

17 May 2022

Industrials | Aerospace & Defence

ST Engineering (STE SP)

Buy (Maintained)

Defensive Amidst An Uncertain Economic Outlook

Target Price (Return): SGD4.80 (+21%)
 Price (Market Cap): SGD3.98 (USD8,901m)
 ESG score: 3.40 (out of 4)
 Avg Daily Turnover (SGD/USD) 21.9m/16.1m

- **BUY, SGD4.80 TP, 21% upside with c.4% yield.** In its 1Q22 update, ST Engineering reported in-line revenue of SGD2bn, with all segments booking YoY growth. It still reported strong order wins, with SGD2.4bn in new contracts during the quarter – which took total orders to an all-time high of SGD21.3bn. STE announced a quarterly DPS of 4 SG cents. We remain upbeat on it delivering defensive growth, aided by a gradual revival in the aerospace business. Key catalysts: Sustained strong contract wins, the commercial aerospace business recovery, and higher margins.
- **All segments reported revenue growth.** In 1Q22, its Commercial Aerospace (CA) revenue rose to SGD674m (+22% YoY, at 26% of our 2022 estimate), while Urban Solutions & Satcom (USS) revenue increased by 12% YoY to SGD297m (23% of our 2022 estimate), and Defence & Public Security (D&PS) revenue rose to SGD1,062m (+9% YoY, at 25% of our 2022 estimate).
- **CA outlook continues to improve.** Its airframe maintenance, repair and overhaul (MRO) business has seen an almost full recovery (80% capacity utilisation in 3Q21), while the engines and component MRO is operating at 80% capacity (70% in 3Q21). Demand for passenger-to-freighter (P2F) services remains strong – with A330P2F conversion slots booked until 2026 and A320/A321P2F conversion slots booked until 2025. Increasing the scale of operations should boost its P2F profitability, as STE will double its P2F aircraft induction this year. Nacelle production is expected to ramp up for the rest of 2022.
- **Strong order win momentum.** STE reported SGD2.4bn worth of order wins in 1Q22 (+54% YoY, -25% QoQ). This comprised of SGD0.9bn from CA, SGD200m from USS and SGD1.3bn from the D&PS business (Figure 1). The CA business continued to see strong order wins with A330P2F orders by DHL and CDB Aviation. The consolidation of TransCore from 17 Mar contributed SGD1.6bn of orders into STE's orderbook, which has now reached a record high of SGD21.3bn (Figure 2), implying >two years of revenue visibility. STE expects SGD5.8bn of the orderbook to be realised as revenue in the last nine months of 2022 (94% of our revenue estimate).
- **Working to keep costs in check.** STE issued USD1bn bonds (USD700m due in 2027, USD300m due in 2032) and has managed to lower its weighted average cost of borrowing undertaken to acquire TransCore to 1.8% pa (Figure 3) – thanks to the favourable settlement of Treasury Locks gains of USD91m, which will be amortised over the period of the bonds. STE remains confident of covering up the SGD200m gap from the government support shortfall through higher revenue, cost savings and productivity improvements. Our SGD4.80 TP includes an 8% ESG premium over the fair value of SGD4.45.

Analyst

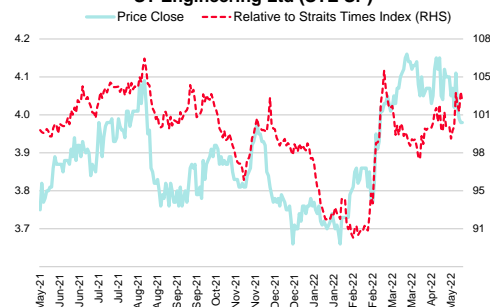
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	5.9	(2.2)	3.1	3.1	7.0
Relative	3.7	2.3	10.0	4.3	4.8
52-wk Price low/high (SGD)				3.66 – 4.16	

ST Engineering Ltd (STE SP)



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 greenhouse gas emissions intensity over 2010 (a 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 the defence business, STE does not design, produce or sell anti-personnel mines, cluster munitions, white phosphorus munitions and the related key components. STE's board comprises 11 directors, of which seven are independent (63%) and two are women (20%).

