

20 November 2020

Industrials | Aerospace & Defence

## ST Engineering (STE SP)

**Buy** (Maintained)

**Strong Order Book, Reorganisation Is Positive; BUY**

Target Price (Return): SGD4.40 (12.5%)  
 Price: SGD3.91  
 Market Cap: USD9,084m  
 Avg Daily Turnover (SGD/USD) 15.0m/10.9m

- **Reiterate BUY with higher SGD4.40 TP from SGD3.90, 13% upside and c.4% yield.** Despite the weak business environment, ST Engineering notched up strong order wins in 3Q20. Management remains committed to working towards cost optimisation. Its recent plans to reorganise its businesses to focus on key growth areas, is a positive. We continue to like STE for its defensive earnings quality and ability to sustain dividend payments. We expect strong earnings growth in 2021F, which STE's share price is yet to fully factor in.
- **Strong order wins, robust orderbook.** STE's SGD15.8bn outstanding order book offers over two years of revenue visibility. In 3Q20, STE won SGD1.7bn worth of new orders, with electronics securing a SGD1.1bn historical record win – its highest ever quarterly order win. STE noted that it did not have to compromise on margins to register such strong order wins. While order wins for aerospace remained sluggish, STE believes the MRO business may have bottomed, and could improve next year.
- **Confident of ability to offset tapering government support.** STE expects to receive SGD300m of government support this year. With the Government extending its support, the company expects to receive another SGD100m next year. While government support is expected to taper off next year, STE remains confident of offsetting the shortfall in 2021, with benefits from ongoing cost optimisation initiatives, and a gradual recovery in demand for most of its business sectors.
- **Reorganisation enables better focus on growth areas.** Effective 1 Jan 2021, STE will reorganise its businesses into two growth-focused segments – commercial, and defence & public security. These will replace the current aerospace, electronics, land systems and marine segments. We view this as a positive, as it will enable STE to better channel its resources towards growth areas in Smart City and international businesses, and make it easier to optimise synergies across the current business segments.
- **Dividends should come through.** STE mentioned that business reorganisation and realignment of focus on growth areas will not impact its dividend policy. We maintain that STE will likely keep its 15 cents DPS from 2019, for 2020F as well.
- **Roll forward our valuation to 2021 earnings,** and raise target multiples to factor in potential earnings recovery. We leave our earnings estimates unchanged, and maintain that STE should see a revival in earnings growth in 2021, aided by the gradual normalisation of order deliveries across all its current business segments.

### Analyst

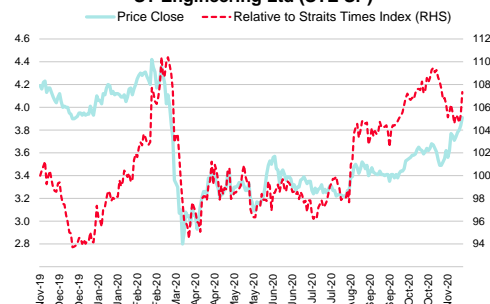
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### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(0.8)	8.3	11.7	17.4	(6.5)
Relative	13.0	(0.9)	3.3	9.8	7.8
52-wk Price low/high (SGD)				2.80 – 4.42	

### ST Engineering Ltd (STE SP)



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)	23.12	20.68	24.14	21.50	18.77
P/B (x)	5.4	5.5	5.4	5.2	4.9
P/CF (x)	19.05	20.65	14.81	11.77	10.87
Dividend Yield (%)	3.8	3.8	3.8	3.9	3.9
EV/EBITDA (x)	15.41	14.02	14.23	12.97	11.55
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

