

26 November 2020

Industrials | Aerospace & Defence

ST Engineering (STE SP)

Buy (Maintained)

New A330 P2F Order Wins; Keep BUY

Target Price (Return): SGD4.40 (8.9%)
 Price: SGD4.04
 Market Cap: USD9,368m
 Avg Daily Turnover (SGD/USD) 14.9m/10.9m

- **Maintaining BUY with SGD4.40 TP, 9% upside and c.4% yield.** ST Engineering continues to register strong order wins, with new orders for two A330 passenger-to-freighter (P2F) conversion from CDB Aviation, an aircraft leasing company that is venturing into freighter conversion for the first time. STE's commitment towards cost optimisation and gradual demand recovery should drive earnings recovery in 2021. Moreover, its plans to reorganise its business should enable greater focus on future growth areas and support earnings beyond 2021. We continue to like STE for its defensive earnings quality, ability to sustain dividends and deliver profit growth in 2021.

- **New A330 P2F order wins.** CDB Aviation, a wholly owned Irish subsidiary of China Development Bank Financial Leasing Co. Ltd, has entered into a partnership with Elbe Flugzeugwerke GmbH (EFW) for the P2F conversion of two Airbus A330-300 aircraft in 2021. These aircraft will be available for lease to CDB Aviation's airline customers from early 2022. Given the record-high freighter utilization, rapidly growing e-commerce demand, and higher cargo yields, CDB Aviation has been seeing an increasing interest from its customers for medium-sized freighters. EFW is a joint venture between ST Engineering and Airbus that offers freighter conversion services. In its 2018 investor day presentation, STE said it expects annual revenue of more than SGD400m from its P2F by 2022. While the upfront R&D cost for new freighter conversions is high, margins should improve with rising order wins and aircraft deliveries.

- **Growing the P2F business.** In an earlier [report](#), we highlighted STE's plans to increase its annual P2F conversion capability from nine to 25 by 2023. Previous news reports suggested that currently, all nine slots for P2F conversions in 2021 are full. In its 3Q20 business update, STE reiterated the plans to grow its P2F business and highlighted that it plans to induct 18 aircraft for P2F conversion next year. Earlier retirement for large fleets of passenger aircraft has pushed feedstock prices lower. P2F business not only generates revenue from direct conversion of the aircraft, but also creates opportunities for additional revenue from routine and non-routine maintenance needed on the modified aircraft. We remain positive on the recovery in STE's aerospace business in 2021 and beyond.

- **Defensive business, sustainable dividends.** Its SGD15.8bn orderbook offers two years of revenue visibility. STE will likely maintain 2019's 15 cent DPS for 2020F, in contrast to other large-cap Singapore companies and banks, which should see lower dividends in 2020.

- **Key risks:** Slower recovery in demand and hence in delivery of orders and delays in new business initiatives.

Analyst

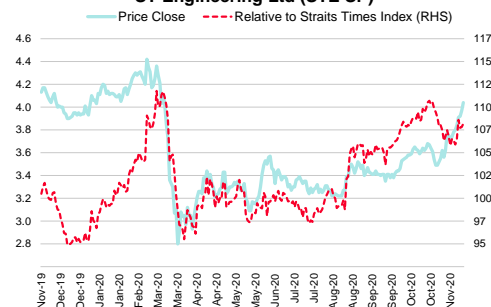
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	2.5	9.8	16.8	30.7	(4.3)
Relative	12.8	(4.2)	2.9	15.0	6.1
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)	23.89	21.37	24.95	22.22	19.39
P/B (x)	5.6	5.7	5.6	5.4	5.0
P/CF (x)	19.68	21.34	15.31	12.16	11.23
Dividend Yield (%)	3.7	3.7	3.7	3.8	3.8
EV/EBITDA (x)	15.91	14.42	14.64	13.35	11.89
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

Financial Exhibits

Asia	Financial summary (SGD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
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
ST Engineering	BVPS	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						
Valuation basis	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
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)	23.89	21.37	24.95	22.22	19.39
	P/B (x)	5.6	5.7	5.6	5.4	5.0
	FCF Yield (%)	2.4	3.3	4.4	6.1	6.8
	Dividend Yield (%)	3.7	3.7	3.7	3.8	3.8
	EV/EBITDA (x)	15.91	14.42	14.64	13.35	11.89
	EV/EBIT (x)	22.72	22.53	23.60	21.13	18.29
Key drivers	Income statement (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
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
Key risks	Cash flow (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
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
Company Profile	Balance sheet (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
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
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	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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Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2019-05-22	Buy	4.45	3.92
2019-02-26	Buy	4.10	3.75

Source: RHB, Bloomberg

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