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (SGDm)	7,158	7,693	8,212	8,703	9,218
Recurring net profit (SGDm)	522	571	612	663	737
Recurring net profit growth (%)	(11.4)	9.3	7.3	8.3	11.1
Recurring P/E (x)	23.77	21.73	20.23	18.69	16.82
P/B (x)	5.4	5.1	4.9	4.6	4.2
P/CF (x)	8.09	11.12	16.89	23.66	10.34
Dividend Yield (%)	3.8	3.8	3.7	3.9	4.3
EV/EBITDA (x)	14.76	13.36	12.44	11.92	10.67
Return on average equity (%)	23.1	24.3	24.6	25.1	26.0
Net debt to equity (%)	51.1	48.7	47.6	53.6	37.4

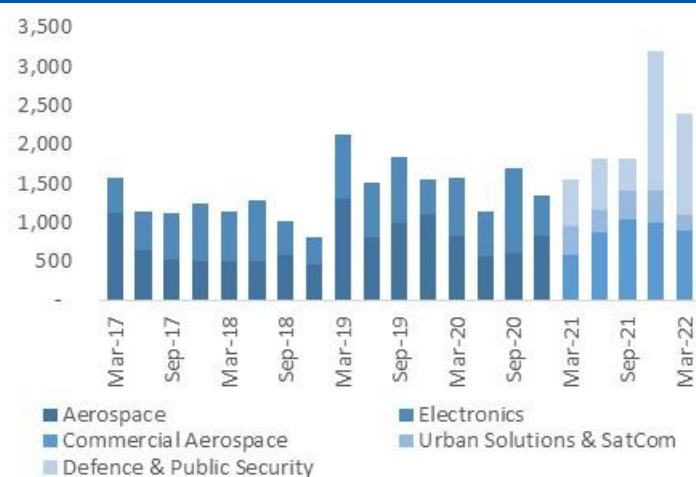
Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (SGD)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Singapore	Recurring EPS	0.17	0.18	0.20	0.21	0.24
Industrials	DPS	0.15	0.15	0.15	0.16	0.17
ST Engineering	BVPS	0.74	0.77	0.82	0.87	0.94
STE SP	Return on average equity (%)	23.1	24.3	24.6	25.1	26.0
Buy						
Valuation basis	Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Our TP is derived by using an average of forward P/E, P/BV, EV/EBITDA and DCF of adjusted FCF.	Recurring P/E (x)	23.77	21.73	20.23	18.69	16.82
	P/B (x)	5.4	5.1	4.9	4.6	4.2
	FCF Yield (%)	10.8	6.6	3.7	2.0	7.6
	Dividend Yield (%)	3.8	3.8	3.7	3.9	4.3
	EV/EBITDA (x)	14.76	13.36	12.44	11.92	10.67
	EV/EBIT (x)	24.57	21.60	20.05	19.05	16.70
Key drivers	Income statement (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. Strong order wins;	Total turnover	7,158	7,693	8,212	8,703	9,218
ii. Contributions from acquisitions.	Gross profit	1,527	1,535	1,646	1,753	1,893
	EBITDA	949	1,044	1,123	1,194	1,295
	Depreciation and amortisation	(379)	(398)	(426)	(447)	(467)
	Operating profit	570	646	697	747	827
	Net interest	(62)	(36)	(40)	(41)	(45)
	Pre-tax profit	534	638	716	775	862
	Taxation	(9)	(71)	(107)	(116)	(129)
	Reported net profit	522	571	612	663	737
	Recurring net profit	522	571	612	663	737
Key risks	Cash flow (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. Slower revival in the commercial aerospace sector;	Change in working capital	587	137	(354)	(635)	(54)
ii. Lower-than-expected contributions from acquisitions;	Cash flow from operations	1,533	1,114	734	524	1,198
iii. Delay in the implementation of Singapore's smart nation initiative.	Capex	(192)	(296)	(280)	(280)	(260)
	Cash flow from investing activities	(295)	(414)	(252)	(240)	(208)
	Dividends paid	(468)	(468)	(467)	(490)	(531)
	Cash flow from financing activities	(959)	(615)	(520)	(543)	(583)
	Cash at beginning of period	453	731	816	778	519
	Net change in cash	279	86	(38)	(259)	407
	Ending balance cash	731	817	778	519	926
Company Profile	Balance sheet (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
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 geographical coverage.	Total cash and equivalents	731	816	778	519	926
	Tangible fixed assets	1,757	1,794	1,735	1,655	1,535
	Total investments	469	483	454	414	362
	Total assets	9,561	10,516	10,598	10,531	10,857
	Short-term debt	496	560	0	0	0
	Total long-term debt	1,551	1,555	2,115	2,115	2,115
	Total liabilities	6,987	7,847	7,788	7,552	7,677
	Total equity	2,575	2,668	2,810	2,979	3,181
	Total liabilities & equity	9,561	10,516	10,598	10,531	10,857
	Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Revenue growth (%)	(9.0)	7.5	6.8	6.0	5.9
	Recurrent EPS growth (%)	(11.5)	9.4	7.4	8.3	11.1
	Gross margin (%)	21.3	20.0	20.0	20.1	20.5
	Operating EBITDA margin (%)	13.3	13.6	13.7	13.7	14.0
	Net profit margin (%)	7.3	7.4	7.5	7.6	8.0
	Dividend payout ratio (%)	89.7	82.0	76.3	73.9	72.0
	Capex/sales (%)	2.7	3.8	3.4	3.2	2.8
	Interest cover (x)	8.00	13.53	11.75	12.51	13.77

