

26 February 2019

Financial Services | Banks

ST Engineering (STE SP)

Buy (Maintained)

Aerospace Secures 10-year MRO Contract; Keep BUY

Target Price (Return)	SGD4.10 (+8%)
Price:	SGD3.79
Market Cap:	USD8,759m
Avg Daily Turnover (SGD/USD)	13.2m/9.8m

- Reiterate BUY with SGD4.10 TP, offering 8% upside and 4% FY19F yield.** STE, one of our country's Top Picks, announced that its Aerospace business signed an agreement to provide aircraft maintenance to a major North American airline company, an existing customer of STE. The contract, valued at USD600m (c.SGD813m), will commence in 2020 and is for a period of 10 years. It will cover a fleet of over 160 wide- and narrow-body aircraft. We continue to maintain that together with contributions from Electronics and improvements in Marine, the ongoing contributions from the Aerospace division will drive a recovery in STE's profit growth in the near term. We view the likely completion of the MRA Systems acquisition by the end of 1Q19 to be a re-rating catalyst.
- Reinforces STE's leadership position in airframe MRO.** STE's Aerospace arm is the world's largest commercial airframe MRO service provider, a leading position it has enjoyed since 2002, based on a biennial ranking survey conducted by the *Aviation Week Network*. The new maintenance contract from an existing customer, which includes the addition of a new aircraft type to be placed under STE's care, reinforces the strong business capabilities that STE's Aerospace division has built over the years.
- A new facility in Pensacola will be used to service this order.** STE will be using its US-based facilities in San Antonio, Texas and Pensacola, Florida to provide airframe maintenance services to its customer. The Pensacola facility, which is currently under construction, is expected to be operational by 2022. This facility will have four aircraft hangers and is expected to increase STE's MRO capacity by 2.1m man hours.
- Contract win boosts an already strong outstanding orderbook.** STE reported an outstanding orderbook of SGD13.2bn, from which SGD4.9bn will be delivered in 2019. Based on rolling four quarters of reported revenue, the orderbook provides revenue visibility for two years. This order win should bring back some confidence amongst investors who were concerned with the 26% YoY decline in order wins reported by the Aerospace division in 2018. During 4Q18 results analyst briefing, STE mentioned that barring the risk of a trade war escalation, it remains confident of witnessing a revival in aerospace order wins in 2019. We maintain our view that in addition to inorganic growth contribution from MRAS, increased MRO capacity and capabilities in the aerospace sector will continue to support STE's earnings growth over the forecast period.
- Continuing on track for revival in earnings growth.** We expect the group to deliver c.13% earnings growth in 2019 (consensus: c.15%). Based on our estimates, much of this growth is expected to come from the Aerospace and Electronics divisions. However, we believe that improvements in Marine's profitability will also be a factor in driving 2019 profit growth. We have not yet factored the MRAS acquisition into our estimates, but assess that the acquisition could lift our earnings estimates 4-5%.

Forecasts and Valuations	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (SGDm)	6,521	6,698	7,061	7,513	8,008
Recurring net profit	482	527	597	639	684
Recurring net profit	(0.5)	9.2	13.4	7.0	7.1
Recurring P/E (x)	23.3	21.6	19.0	17.7	16.6
P/BV (x)	5.3	5.3	5.0	4.7	4.5
P/CF (x)	14.3	16.5	20.2	11.2	10.8
Dividend Yield (%)	4.0	4.0	3.9	4.3	4.6
EV/EBITDA (x)	16.1	15.0	13.6	12.5	11.6
ROE (%)	21.9	23.6	25.8	26.2	26.6
Net debt to equity (%)	5.3	3.6	12.0	2.7	net cash
Interest coverage (x)	12.7	12.7	23.9	22.9	29.7

Source: Company data, RHB

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