

6 May 2024

Industrials | Aerospace & Defence

ST Engineering (STE SP)

Buy (Maintained)

New Contract Win In Singapore; BUY

Target Price (Return): SGD4.50 (+14%)
 Price (Market Cap): SGD3.94 (USD9,097m)
 ESG score: 3.3 (out of 4)
 Avg Daily Turnover (SGD/USD) 14.7m/10.9m

- **Keep BUY and SGD4.50 TP, 14% upside with 4% yield.** ST Engineering has won a SGD175m contract from Singapore's Land Transport Authority (LTA) to modernise Singapore's public buses. This new contract adds to its already-high orderbook of SGD27.4bn. While its recent share price weakness could be related to concerns over STE's leverage position and market expectations of higher-for-longer interest rates, we see limited earnings risk as only 38% of its debt is exposed to floating rates. We remain upbeat on STE, which offers defensive dividends of SGD0.04 per quarter and strong profit growth.

- **STE to modernise Singapore public bus fleet.** STE's Urban Solutions and Satcom (USS) arm, along with Trapeze Group as its consortium partner, has been the technology provider for Singapore's bus fleet management system since 2014. The USS segment has won a contract valued at over SGD175m from Singapore's LTA to modernise Singapore's public bus fleet and operations. The scope of work involves technology upgrades for the fleet management system, fare collection, as well as power and communications systems. The upgrades will take advantage of the 5G network, which will allow for faster fare transactions for commuters and faster data exchanges between the buses and the back-end systems. The contract will cover c. 5,800 public buses, and the modernisation exercise will be implemented progressively from 2Q24 and completed by 2027. This contract adds to STE's order backlog of SGD27.4bn, which implies a book-to-bill ratio of 2.7 years.

- **Not overly concerned with higher-for-longer interest rates.** We believe the recent decline in STE's share price was probably related to concerns around its leveraged balance sheet, as well as revised market expectations of interest rates remaining elevated for longer. In its 1H23 results, STE had guided for a 2024 weighted average borrowing cost of mid-3%. As of end Dec 2023, its total borrowings stood at SGD6.1bn. The ratio between fixed- vs floating-rate borrowings stands at 62:38. We do not estimate a material decline in total borrowings, with our end-2024 total borrowings forecasted at SGD6bn. We estimate the 2024 average borrowing cost at 3.5%, and we are maintaining this figure for our 2025-2026 projections as well, even though there are expectations of an eventual cut in interest rates. Assuming all debt is exposed to a floating interest rate, every 50bps rise in average interest costs would lower our FY24-26 profit estimates by only 2-3%.

- **ESG premium and key risks.** With STE's ESG score of 3.3, which is two notches above the country median, our TP includes a 4% ESG premium over its intrinsic value of SGD4.32. Key downside risks include a slower revival in the commercial aerospace sector, and delays in contract deliveries amidst a sharp slowdown in economic growth.

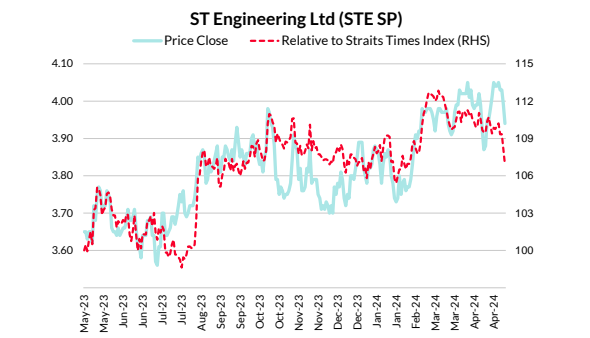
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	1.3	(1.8)	3.7	0.8	7.7
Relative	(0.3)	(4.0)	0.1	(3.9)	6.8
52-wk Price low/high (SGD)	3.56 - 4.05				



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)	25.45	20.05	17.20	14.61	13.25
P/B (x)	5.1	5.0	4.6	4.1	3.6
P/CF (x)	18.22	10.41	9.41	8.30	8.49
Dividend Yield (%)	5.6	4.1	4.0	4.0	4.0
EV/EBITDA (x)	15.62	13.26	11.94	10.50	9.65
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 women (23%).