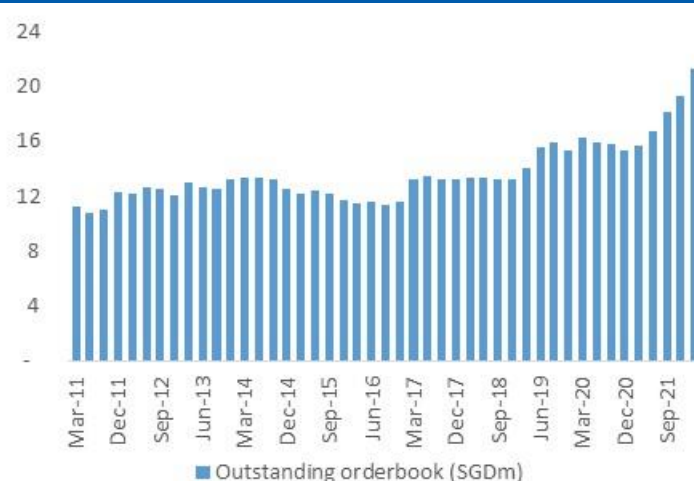
Source: Company data, RHB

Figure 1: STE's quarterly order wins in SGDm terms



Source: Company data, RHB

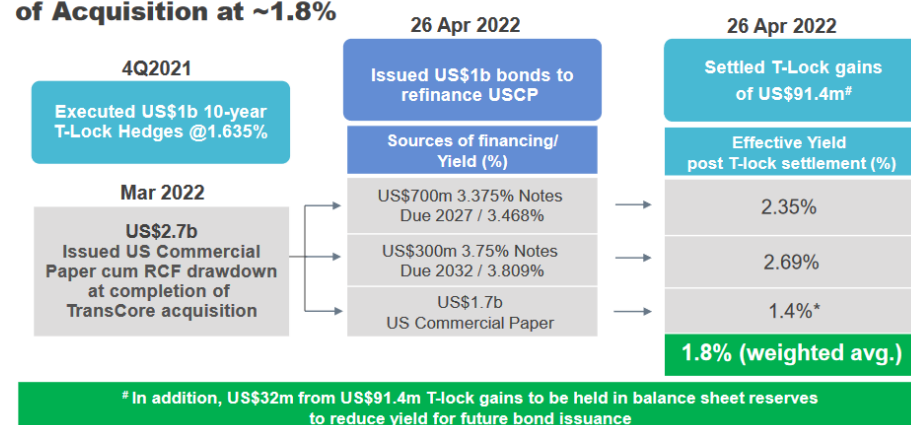
Figure 2: Its orderbook is at all-time high of SGD21.3bn



Source: Company data, RHB

Figure 3: TransCore financing update

Estimated Weighted Avg. Financing Cost for 1st Year of Acquisition at ~1.8%



Source: Company

17 May 2022

Industrials | Aerospace & Defence

Recommendation Chart

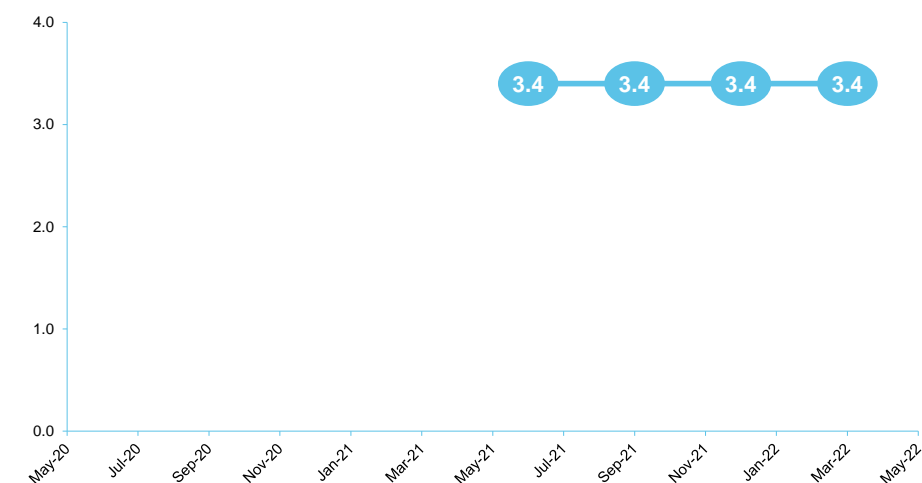


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2019-11-12	Buy	4.55	4.17
2019-08-15	Buy	4.70	4.07

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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