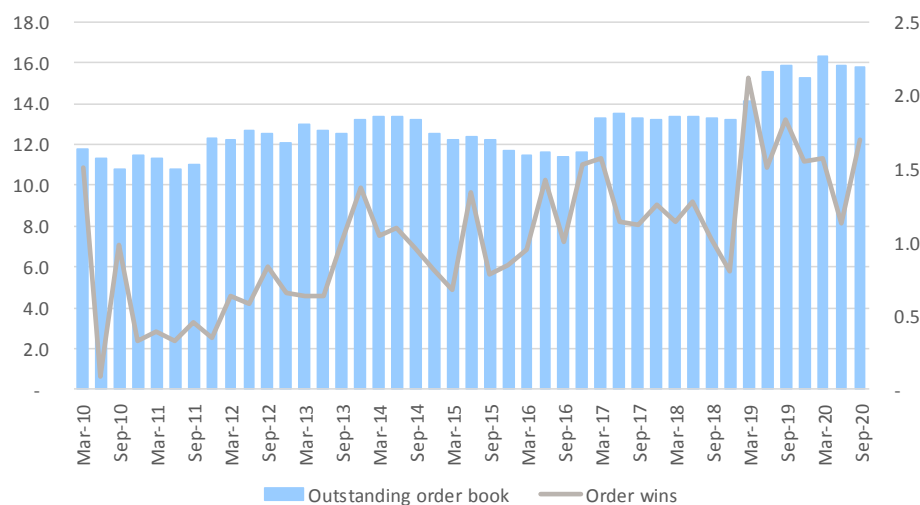
<b>Asia</b>	<b>Financial summary (SGD)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
Singapore	Recurring EPS	0.17	0.19	0.16	0.18	0.21
Industrials	DPS	0.15	0.15	0.15	0.15	0.15
<b>ST Engineering</b>	BV/PS	0.72	0.71	0.72	0.75	0.80
STE SP	Return on average equity (%)	22.2	25.9	22.6	24.7	26.8
Buy						
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
Our TP is derived by using an average of forward P/E, P/BV, EV/EBITDA and DCF of adjusted free cash flows.	Recurring P/E (x)	23.12	20.68	24.14	21.50	18.77
	P/B (x)	5.4	5.5	5.4	5.2	4.9
	FCF Yield (%)	2.5	3.4	4.5	6.3	7.1
	Dividend Yield (%)	3.8	3.8	3.8	3.9	3.9
	EV/EBITDA (x)	15.41	14.02	14.23	12.97	11.55
	EV/EBIT (x)	22.01	21.91	22.95	20.54	17.76
<b>Key drivers</b>	<b>Income statement (SGDm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
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
<b>Key risks</b>	<b>Cash flow (SGDm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
i. Poor execution of diversification in the aerospace sector;	Change in working capital	(166)	(439)	(168)	(55)	(71)
ii. Lower-than-expected contributions from acquisitions;	Cash flow from operations	639	590	824	1,037	1,123
iii. Delay in the implementation of Singapore's Smart Nation initiative.	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
<b>Company Profile</b>	<b>Balance sheet (SGDm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
ST Engineering is an integrated engineering group in the aerospace, electronics, land systems and marine sectors. The company has, over the years, diversified its businesses and expanded its geographical coverage.	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
	<b>Key metrics</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
	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

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Figure 1: ST Engineering has maintained a strong outstanding order book



