

9 November 2022

Industrials | Aerospace & Defence

ST Engineering (STE SP)

Buy (Maintained)

Mildly Positive On US Marine Business Sale; BUY

Target Price (Return): SGD4.15 (+25%)
 Price (Market Cap): SGD3.33 (USD7,381m)
 ESG score: 3.40 (out of 4)
 Avg Daily Turnover (SGD/USD) 20.8m/14.7m

- **BUY, new SGD4.15 TP from SGD4.10, 25% upside with c.4% FY23F yield.** ST Engineering has decided to dispose of its loss-making US marine business. While orders for this unit account for c.8% of its total orderbook, outstanding jobs excluding these contracts still provide over two years of revenue visibility. We expect the margin improvement in its defense business to more than offset the revenue decline from this sale. Beyond 2022, STE should deliver a 10% profit CAGR in 2022–2024F, and a steady DPS of 16 cents.

- **US marine business exit deal.** STE plans to divest its entire stakes in VT Halter Marine (VTHM) and ST Engineering Halter Marine and Offshore to Bollinger Shipyards Lockport for a cash consideration of USD15m (c.SGD21m) on a cash-free, debt-free basis – subject to net working capital adjustments, if any, post-closing. STE may receive earn-out payments of up to USD10.25m, subject to the award of certain future shipbuilding contracts to VTHM, and such contracts meeting the requisite operating profit margins. The proposed divestment is expected to be completed before the end of Dec 2022, and translate into a non-cash loss on disposal of c.SGD13.3m.

- **STE's US marine business has been in the red.** STE noted that it had conducted a thorough review of the two US marine businesses. These two units have incurred a combined pre-tax net loss of USD256m (SGD349m) in the last five years (2017-2021), with an annual pre-tax net loss that ranged from about USD40m (c.SGD56m) to USD60m (c.SGD85m).

- **Reduction in the orderbook, but this may be positive for the margin outlook.** STE's outstanding orderbook remains strong at SGD25bn at the end of Sep 2022. This includes the orders for the two US marine businesses worth SGD1.9bn, which will be removed from its orderbook after the close of the transaction. Excluding these orders, the group's outstanding orderbook of SGD23.1bn still provides over two years of revenue visibility. We expect a sharp drop in marine business revenue from 2023, but expect the improvement in defense business margins (due to the sale of the loss-making US marine businesses) to more than offset the revenue decline.

- **Strong earnings growth beyond 2022.** We increase 2024F earnings by 3%, and maintain that the delivery of STE's strong orderbook, growing defence revenue and Urban Solutions & Satcom Security's potentially sharp recovery should support its 14-17% profit growth in 2023-2024F. We continue to derive our TP by using an average of P/E, P/BV, EV/EBITDA, and DCF of FCF. Our TP includes an ESG premium of 8%, over the fair value of SGD3.85.

Analyst

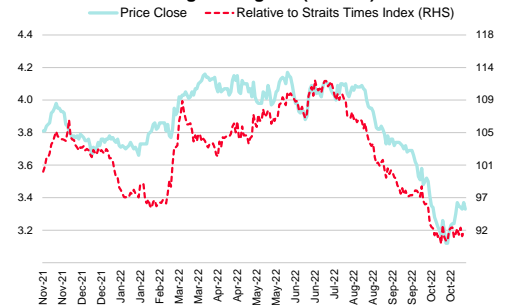
Shekhar Jaiswal
 +65 6320 0806
shekhar.jaiswal@rhbgroup.com



Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(11.4)	(2.4)	(18.4)	(17.2)	(12.6)
Relative	(12.0)	(2.2)	(14.4)	(12.6)	(8.8)
52-wk Price low/high (SGD)	3.12 – 4.17				

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 2021, it reported a 46% reduction in GHG emissions intensity over the base year of 2010, and is working towards its target to achieve a 50% absolute Scope 1 and 2 GHG emissions reduction by 2030 compared to 2010.

S: EXCELLENT

In 2021, it delivered SGD7.2bn in economic contributions despite challenging business conditions. With people remaining the cornerstone of its business, STE further strengthened its learning and development framework, accelerated workforce digitalisation and deepened our engineering, technology and innovation capabilities.

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 which nine are independent (69%) and two are female (15%).

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (SGDm)	7,158	7,693	8,812	9,216	9,798
Recurring net profit (SGDm)	522	571	545	618	725
Recurring net profit growth (%)	(11.4)	9.3	(4.5)	13.5	17.3
Recurring P/E (x)	19.89	18.18	19.03	16.77	14.30
P/B (x)	4.5	4.3	4.3	3.9	3.6
P/CF (x)	6.77	9.31	12.94	16.54	7.57
Dividend Yield (%)	4.5	4.5	5.4	3.8	4.7
EV/EBITDA (x)	12.63	11.42	13.67	12.55	11.01
Return on average equity (%)	23.1	24.3	24.7	24.2	26.1
Net debt to equity (%)	51.1	48.7	211.2	209.1	181.4

