30 November 2022

Industrials | Aerospace & Defence

ST Engineering (STE SP)

Buy (Maintained)

In Line 9M22 And Strong Order Wins; Keep BUY

Target Price (Return):	SGD4.15 (18.9%)
Price (Market Cap):	SGD3.49 (USD7,914m)
ESG score:	3.40 (out of 4)
Avg Daily Turnover (SGD/USD)	21.4m/15.2m

- **Maintain BUY and SGD4.15 TP, 19% upside, with c.4% FY23F yield.** ST Engineering's 9M22 revenue of SGD6.5bn was in line, accounting for 74% of our 2022 estimate. It reported strong order wins in 3Q22, with an outstanding order book (excluding the US marine business) of SGD23.1bn at an all-time high. TransCore's latest contract delivery is expected to start in 2024. Despite some concerns about higher interest costs, we continue to like STE for its strong revenue visibility and a defensive dividend outlook. We expect it to deliver a 8% profit CAGR in 2022–2024F.
- **All businesses reported YoY growth.** STE reported 3Q22 revenue of SGD2.2bn (+22% YoY, unchanged QoQ). On a YoY basis, all businesses reported revenue growth: Commercial aerospace (CA) (+28% YoY), urban solutions & satcomm (USS) (+74% YoY), and defence & public security (DPS) (+5% YoY). However, on a QoQ basis, growth in CA revenue (+6% QoQ) was offset by lower USS (-2% QoQ) and DPS (-3% QoQ) revenue. CA revenue growth was driven by higher demand for nacelle deliveries, MRO services, and passenger-to-freighter (PTF) conversions. STE's P2F conversion slots are booked until 2025-2026 but the rate of growth is expected to slow down in the near term.
- **Strong order wins.** STE reported SGD4.8bn (+163% YoY, +56% QoQ) of order wins in 3Q22. Excluding SGD1.9bn in orders related to STE's US marine business, which it intends to divest, the company's outstanding order book stood at an all-time high of SGD23.1bn, providing over two years of revenue visibility. USS reported SGD2.0bn (+424% YoY, +388% QoQ) of order wins, followed by SGD1.8bn (+336% YoY, +25% QoQ) by DPS and SGD1.0bn (-3% YoY, -18% QoQ) by CA.
- **Capital optimisation plans.** STE reported a gross debt of SGD6.8bn as at end-3Q22, of which 46% (SGD3.1bn) was based on floating rates. The QoQ increase in debt was attributed to an increase in the aviation asset business and the USD's appreciation vs SGD. STE intends to term out USD500m-700m of its floating rate debt via longer-term fixed coupon bonds or loans. STE shared that it would look at securitising several hundred million (c.SGD500m) worth of aviation assets in the next few months to pare down its debt. It will also continue to optimise its net working capital and divest non-core businesses.
- **Steady dividend outlook.** STE declared a quarterly dividend per share of 4 cents. A full year dividend per share of 16 cents implies a yield of c.4%. We continue to derive our TP using an average of P/E, P/BV, EV/EBITDA, and DCF. The TP of SGD4.15 includes an 8% ESG premium over the fair value of SGD3.85.

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)	20.85	19.05	19.95	17.57	14.99
P/B (x)	4.7	4.5	4.5	4.1	3.8
P/CF (x)	7.10	9.76	13.56	17.33	7.93
Dividend Yield (%)	4.3	4.3	5.1	3.6	4.5
EV/EBITDA (x)	13.15	11.90	14.09	12.92	11.35
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

Analyst

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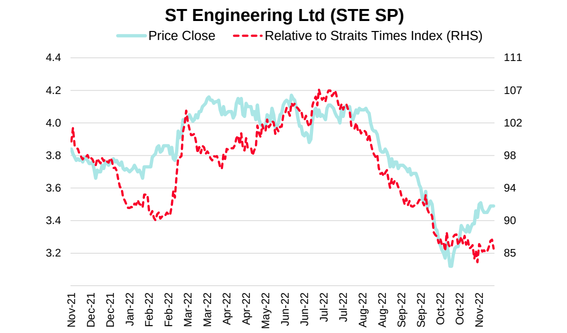
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(7.2)	7.7	(8.6)	(13.8)	(9.1)
Relative	(12.1)	0.6	(10.3)	(15.2)	(14.1)
52-wk Price low/high (SGD)					3.12 – 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 2021, it reported a 46% reduction in GHG emissions intensity over 2010 base year and is working towards its target to achieve a 50% absolute Scope 1 and 2 GHG emissions reduction by 2030 compared to a 2010 base year.