Source: Company data, RHB

Figure 2: Peer comparison

	BBG	Price	M Cap	Last	P/E		EV/EBITDA		P/BV		D Yield	ROE
Company name	ticker	(LCY)	(USD m)	year	1FY	2FY	1FY	2FY	1FY	2FY	1FY	1FY
<b>Aerospace</b>												
Safran SA	SAFFP	119.50	60,420	Dec-19	50.9	30.5	20.0	15.7	3.97	3.70	0.9%	8.7%
Thales SA	HOFP	78.94	19,928	Dec-19	18.5	13.5	10.3	8.4	2.92	2.60	1.7%	16.6%
HEICO Corp	HEIUS	134.29	16,875	Oct-19	59.7	61.2	38.3	34.9	7.85	7.33	0.1%	17.1%
Air France - KLM	AFFP	4.26	2,163	Dec-19	-	-	-	9.2	-	-	0.0%	-659.5%
SIA Engineering	SIESP	1.89	1,575	Mar-20	-	105.0	62.4	32.5	1.37	1.37	2.1%	0.6%
AAR Corp	AIRUS	26.21	925	May-20	24.0	13.4	12.4	8.4	0.81	0.73	0.0%	1.7%
<b>Weighted average</b>			<b>101,887</b>		<b>43.9</b>	<b>32.6</b>	<b>21.3</b>	<b>17.5</b>	<b>4.26</b>	<b>3.94</b>	<b>0.9%</b>	<b>-2.8%</b>
<b>Electronics</b>												
CISCO Systems	CSCOUS	41.32	174,598	Jul-20	13.1	12.3	9.0	8.8	4.28	3.84	3.5%	33.1%
Siemens AG	SIEGR	109.62	110,269	Sep-20	17.3	14.7	13.2	11.8	1.95	1.84	3.4%	11.2%
Hitachi	6501JP	3,926.00	36,538	Mar-20	9.6	9.1	6.6	5.5	1.20	1.10	2.5%	11.5%
China Spacesat	600118CH	33.17	5,958	Dec-19	87.3	75.4	-	-	6.32	5.96	0.3%	6.3%
<b>Weighted average</b>			<b>327,362</b>		<b>15.5</b>	<b>13.9</b>	<b>10.0</b>	<b>9.3</b>	<b>3.19</b>	<b>2.90</b>	<b>3.3%</b>	<b>22.8%</b>
<b>Land Systems</b>												
Caterpillar	CATUS	172.74	93,842	Dec-19	31.9	23.2	14.9	12.3	6.57	6.75	2.4%	20.7%
General Dynamics	GDUS	153.50	44,050	Dec-19	13.9	13.3	11.4	11.0	2.88	2.60	2.9%	22.1%
Komatsu	6301JP	2,508.0	23,462	Mar-20	27.6	16.4	12.1	9.0	1.30	1.25	1.8%	5.6%
BAE Syetism	BA/LN	507.20	21,610	Dec-19	11.7	10.4	8.0	7.2	2.88	2.55	4.8%	23.8%
Zoomlion	000157CH	7.71	9,000	Dec-19	9.0	7.8	8.7	7.7	1.35	1.22	4.3%	15.0%
<b>Weighted average</b>			<b>191,965</b>		<b>23.9</b>	<b>17.9</b>	<b>12.7</b>	<b>10.8</b>	<b>4.42</b>	<b>4.39</b>	<b>2.8%</b>	<b>19.3%</b>
<b>Marine</b>												
Yangzijiang	YZJSGDSP	0.92	2,652	Dec-19	6.6	6.5	(0.1)	(0.1)	0.53	0.50	4.7%	8.2%
Samsung Heavy Industries	010140KS	5,790	3,271	Dec-19	-	-	-	28.5	0.79	0.81	0.1%	-19.1%
Sembcorp Marine	SMMSP	0.13	1,204	Dec-19	-	-	-	42.1	0.21	0.21	0.0%	-9.6%
<b>Weighted average</b>			<b>7,127</b>		<b>2.5</b>	<b>2.4</b>	<b>(0.0)</b>	<b>20.1</b>	<b>0.60</b>	<b>0.59</b>	<b>1.8%</b>	<b>-7.3%</b>
ST Engineering	STESP	3.91	9,052	Dec-19	24.1	21.5	13.8	12.8	5.40	5.20	3.8%	22.6%

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
2019-11-12	Buy	4.55	4.17
2019-08-15	Buy	4.70	4.07
2019-05-22	Buy	4.45	3.92
2019-02-22	Buy	4.10	3.73

Source: RHB, Bloomberg

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Analyst	Company
-	-

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