

8 October 2024

Industrials | Aerospace & Defence

ST Engineering (STE SP)

Buy (Maintained)

Continues To Win New Contracts; Stay BUY

- **Stay BUY and SGD5.32 TP, 14% upside, and c.3.5% yield.** We stay positive on ST Engineering's growth trajectory after it announced a new exclusive MRO contract from Akasa Air for maintenance of the LEAP-1B engines that power the Indian airline's Boeing 737 fleet. The contract covers its existing 25 planes and yet-to-be-delivered 201 aircraft. Meanwhile a STE JV has re-entered the Airbus A380 airframe MRO market with a new customer while TransCore has landed a contract with Denver International Airport (DEN) to expand/modernise its ground transportation management system.
- **New MRO contracts.** STE has signed an exclusive 15-year contract with Akasa Air to provide MRO solutions for the LEAP-1B engines that power the airline's Boeing 737 MAX fleet. The contract covers Akasa Air's current fleet of 25 aircraft plus the 201 planes it will receive over the next eight years. Meanwhile, STE and Airbus' Elbe Flugzeugwerke (EFW) JV is re-entering the Airbus A380 MRO market, conducting airframe heavy maintenance services in 4Q24 for a new customer's (Global Airlines) first A380 aircraft – this is to facilitate its entry into service. EFW will be responsible for all scheduled maintenance, including mandatory inspections and component replacements. It has also received A380 MRO orders from other customers and will expand its maintenance activities from 2025 for this aircraft type.
- **TransCore's new contract win.** TransCore has secured a contract with DEN to expand and modernise the latter's existing ground transportation management system. This upgraded system will help the airport improve commercial vehicle access control and revenue collection while improving traffic flow on its terminal's roadways network. The system upgrade will also deploy leading tech for automated commercial vehicle identification, combining radio frequency identification and license plate recognition technologies to provide virtual queuing, automated taxi dispatching, and improved access control for commercial vehicles and transportation network companies entering passenger pick-up and drop-off zones.
- **Unchanged positive investment thesis.** We expect STE to deliver a 15% profit CAGR and steady dividends during 2023-2026. Its record order backlog of SGD27.9bn provides three years of revenue visibility. The growth will be aided by strong demand for aviation MRO services, sustained delivery of defence contracts, and a recovery in the Urban Solution & Satcom or USS segment. We see further earnings tailwind from interest rate declines, as c.39% of STE's debt is exposed to floating rates. We estimate that a 100bps reduction in 2025 interest costs will boost profit by 2%. Our TP includes a 4% ESG premium over the SGD5.11 FV, given its 3.3 ESG score vs the 3.1 country median.

Target Price (Return): SGD5.32 (14.1%)
 Price (Market Cap): SGD4.66 (USD11,148m)
 ESG score: 3.3 (out of 4)
 Avg Daily Turnover (SGD/USD) 20.0m/15.2m

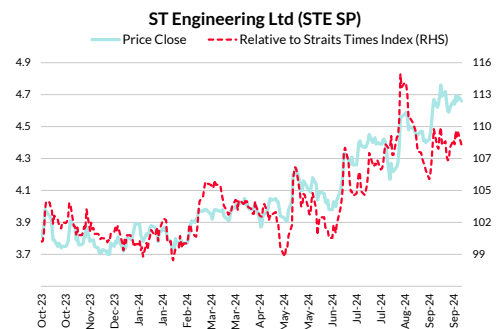
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	19.8	5.9	9.4	16.8	21.4
Relative	8.7	1.7	3.9	5.0	8.0
52-wk Price low/high (SGD)				3.70	–4.76



Source: Bloomberg

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (SGDm)	9,035	10,101	10,876	11,715	12,644
Recurring net profit (SGDm)	482	612	713	840	926
Recurring net profit growth (%)	(15.5)	26.9	16.6	17.7	10.3
Recurring P/E (x)	30.10	23.71	20.35	17.28	15.67
P/B (x)	6.0	5.9	5.5	4.8	4.2
P/CF (x)	21.55	12.31	11.13	9.82	10.04
Dividend Yield (%)	4.7	3.4	3.4	3.4	3.4
EV/EBITDA (x)	17.52	14.88	13.41	11.82	10.89
Return on average equity (%)	22.2	24.1	27.8	29.5	28.7
Net debt to equity (%)	223.6	209.1	192.1	159.1	127.9

Source: Company data, RHB

Overall ESG Score: 3.3 (out of 4)

E: GOOD

In 2023, it reported a 36% reduction in absolute Scope 1 and 2 emissions over the 2010 base year and is on track to meet its target of achieving a 50% reduction in absolute Scope 1 and 2 emissions by 2030 compared to the 2010 base year.