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 learning and development framework, accelerated workforce digitalisation and deepened our engineering, technology and innovation capabilities.

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 13 directors, of which 9 are independent (69%) and 2 are female (15%).

Financial Exhibits

Asia
Singapore
Industrials
ST Engineering
STE SP
Buy

Valuation basis

Our TP is derived by using an average of forward P/E, P/BV, EV/EBITDA and DCF of adjusted free cash flows.

Key drivers

a) Strong order wins
b) Contributions from acquisitions

Key risks

a) Slower revival in commercial aerospace sector
b) Lower than expected contribution from acquisitions
c) Delay in the implementation of Singapore's smart nation initiative

Company Profile

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.

Financial summary (SGD)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Recurring EPS	0.17	0.18	0.17	0.20	0.23
DPS	0.15	0.15	0.18	0.13	0.16
BVPS	0.74	0.77	0.78	0.85	0.92
Return on average equity (%)	23.1	24.3	24.7	24.2	26.1

Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Recurring P/E (x)	20.85	19.05	19.95	17.57	14.99
P/B (x)	4.7	4.5	4.5	4.1	3.8
FCF Yield (%)	12.3	7.5	0.2	1.4	9.6
Dividend Yield (%)	4.3	4.3	5.1	3.6	4.5
EV/EBITDA (x)	13.15	11.90	14.09	12.92	11.35
EV/EBIT (x)	21.89	19.24	22.59	20.65	17.64

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

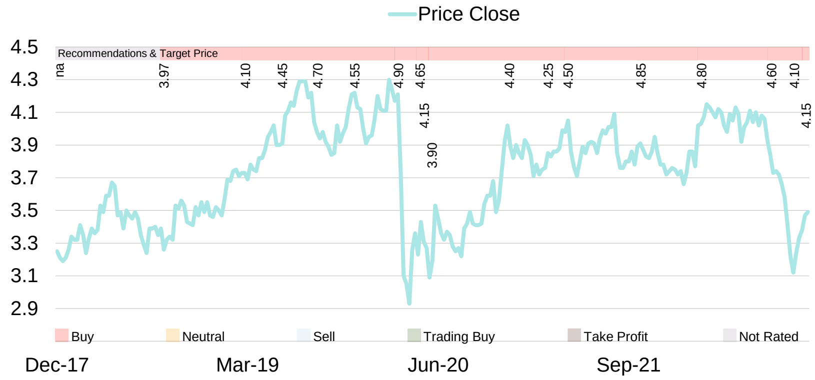
Cash flow (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Change in working capital	587	137	(357)	(687)	(70)
Cash flow from operations	1,533	1,114	801	627	1,370
Capex	(192)	(296)	(780)	(480)	(330)
Cash flow from investing activities	(295)	(414)	(4,492)	(443)	(284)
Dividends paid	(468)	(468)	(560)	(392)	(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

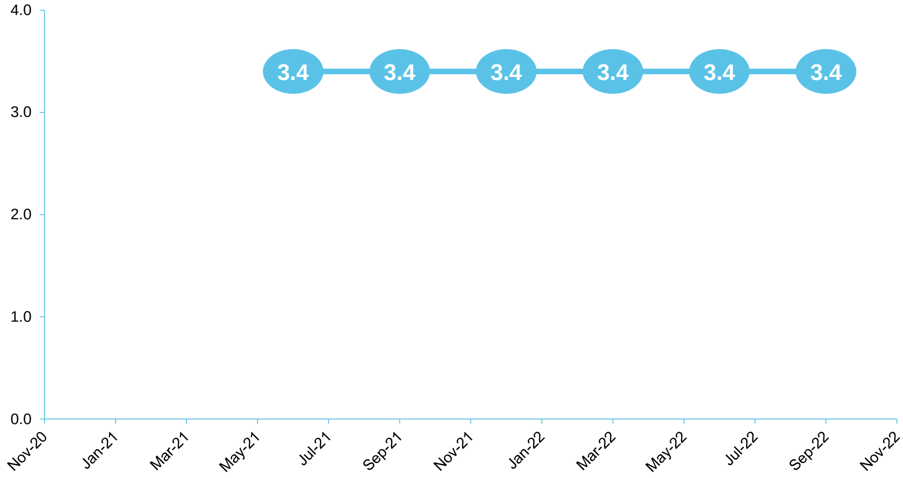


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-11-08	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
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

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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Sell:	Share price may fall by more than 10% over the next 12 months
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