

19 June 2020

Industrials | Aerospace & Defence

ST Engineering (STE SP)

Buy (Maintained)

Keeps Building Capabilities; Maintain BUY

Target Price (Return): SGD3.90 (+14%)
 Price: SGD3.41
 Market Cap: USD7,633m
 Avg Daily Turnover (SGD/USD) 26.2m/18.4m

- **BUY, SGD3.90 TP, 14% upside with c.4% FY20F yield.** While 2020F profit will decline on weak demand, supply chain disruption and workforce disruption amidst the COVID-19 pandemic, normalisation of order deliveries across all segments should support the return of profit growth in 2021F. Barring the risk of COVID-19 infections resurging, ST Engineering should continue to outperform the STI. It still has a well-diversified business portfolio, record-high orderbook, and offers sustainable DPS – which puts it in a far superior position vs other large-cap STI counters.
- **Diversified business model and sustainable long-term growth.** With its business spread across four segments (Aerospace, Electronics, Land Systems and Marine) and across geographies, STE has a well-diversified portfolio – ensuring resilient earnings through business cycles. Moreover, its record orderbook of SGD16.3bn offers two year of revenue visibility. STE remains focused on long-term growth, by strengthening core businesses and capitalising on new demand opportunities in cybersecurity and robotics. We expect Smart City initiatives, in Singapore and overseas, to be a key contributor to earnings in the long term.
- **Can now perform aircraft inspection using drones.** STE has received the authorisation from Civil Aviation Authority of Singapore to use its in-house developed drone solution, DroScan, to carry out general visual inspection during aircraft maintenance on approved aircraft models at its Singapore MRO facilities. Over the past year, it has showcased the solution's capabilities and benefits through trials with participating airline customers. DroScan reduces the need to set up bulky ground equipment required during manual inspections. Instead, inspection can be done using live video feeds and images captured by the drones. These images can be fed through algorithms that can help detect and classify defects. STE's DroScan already has additional capabilities that make it suitable for future operations within Singapore's civil aerodromes.
- **Sustainable dividends, reasonable valuations and inorganic growth potential.** Despite an earnings decline in 2020F, STE should be able to sustain its DPS of 15 SG cents, vs that of other large-cap companies, which are cutting dividends. Its 2021 P/E is close to its 10-year average of 19x. Given expectations of a strong earnings recovery in 2021, STE should trade above its historical average. With its positive FCF generation, strong balance sheet and liquidity, the company could also undertake earnings-accretive acquisitions to support long-term growth.
- **Key risks.** Slower recovery in the Aerospace maintenance, repair and overhaul business, deferment of contracts in Electronics, lower contributions from new acquisitions, and delays in Singapore's Smart Nation initiative could derail long-term earnings growth recovery.

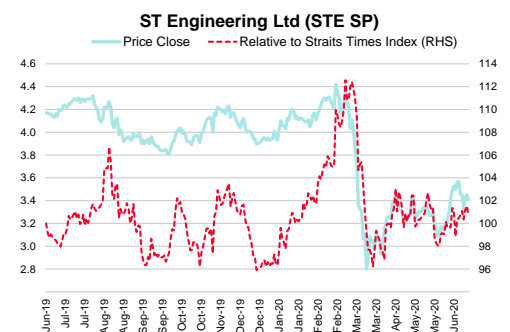
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(13.5)	4.3	3.3	(12.6)	(16.8)
Relative	3.8	(0.7)	(6.6)	4.4	0.9
52-wk Price low/high (SGD)	2.80 – 4.42				



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)	20.17	18.04	21.06	18.75	16.37
P/B (x)	4.7	4.8	4.7	4.6	4.3
P/CF (x)	16.61	18.01	12.92	10.27	9.48
Dividend Yield (%)	4.4	4.4	4.4	4.5	4.5
EV/EBITDA (x)	13.50	12.50	12.68	11.54	10.24
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	BV/PS	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 metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Valuation basis	Recurring P/E (x)	20.17	18.04	21.06	18.75	16.37
Our TP is derived by using an average of forward P/E, P/BV, EV/EBITDA and DCF of adjusted free cash flows.	P/B (x)	4.7	4.8	4.7	4.6	4.3
	FCF Yield (%)	2.9	3.9	5.2	7.2	8.1
	Dividend Yield (%)	4.4	4.4	4.4	4.5	4.5
	EV/EBITDA (x)	13.50	12.50	12.68	11.54	10.24
	EV/EBIT (x)	19.28	19.53	20.45	18.27	15.76
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
	Cash flow (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Change in working capital	(166)	(439)	(168)	(55)	(71)
	Cash flow from operations	639	590	824	1,037	1,123
	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
	Balance sheet (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	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

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-05-18	Buy	3.90	3.27
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
2019-11-11	Buy	4.70	4.00
2019-07-05	Buy	4.45	4.23
2019-04-25	Buy	4.10	3.89

Source: RHB, Bloomberg

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