

2 September 2022

Industrials | Aerospace & Defence

## ST Engineering (STE SP)

**Buy** (Maintained)

### USS Contract Wins; BUY On Share Price Weakness

Target Price (Return):	SGD4.60 (21.7%)
Price (Market Cap):	SGD3.78 (USD8,426m)
ESG score:	3.40 (out of 4)
Avg Daily Turnover (SGD/USD)	18.5m/13.1m

- **Keep BUY with SGD4.60 TP, 22% upside and c.4% yield.** We see ST Engineering's (STE) recent share price correction as a buying opportunity. The price correction was caused by a lower than expected 1H22 earnings and concerns around its growing debt levels in a rising interest rate environment. We see no changes in STE's growth outlook and maintain that it should deliver defensive growth beyond 2022, aided by a revival in global aviation traffic, gains from growing demand for smart-city solutions, and rising global defence spending. We expect its DPS of 16 cents to remain steady and forecast 8% core profit CAGR in 2021-2024F.

- **Share price weakness offers an opportunity to accumulate the stock.** STE's share price has corrected by 6.9% since the announcement of its 1H22 results on 12 Aug 2022. The stock has also underperformed the STI Index by 5.4% during the same period. We had noted in our post results [research report](#) that its 1H22 core net profit of SGD226m had accounted only for 37% of our previous 2022F estimates. This had led to us lowering 2022F core net profit by 9% and 2023F-2024F profit by 1% and 2%. 2023F consensus earnings was downgraded 2%. Despite the downgrades, both the Street and us remain positive about STE delivering strong earnings growth beyond 2022F and a steady DPS of 16 cents, implying an yield of over 4%. Based on our estimates, STE is now trading at 18.2x 2023F EPS, which is below the six-year average P/E of 19.8x.

- **Continues to win new orders.** STE announced a SGD1.4bn contract win to provide turnkey rail services including rail electronics solutions as well as above-ground train depot design, construction and equipment fit out for the new Kaohsiung MRT Yellow Line. STE will be responsible for overall project management and serve as the systems integration lead. It will also provide the communications system, automatic fare collection system, platform screen doors, traction electrification system, depot design and construction, and depot maintenance equipment for the Yellow Line. The contracted scope is expected to start by late 2022 over a period of 10 years. This is a strong order win under its Urban Solutions & Satellite Communications (USS) business, which has been reporting an average quarterly order win of SGD340m since 1Q21.

- **Strong quarterly order wins and record orderbook.** STE announced SGD3.1bn worth of new contracts in 2Q22 (+69% YoY, +28% QoQ). Strong order wins were reported by its Defence & Public Security and Commercial Aerospace businesses. STE reported its highest order backlog of SGD22.2bn, which implies a book-to-bill ratio of 2.7 years – SGD4.6bn of this order book is expected to be delivered in 2H22, representing 100% of our 2H22 revenue estimates.

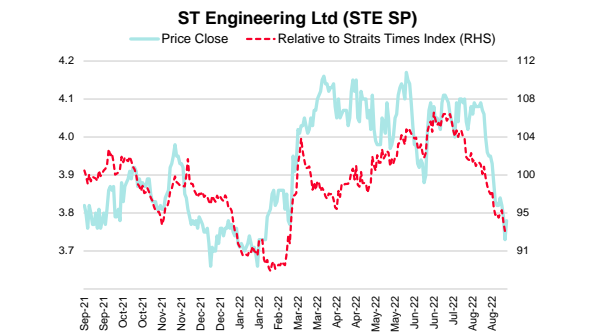
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	0.5	(6.7)	(8.5)	(4.3)	(1.1)
Relative	(2.6)	(6.2)	(7.8)	(2.6)	(5.4)
52-wk Price low/high (SGD)	3.66 – 4.17				



Source: Bloomberg

#### Overall ESG Score: 3.40 (out of 4)

##### E: GOOD

STE believes in conserving resources and contributing to a sustainable future by developing and deploying greener products and solutions. In 2020, it reported a 44% reduction in GHG emissions intensity over 2010 base year and recycled 54% of 11,700 tonnes of material and waste generated.