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	0.17	0.20	0.23
Industrials	DPS	0.15	0.15	0.18	0.13	0.16
ST Engineering	BVPS	0.74	0.77	0.78	0.85	0.92
STE SP	Return on average equity (%)	23.1	24.3	24.7	24.2	26.1
Buy						
	Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Valuation basis	Recurring P/E (x)	19.89	18.18	19.03	16.77	14.30
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)	4.5	4.3	4.3	3.9	3.6
	FCF Yield (%)	12.9	7.9	0.2	1.4	10.0
	Dividend Yield (%)	4.5	4.5	5.4	3.8	4.7
	EV/EBITDA (x)	12.63	11.42	13.67	12.55	11.01
	EV/EBIT (x)	21.02	18.47	21.92	20.05	17.11
Key drivers						
i. Strong order wins;						
ii. Contributions from acquisitions.						
Key risks						
i. Slower revival in the commercial aerospace sector;						
ii. Lower-than-expected contributions from acquisitions;						
iii. Delay in the implementation of Singapore's smart nation initiative.						
Company Profile						
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.						
	Income statement (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Total turnover	7,158	7,693	8,812	9,216	9,798
	Gross profit	1,527	1,535	1,761	1,897	2,083
	EBITDA	949	1,044	1,190	1,329	1,478
	Depreciation and amortisation	(379)	(398)	(448)	(497)	(527)
	Operating profit	570	646	742	832	951
	Net interest	(62)	(36)	(103)	(178)	(182)
	Pre-tax profit	534	638	700	723	848
	Taxation	(9)	(71)	(105)	(108)	(127)
	Reported net profit	522	571	599	618	725
	Recurring net profit	522	571	545	618	725
	Cash flow (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Change in working capital	587	137	(357)	(687)	(70)
	Cash flow from operations	1,533	1,114	801	627	1,370
	Capex	(192)	(296)	(780)	(480)	(330)
	Cash flow from investing activities	(295)	(414)	(4,492)	(443)	(284)
	Dividends paid	(468)	(468)	(560)	(392)	(495)
	Cash flow from financing activities	(959)	(615)	4,368	(945)	(1,037)
	Cash at beginning of period	453	731	816	1,493	732
	Net change in cash	279	86	677	(761)	48
	Ending balance cash	731	817	1,493	732	781
	Balance sheet (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Total cash and equivalents	731	816	1,493	732	781
	Tangible fixed assets	1,757	1,794	2,216	2,292	2,188
	Total investments	469	483	456	419	373
	Total assets	9,561	10,516	15,724	15,295	15,302
	Short-term debt	496	560	0	0	0
	Total long-term debt	1,551	1,555	7,173	6,823	6,473
	Total liabilities	6,987	7,847	13,035	12,382	12,164
	Total equity	2,575	2,668	2,689	2,912	3,138
	Total liabilities & equity	9,561	10,516	15,724	15,295	15,302
	Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Revenue growth (%)	(9.0)	7.5	14.5	4.6	6.3
	Recurrent EPS growth (%)	(11.5)	9.4	(4.5)	13.5	17.3
	Gross margin (%)	21.3	20.0	20.0	20.6	21.3
	Operating EBITDA margin (%)	13.3	13.6	13.5	14.4	15.1
	Net profit margin (%)	7.3	7.4	6.8	6.7	7.4
	Dividend payout ratio (%)	89.7	82.0	93.6	63.3	68.2
	Capex/sales (%)	2.7	3.8	8.9	5.2	3.4
	Interest cover (x)	8.00	13.53	6.03	3.96	4.74

Source: Company data, RHB

Recommendation Chart

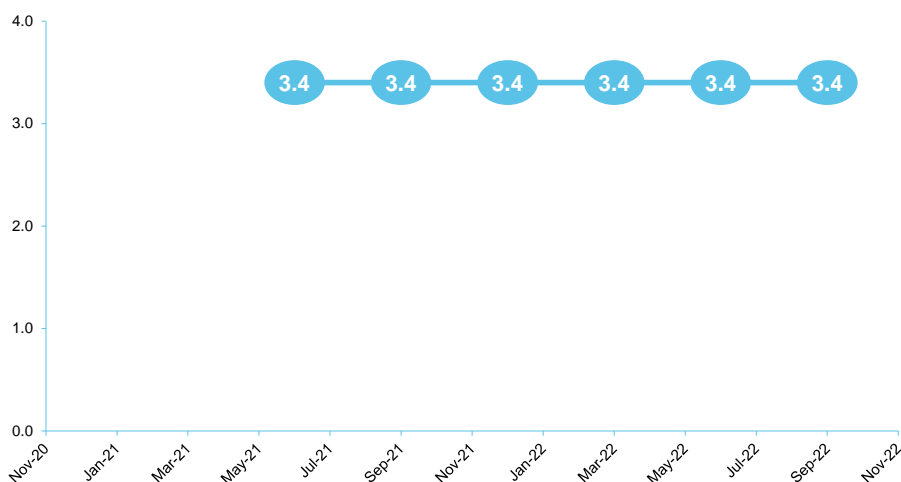


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
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

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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KUALA LUMPUR

RHB Investment Bank Bhd

Level 3A, Tower One, RHB Centre
Jalan Tun Razak
Kuala Lumpur 50400
Malaysia
Tel : +603 9280 8888
Fax : +603 9200 2216

JAKARTA

PT RHB Sekuritas Indonesia

Revenue Tower, 11th Floor, District 8 - SCBD
Jl. Jendral Sudirman Kav 52-53
Jakarta 12190
Indonesia
Tel : +6221 509 39 888
Fax : +6221 509 39 777

BANGKOK

RHB Securities (Thailand) PCL

10th Floor, Sathorn Square Office Tower
98, North Sathorn Road, Silom
Bangrak, Bangkok 10500
Thailand
Tel: +66 2088 9999
Fax :+66 2088 9799

SINGAPORE

RHB Bank Berhad (Singapore branch)

90 Cecil Street
#04-00 RHB Bank Building
Singapore 069531
Fax: +65 6509 0470