S: EXCELLENT

STE serves its communities through a combination of volunteer work and skills-based contributions, as well as in kind and monetary support. In 2023, it contributed SGD2.3m to community causes. STE promotes the professional and personal development of its employees, as seen by the increase in the average number of training hours per employee.

G: EXCELLENT

Despite having exposure to the defence business, STE does not design, produce, or sell anti-personnel mines, cluster munitions, white phosphorus munitions, or their related key components. STE's board comprises 13 directors, of whom seven are independent (54%), and three are female (23%).

Financial Exhibits

Asia	Financial summary (SGD)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Singapore	Recurring EPS	0.15	0.20	0.23	0.27	0.30
Industrials	DPS	0.22	0.16	0.16	0.16	0.16
ST Engineering	BVPS	0.77	0.79	0.85	0.96	1.10
STE SP	Return on average equity (%)	22.2	24.1	27.8	29.5	28.7
Buy						
	Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Valuation basis	Recurring P/E (x)	30.10	23.71	20.35	17.28	15.67
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)	6.0	5.9	5.5	4.8	4.2
	FCF Yield (%)	(0.5)	6.2	4.5	7.1	7.3
	Dividend Yield (%)	4.7	3.4	3.4	3.4	3.4
Key drivers	EV/EBITDA (x)	17.52	14.88	13.41	11.82	10.89
i. New order wins and continuing delivery of order book;	EV/EBIT (x)	31.14	24.47	21.17	18.23	16.68
ii. Sustained improvement in global aviation market;						
iii. Contributions from acquisitions.						
	Income statement (SGDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Key risks	Total turnover	9,035	10,101	10,876	11,715	12,644
i. Slower revival in commercial aerospace sector;	Gross profit	1,699	1,973	2,215	2,446	2,630
ii. Lower margin from higher costs caused by supply chain issues;	EBITDA	1,181	1,382	1,531	1,705	1,812
iii. Delays in the delivery of orderbook;	Depreciation and amortisation	(517)	(541)	(562)	(600)	(629)
iv. Lower-than-expected contributions from acquisitions.	Operating profit	665	840	970	1,105	1,183
	Net interest	(138)	(210)	(209)	(203)	(189)
	Pre-tax profit	597	704	875	1,030	1,137
	Taxation	(54)	(100)	(140)	(165)	(182)
	Reported net profit	535	586	713	840	926
	Recurring net profit	482	612	713	840	926
Company Profile						
ST Engineering is an integrated engineering group in the Commercial Aerospace (CA), Urban Solutions & Satcom (USS), and Defence & Public Security (DPS) sectors. The company has over the years, diversified its businesses and geographical coverage.	Cash flow (SGDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Change in working capital	(442)	(101)	(205)	(192)	(332)
	Cash flow from operations	673	1,179	1,304	1,478	1,445
	Capex	(743)	(279)	(650)	(450)	(380)
	Cash flow from investing activities	(4,571)	(201)	(582)	(371)	(290)
	Dividends paid	(686)	(499)	(498)	(498)	(498)
	Cash flow from financing activities	3,698	(1,226)	(810)	(1,003)	(1,091)
	Cash at beginning of period	816	602	353	265	368
	Net change in cash	(201)	(248)	(89)	104	64
	Ending balance cash	602	353	265	368	432
	Balance sheet (SGDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Total cash and equivalents	602	353	265	368	432
	Tangible fixed assets	2,076	2,076	2,358	2,401	2,344
	Total investments	468	567	499	421	331
	Total assets	14,964	15,379	15,609	15,775	15,822
	Short-term debt	3,628	2,564	0	0	0
	Total long-term debt	2,907	3,544	6,008	5,708	5,308
	Total liabilities	12,311	12,627	12,620	12,419	12,010
	Total equity	2,653	2,752	2,989	3,356	3,813
	Total liabilities & equity	14,964	15,379	15,609	15,775	15,822
	Key metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Revenue growth (%)	17.4	11.8	7.7	7.7	7.9
	Recurrent EPS growth (%)	(15.5)	26.9	16.5	17.7	10.3
	Gross margin (%)	18.8	19.5	20.4	20.9	20.8
	Operating EBITDA margin (%)	13.1	13.7	14.1	14.6	14.3
	Net profit margin (%)	5.9	5.8	6.6	7.2	7.3
	Dividend payout ratio (%)	128.2	85.0	69.9	59.3	53.8
	Capex/sales (%)	8.2	2.8	6.0	3.8	3.0
	Interest cover (x)	4.47	3.34	4.40	5.16	5.83

Source: Company data, RHB

Emissions And ESG

Trend analysis

Although overall emissions have been on the rise on the back of rising economic output, during 2020–2023, STE has reduced greenhouse gas (GHG) intensity as a measure of revenue for its Singapore operations to 10.99 tCO₂e/SGDm in 2023 from 16.34 tCO₂e/SGDm in 2020 and 14.82 tCO₂e/SGDm in 2021.