##### S: EXCELLENT

In 2020, it delivered SGD6.7bn in economic contributions despite challenging business conditions. STE continued operations as an essential service provider across its global geographies, providing work for local companies in its supply chain, and delivering to its customers. STE offers internship positions to technology and engineering students and has pledged SGD1m to NTUC Education and Training Fund over four years.

##### G: EXCELLENT

Despite having exposure to defence business, STE does not design, produce or sell anti-personnel mines, cluster munitions, white phosphorus munitions, and their related key components. STE's board comprises of 11 directors, of which 7 are independent (63%) and 2 are female (20%).

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (SGDm)	7,158	7,693	8,812	9,464	10,066
Recurring net profit (SGDm)	522	571	555	647	728
Recurring net profit growth (%)	(11.4)	9.3	(2.7)	16.6	12.4
Recurring P/E (x)	22.58	20.64	21.20	18.19	16.18
P/B (x)	5.1	4.9	4.8	4.4	4.1
P/CF (x)	7.69	10.57	14.62	19.22	8.66
Dividend Yield (%)	4.0	4.0	4.7	3.4	4.4
EV/EBITDA (x)	14.11	12.77	14.75	13.54	12.15
Return on average equity (%)	23.1	24.3	25.1	25.2	26.0
Net debt to equity (%)	51.1	48.7	210.1	206.3	180.4

Source: Company data, RHB

## Financial Exhibits

Asia	Financial summary (SGD)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Singapore	Recurring EPS	0.17	0.18	0.18	0.21	0.23
Industrials	DPS	0.15	0.15	0.18	0.13	0.17
<b>ST Engineering</b>	BVPS	0.74	0.77	0.78	0.86	0.93
STE SP	Return on average equity (%)	23.1	24.3	25.1	25.2	26.0
Buy						
	<b>Valuation metrics</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
<b>Valuation basis</b>	Recurring P/E (x)	22.58	20.64	21.20	18.19	16.18
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	4.9	4.8	4.4	4.1
	FCF Yield (%)	11.4	7.0	0.2	1.1	8.7
	Dividend Yield (%)	4.0	4.0	4.7	3.4	4.4
	EV/EBITDA (x)	14.11	12.77	14.75	13.54	12.15
	EV/EBIT (x)	23.48	20.63	23.56	21.60	19.06
<b>Key drivers</b>						
i. Strong order wins						
ii. Contributions from acquisitions						
<b>Key risks</b>						
i. Slower revival in commercial aerospace sector						
ii. Lower than expected contribution from acquisitions						
iii. Delay in the implementation of Singapore's smart nation initiative						
<b>Company Profile</b>						
ST Engineering (STE) is an integrated engineering group in the aerospace, electronics, land systems and marine sectors. The company has over the years, diversified its businesses and geographical coverage.						
	<b>Income statement (SGDm)</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
	Total turnover	7,158	7,693	8,812	9,464	10,066
	Gross profit	1,527	1,535	1,768	1,930	2,090
	EBITDA	949	1,044	1,197	1,333	1,453
	Depreciation and amortisation	(379)	(398)	(448)	(497)	(527)
	Operating profit	570	646	749	836	926
	Net interest	(62)	(36)	(99)	(152)	(159)
	Pre-tax profit	534	638	712	757	851
	Taxation	(9)	(71)	(107)	(113)	(128)
	Reported net profit	522	571	609	647	728
	Recurring net profit	522	571	555	647	728
	<b>Cash flow (SGDm)</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
	Change in working capital	587	137	(360)	(699)	(62)
	Cash flow from operations	1,533	1,114	805	613	1,360
	Capex	(192)	(296)	(780)	(480)	(330)
	Cash flow from investing activities	(295)	(414)	(4,491)	(440)	(278)
	Dividends paid	(468)	(468)	(560)	(400)	(518)
	Cash flow from financing activities	(959)	(615)	4,057	(571)	(689)
	Cash at beginning of period	453	731	816	1,187	788
	Net change in cash	279	86	371	(399)	392
	Ending balance cash	731	817	1,187	788	1,181
	<b>Balance sheet (SGDm)</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
	Total cash and equivalents	731	816	1,187	788	1,181
	Tangible fixed assets	1,757	1,794	2,216	2,292	2,188
	Total investments	469	483	454	414	362
	Total assets	9,561	10,516	15,417	15,432	15,784
	Short-term debt	496	560	0	0	0
	Total long-term debt	1,551	1,555	6,858	6,858	6,858
	Total liabilities	6,987	7,847	12,717	12,489	12,637
	Total equity	2,575	2,668	2,700	2,943	3,148
	Total liabilities & equity	9,561	10,516	15,417	15,432	15,784
	<b>Key metrics</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
	Revenue growth (%)	(9.0)	7.5	14.5	7.4	6.4
	Recurrent EPS growth (%)	(11.5)	9.4	(2.7)	16.6	12.4
	Gross margin (%)	21.3	20.0	20.1	20.4	20.8
	Operating EBITDA margin (%)	13.3	13.6	13.6	14.1	14.4
	Net profit margin (%)	7.3	7.4	6.9	6.8	7.2
	Dividend payout ratio (%)	89.7	82.0	92.0	61.8	71.2
	Capex/sales (%)	2.7	3.8	8.9	5.1	3.3
	Interest cover (x)	8.00	13.53	6.29	4.67	5.16

