

22 July 2024

Industrials | Aerospace & Defence

## ST Engineering (STE SP)

**Buy** (Maintained)

### Rolling Forward Our Valuation; Still BUY

Target Price (Return): SGD5.00 (+12%)  
 Price (Market Cap): SGD4.45 (USD10,319m)  
 ESG score: 3.3 (out of 4)  
 Avg Daily Turnover (SGD/USD) 19.5m/14.4m

- **Keep BUY, with new SGD5.00 TP from SGD4.50, 12% upside and c.4% yield.** We roll forward our valuation to a blended FY24F-25F. In June, ST Engineering announced the development of a highly secure and AI-ready data centre in Singapore by 2026 costing SGD120m. It recently entered into a two-year agreement (with an extension option) to provide module repair offload support for CFM LEAP-1A and LEAP-1B engines, thereby further strengthening its commercial aerospace (CA) capabilities. We maintain STE remains on track to deliver a c.15% profit CAGR during 2023-2026.
- **Adding capabilities to CA.** STE's CA business has entered into a two-year agreement (with an extension option) to provide module repair offload support for CFM LEAP-1A and LEAP-1B engines for Safran Aircraft Engines (Safran). STE is also expanding its LEAP engine capabilities, including the addition of LEAP-1A engine testing services expected by 3Q24. It will also support Safran with LEAP-1B engine maintenance offload services, in addition to existing support for CFM56-5B, CFM56-7B, and LEAP-1A engines. There is a growing demand for MRO services as the number of LEAP engines – which power the Airbus A320neo and Boeing B737 MAX family of aircraft – in operation grows rapidly. The LEAP engine has a substantial backlog of over 10,600 engines indicating continued growth in the industry.
- **Investing in new AI-ready data centre in Singapore.** STE has commenced construction on its fourth data centre in Singapore, scheduled for completion in 2026. This seven-storey facility, which is designed to meet international cybersecurity standards and standards for responsible AI development, aims to attract customers prioritising security and sustainability. The data centre will achieve a high Power Usage Effectiveness (PUE) of 1.25, exceeding the BCA-IMDA Green Mark Platinum standard of 1.3, with sustainability features like solar panels covering 2,400sqm. With an estimated cost of SGD120m over the next three years, the data centre will expand STE's total IT capacity to over 30MW across four Singapore locations.
- **1H24 results on 14 Aug 2024.** We remain upbeat on STE for its defensive dividends (4 SG cents per quarter) and strong profit growth, aided by continued growth and margin improvement in CA and a strong recovery in the urban solutions & satcom (USS) segment. We look forward to further updates about the outlook from management on 14 Aug (1H24 results announcement). Our TP includes a 4% ESG premium.

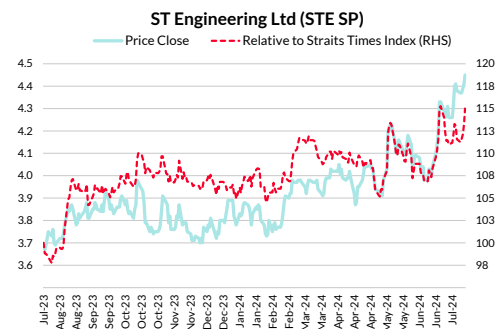
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	14.4	10.7	12.7	16.2	21.9
Relative	8.0	6.4	4.2	6.8	16.6
52-wk Price low/high (SGD)				3.67	-4.45



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)	28.74	22.65	19.43	16.50	14.96
P/B (x)	5.8	5.6	5.2	4.6	4.1
P/CF (x)	20.58	11.76	10.63	9.38	9.59
Dividend Yield (%)	4.9	3.6	3.6	3.6	3.6
EV/EBITDA (x)	16.96	14.41	12.98	11.43	10.52
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
<b>ST Engineering</b>	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						
	<b>Valuation metrics</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
<b>Valuation basis</b>	Recurring P/E (x)	28.74	22.65	19.43	16.50	14.96
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)	5.8	5.6	5.2	4.6	4.1
	FCF Yield (%)	(0.5)	6.5	4.7	7.4	7.7
	Dividend Yield (%)	4.9	3.6	3.6	3.6	3.6
	EV/EBITDA (x)	16.96	14.41	12.98	11.43	10.52
	EV/EBIT (x)	30.16	23.69	20.49	17.64	16.12
<b>Key drivers</b>						
i. New order wins and continuing delivery of order book;						
ii. Sustained improvement in global aviation market;						
iii. Contributions from acquisitions.						
	<b>Income statement (SGDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
<b>Key risks</b>	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 order book;	Depreciation and amortisation	(517)	(541)	(562)	(600)	(629)
iv. Lower-than-expected contribution 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
<b>Company Profile</b>						
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.	<b>Cash flow (SGDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	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
	<b>Balance sheet (SGDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	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
	<b>Key metrics</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	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 GHG intensity as a measure of revenue for its Singapore operations to 10.99 tCO<sub>2</sub>e/SGDm in 2023 from 16.34 tCO<sub>2</sub>e/SGDm in 2020 and 14.82 tCO<sub>2</sub>e/SGDm in 2021.