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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)	25.45	20.05	17.20	14.61	13.25
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)	5.1	5.0	4.6	4.1	3.6
	FCF Yield (%)	(0.6)	7.3	5.3	8.4	8.7
	Dividend Yield (%)	5.6	4.1	4.0	4.0	4.0
	EV/EBITDA (x)	15.62	13.26	11.94	10.50	9.65
	EV/EBIT (x)	27.77	21.80	18.86	16.21	14.78
Key drivers	Income statement (SGDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
i. Strong order wins;	Total turnover	9,035	10,101	10,876	11,715	12,644
ii. Contributions from acquisitions.	Gross profit	1,699	1,973	2,215	2,446	2,630
	EBITDA	1,181	1,382	1,531	1,705	1,812
	Depreciation and amortisation	(517)	(541)	(562)	(600)	(629)
	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
Key risks	Cash flow (SGDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
i. Slower revival of the commercial aerospace sector;	Change in working capital	(442)	(101)	(205)	(192)	(332)
ii. Lower-than-expected contributions from acquisitions;	Cash flow from operations	673	1,179	1,304	1,478	1,445
iii. Delay in the implementation of Singapore's Smart Nation initiative.	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
Company Profile	Balance sheet (SGDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
ST Engineering is an integrated engineering group that is involved in the aerospace, electronics, land systems and marine sectors. The company has, over the years, diversified its businesses and geographical coverage.	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 its overall emissions have been increasing on the back of rising economic output, STE reduced its 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.

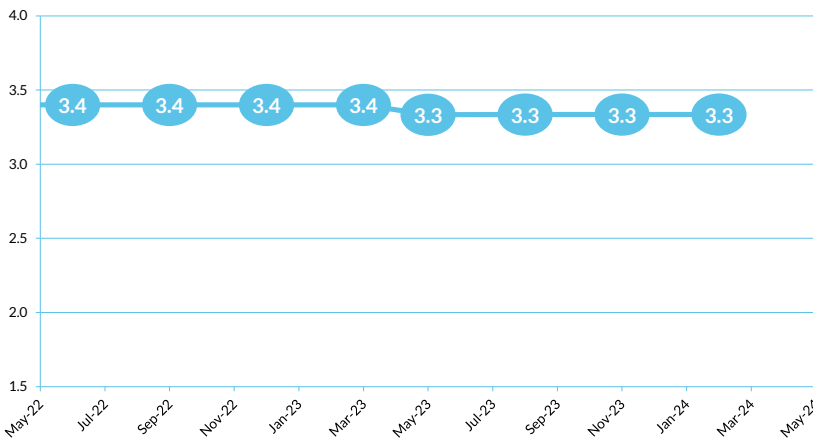
Emissions (tCO ₂ e)	Dec-21	Dec-22	Dec-23
Scope 1	36,000	39,000	37,000
Scope 2	78,000	71,000	74,000
Scope 3	1,900	33,000	39,000
Total emissions	115,900	143,000	150,000

Source: Company data, RHB

Latest ESG-Related Developments

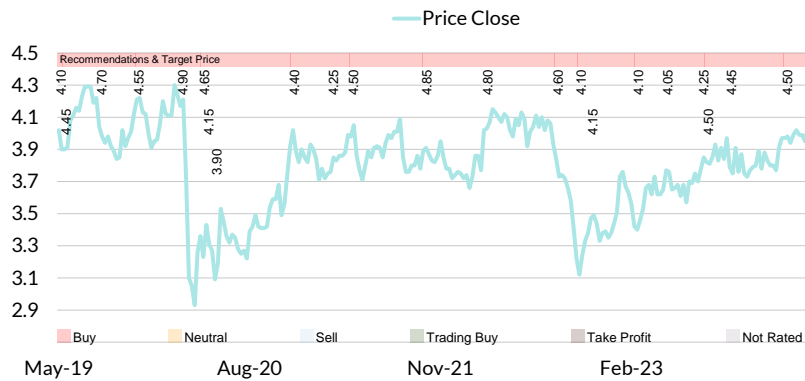
- In 2021, STE set a target to halve its absolute Scope 1 and Scope 2 GHG emissions by 2030 compared to a 2010 base year. In the same year, it also set a target to increase its sustainability-linked revenue to more than SGD3bn by 2026.
- In 2022, STE was included in the Dow Jones Sustainability Asia 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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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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