Source: Company data, RHB

## Recommendation Chart

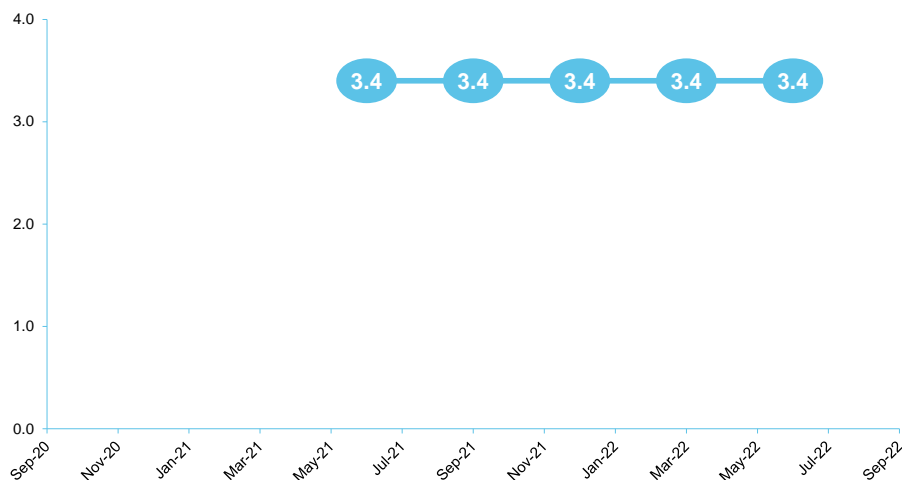


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-08-15	Buy	4.60	4.00
2022-02-27	Buy	4.80	3.77
2021-10-04	Buy	4.85	3.88
2021-04-12	Buy	4.50	3.97
2021-02-22	Buy	4.25	3.82
2020-11-20	Buy	4.40	3.92
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
2019-11-29	Buy	4.55	4.13
2019-11-12	Buy	4.55	4.17
2019-11-11	Buy	4.70	4.00
2019-10-14	Buy	4.70	4.04

Source: RHB, Bloomberg

## ESG Rating History



Source: RHB

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<b>Neutral:</b>	Share price may fall within the range of +/- 10% over the next 12 months
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<b>Not Rated:</b>	Stock is not within regular research coverage

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