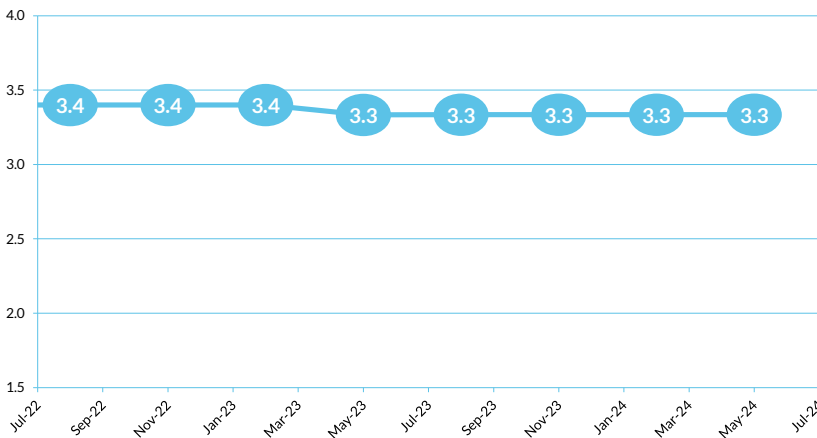
Emissions (tCO <sub>2</sub> e)	Dec-21	Dec-22	Dec-23
Scope 1	36,000	39,000	37,000
Scope 2	78,000	71,000	74,000
Scope 3	1,900	33,000	39,000
Total emissions	115,900	143,000	150,000

Source: Company data, RHB

## Latest ESG-Related Developments

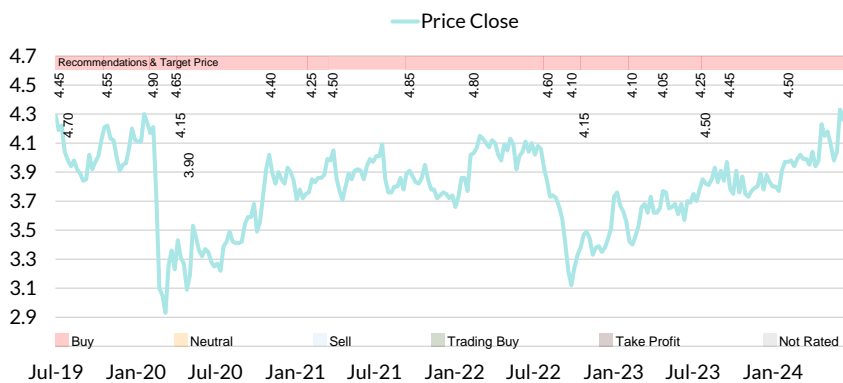
- In 2021, STE set a target to halve its absolute Scope 1 and Scope 2 GHG emissions by 2030 compared to a 2010 base year. In the same year, it also set a target to increase its sustainability linked revenue to more than SGD3bn by 2026.
- In 2022, STE was included in the Dow Jones Sustainability Asia 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 the 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
2024-04-08	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
2022-08-15	Buy	4.60	4.00
2022-02-27	Buy	4.80	3.77

Source: RHB, Bloomberg

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<b>Buy:</b>	Share price may exceed 10% over the next 12 months
<b>Trading Buy:</b>	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
<b>Neutral:</b>	Share price may fall within the range of +/- 10% over the next 12 months
<b>Take Profit:</b>	Target price has been attained. Look to accumulate at lower levels
<b>Sell:</b>	Share price may fall by more than 10% over the next 12 months
<b>Not Rated:</b>	Stock is not within regular research coverage

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