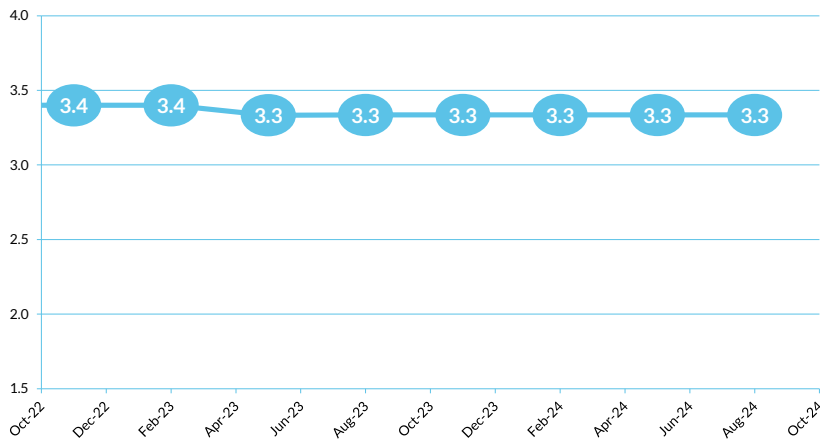
Emissions (tCO ₂ e)	Dec-21	Dec-22	Dec-23
Scope 1	36,000	39,000	37,000
Scope 2	78,000	71,000	74,000
Scope 3	1,900	33,000	39,000
Total emissions	115,900	143,000	150,000

Source: Company data, RHB

Latest ESG-Related Developments

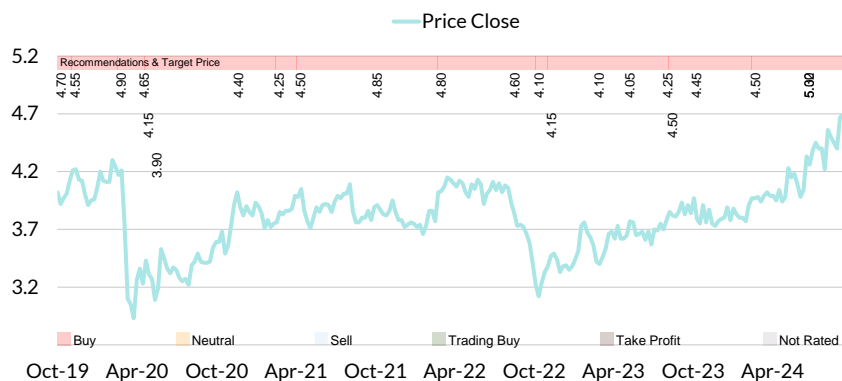
- In 2021, STE set a target to halve its absolute Scope 1 and Scope 2 GHG emissions by 2030 compared to the 2010 base year. In the same year, it also set a target to increase its sustainability-linked revenue to more than SGD3bn by 2026.
- In 2022, STE was included in the Dow Jones Sustainability Asia Pacific Index as identified by S&P Global through the Corporate Sustainability Assessment. It is also a component stock of the iEdge SG ESG Transparency Index and iEdge SG ESG Leaders Index.
- In 2023, STE implemented an internal shadow carbon price on major capital expenditure, established roadmaps, and embarked on the development of a product carbon footprint for its major products and services.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-09-18	Buy	5.32	4.69
2024-07-21	Buy	5.00	4.45
2024-04-08	Buy	4.50	3.98
2024-03-04	Buy	4.50	3.95
2024-02-21	Buy	4.50	3.92
2023-10-23	Buy	4.45	3.75
2023-10-09	Buy	4.45	3.81
2023-08-14	Buy	4.50	3.85
2023-08-02	Buy	4.25	3.70
2023-05-08	Buy	4.05	3.65
2023-02-27	Buy	4.10	3.54
2023-01-18	Buy	4.15	3.45
2022-11-08	Buy	4.15	3.33
2022-10-11	Buy	4.10	3.34
2022-09-23	Buy	4.60	3.66

Source: RHB, Bloomberg

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