended	x	Based on 2020 estimates
PE based valuation	20.5	4.39
PB based valuation	5.5	4.37
EV/EBITDA based valuation	11.0	4.19
DCF based valuation		4.86
RHB target price		**4.45**

Source: RHB

Figure 2: DCF based valuation

Financial year ended						2019	2020	2021	2022	2023
Quarter ended		**Mar-19**	**Jun-19**	**Sep-19**	**Dec-19**	**Dec-19**	**Dec-20**	**Dec-21**	**Dec-22**	**Dec-23**
EBITDA	SGDm	217.3				980.9	1,107.5	1,208.6	1,311.0	1,428.7
Depreciation & amortisation	SGDm	(75.4)				(308.9)	(325.5)	(342.3)	(358.7)	(374.7)
EBIT	SGDm	141.9				672.0	782.0	866.3	952.3	1,054.0
Tax rate (%)	%	16%				17%	17%	17%	17%	17%
EBIT (1 - tax rate)	**USDm**	**118.8**				**558.8**	**650.3**	**720.4**	**791.9**	**876.4**
Change in net working capital	SGDm	145.7				69.4	(279.5)	(90.3)	(101.4)	(119.3)
Net capex	SGDm	28.5				22.0	50.5	72.3	98.7	114.7
Free cash flow	**SGDm**	**293.0**				**650.1**	**421.3**	**702.4**	**789.2**	**871.9**
Terminal value	**SGDm**	**-**				**-**	**-**	**-**	**-**	**16,856.3**
Discount factor (nominal)	x	1.0				1.0	0.9	0.9	0.8	0.8
PV of nominal cash flow	**SGDm**	**293.0**				**650**	**395**	**616**	**649**	**13,649**
PV of cash flows	**SGDm**	**15,666.1**								
Cash	**SGDm**	**610.4**	1Q19							
Total debt	SGDm	807.7	1Q19							
Net debt / (net cash)	SGDm	197.3								
Minority interest	SGDm	282.9	1Q19							
Equity value	SGDm	15,185.9								
Shares outstanding (basic)	m	3,122.5	1Q19							
Equity value	**SGDm**	**4.86**								

Source: RHB
Note: DCF value is adjusted for reported quarters

Figure 3: DCF assumptions

Key assumptions	
beta	1.00
risk free rate	2.50%
market risk premium	4.75%
tax	17.50%
cost of debt	3.50%
cost of equity	7.25%
LT growth	1.50%
WACC used	**6.8%**

Source: RHB

Figure 4: DCF sensitivity

				WACC		
		5.8%	**6.3%**	**6.8%**	**7.3%**	**7.8%**
Long term growth	**0.5%**	5.00	4.55	4.16	3.84	3.56
	1.0%	5.47	4.93	4.48	4.11	3.79
	1.5%	6.06	5.40	**4.86**	4.42	4.05
	2.0%	6.80	5.97	5.32	4.80	4.36
	2.5%	7.77	6.70	5.89	5.25	4.73

Source: RHB

Figure 5: Relative valuations

Company name	BBG ticker	Price (LCY)	MCap (USDm)	Last year	P/E Last	P/E 1FY	P/E 2FY	EV/EBITDA Last	EV/EBITDA 1FY	EV/EBITDA 2FY	P/BV Last	P/BV 1FY	P/BV 2FY	DYield 1FY	ROE 1FY
Aerospace															
Safran SA	SAF FP	124.90	60,665	Dec-18	26.0	22.0	18.9	15.2	13.5	12.1	5.02	4.20	3.74	1.8%	19.8%
Thales SA	HO FP	101.75	24,177	Dec-18	19.2	16.1	13.8	9.0	7.9	7.0	3.76	3.45	3.01	2.4%	21.5%
HEICO Corp	HEI US	102.70	12,285	Oct-18	54.5	48.6	43.9	29.0	25.9	23.8	8.05	7.37	6.56	0.2%	19.1%
Air France - KLM	AF FP	8.11	3,876	Dec-18	5.5	5.6	4.7	2.5	2.5	2.4	1.07	1.45	1.13	0.0%	26.6%
SIA Engineering	SIE SP	2.46	1,997	Mar-19	17.7	16.5	15.7	20.7	17.7	16.9	1.84	1.77	1.70	4.7%	10.8%
AAR Corp	AIR US	31.10	1,091	May-18	20.0	12.0	10.8	8.8	7.8	6.8	0.94	0.92	0.76	1.0%	1.0%
Weighted average			**104,090**		**26.8**	**22.9**	**20.0**	**14.9**	**13.3**	**12.0**	**4.83**	**4.22**	**3.74**	**1.7%**	**20.0%**
Electronics															
CISCO Systems	CSCO US	56.01	246,558	Jul-18	21.6	18.2	16.5	13.4	12.8	12.1	6.35	7.19	9.14	2.4%	36.8%
Siemens AG	SIE GR	107.48	101,826	Sep-18	14.8	15.2	13.6	11.1	10.6	9.8	1.93	1.84	1.76	3.5%	11.9%
Hitachi	6501 JP	3,714.00	32,559	Mar-19	16.8	8.3	7.6	4.4	4.0	3.7	1.05	0.96	0.87	2.7%	12.4%
China Spacecast	600118 CH	23.38	4,002	Dec-18	58.6	52.1	47.9	32.2	32.3	28.6	4.98	4.62	4.31	0.3%	8.3%
China All Access	633 HK	0.37	90	Dec-18	-	-	-	-	-	-	-	-	-	0.0%	0.0%
Weighted average			**385,035**		**19.8**	**16.9**	**15.3**	**12.2**	**11.7**	**10.9**	**4.72**	**5.22**	**6.44**	**2.7%**	**27.8%**
Land Systems															
Caterpillar	CAT US	122.43	70,015	Dec-18	10.5	9.9	9.3	6.3	5.9	5.8	4.50	3.39	2.87	3.1%	43.0%
General Dynamics	GD US	169.29	48,903	Dec-18	15.2	14.4	13.0	12.1	11.7	10.9	3.82	3.68	3.18	2.4%	27.5%
Komatsu	6301 JP	2,429.5	21,421	Mar-19	9.1	8.9	8.8	6.1	6.1	6.0	1.26	1.16	1.08	4.6%	13.6%
BAE Syetsm	BA/ LN	460.30	18,715	Dec-18	10.9	10.3	9.6	7.2	6.7	6.3	2.51	2.32	2.10	5.0%	23.2%
Zoomlion	000157 CH	5.18	5,611	Dec-18	21.9	13.2	11.3	12.4	8.8	8.1	1.03	1.00	0.95	4.4%	7.5%
Weighted average			**164,665**		**12.2**	**11.3**	**10.5**	**8.3**	**7.8**	**7.5**	**3.53**	**2.99**	**2.57**	**3.4%**	**31.1%**
Marine															
Yangzhijiang	YZJSGD SP	1.44	4,121	Dec-18	9.5	9.0	8.8	2.9	2.8	2.8	1.00	0.91	0.85	3.3%	10.7%
Samsung Heavy Ind.	010140 KS	7,630	4,024	Dec-18	-	-	55.3	-	23.2	14.7	0.71	0.70	0.69	0.0%	-1.2%
Sembcorp Marine	SMM SP	1.52	2,303	Dec-18	-	217.1	43.4	57.1	24.7	21.0	1.47	1.36	1.33	0.3%	0.8%
Weighted average			**10,448**		**3.8**	**51.4**	**34.3**	**13.7**	**15.5**	**11.4**	**0.99**	**0.93**	**0.89**	**1.4%**	**3.9%**
ST Engineering	STE SP	3.96	8,964	Dec-18	23.5	20.8	18.5	15.8	13.1	11.6	5.50	5.34	4.99	3.8%	26.1%

Source: Bloomberg, RHB

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