# Singapore Company Update

23 September 2022

Industrials | Aerospace & Defence

# ST Engineering (STE SP)

**Buy** (Maintained)

## New Commercial Aerospace Contract; Keep BUY

| | |
|---|---|
| Target Price (Return): | SGD4.60 (24.7%) |
| Price (Market Cap): | SGD3.69 (USD8,128m) |
| ESG score: | 3.40 (out of 4) |
| Avg Daily Turnover (SGD/USD) | 19.0m/13.7m |

- **Keep BUY and SGD4.60 TP, 25% upside and 4.7% yield.** The share price has been underperforming on concerns over potential unexciting 2H22 earnings amidst a weakening macro environment and sharp rise in debt, especially in a rising interest rate environment. We stay confident of ST Engineering's defensive characteristics that remain supported by a record-high orderbook, growing defence revenue, and Urban Solutions & Satcom Security's potentially sharp recovery. We expect the DPS of 16 cents to stay steady and forecast an 8% core profit CAGR in 2021-2024.
- **Nok Air maintenance contract renewal.** The commercial aerospace business has secured a 5-year component maintenance-by-the-hour (MBH) contract to service Thai budget carrier Nok Air's Boeing 737-800 fleet. Under the multi-year component MBH contract, STE will provide a full suite of component support solutions covering component repair management, pool support, and dedicated consignment stock in Bangkok for the airline's entire 737-800 fleet. The contract is a renewal of the partnership in component MRO between Nok Air and STE. This will further strengthen its commercial aerospace orderbook, in our view, which has reported an average of SGD930m in order wins each quarter since 1Q21.
- **Key concerns.** Based on our recent discussions with some investors, it seems the disappointment around the recent bottomline miss during 1H22 and potential for another miss for 2H22 earnings amidst a weakening macroeconomic environment remains the one of the key concerns. In addition, the rise in STE's debt levels to fund the TransCore acquisition, especially in a rising interest rate environment, is also getting identified as a concern. On the back of higher earnings and improvement in cash flows, we expect STE's net debt to equity to gradually improve over the forecast period, but estimate it to remain above 1.5x in 2024.
- **Outlook beyond 2022 still solid.** We expect STE's strong orderbook to support earnings growth beyond 2022 and estimate its 2023-2024 profit growth at 13-17%. We expect strong recovery in its Urban Solutions & Satcom Security or USS unit along with a sustained improvement in the Defence & Public Security wing to drive 2023-2024 earnings growth. With SGD3.1bn worth of new contracts in 2Q22 (+69% YoY, +28% QoQ), STE reported its highest order backlog of SGD22.2bn, which implies a book-to-bill ratio of 2.7 years – SGD4.6bn of this orderbook is expected to be delivered in 2H22, representing 100% of our 2H22 revenue estimates.
- **We assess STE to deserve an ESG premium.** We continue to derive our TP by using an average of P/E, P/BV, EV/EBITDA, and DCF of FCF. Given our internally assessed ESG rating of 3.40 is higher than the country median of 3.00, we include an ESG premium of 8% over the fair value of SGD4.25 in our TP.

| Forecasts and Valuation | Dec-20 | Dec-21 | Dec-22F | Dec-23F | Dec-24F |
|---|---|---|---|---|---|
| Total turnover (SGDm) | 7,158 | 7,693 | 8,812 | 9,464 | 10,066 |
| Recurring net profit (SGDm) | 522 | 571 | 552 | 645 | 725 |
| Recurring net profit growth (%) | (11.4) | 9.3 | (3.3) | 16.9 | 12.5 |
| Recurring P/E (x) | 22.04 | 20.14 | 20.82 | 17.81 | 15.84 |
| P/B (x) | 5.0 | 4.8 | 4.7 | 4.3 | 4.0 |
| P/CF (x) | 7.50 | 10.31 | 14.26 | 18.58 | 8.41 |
| Dividend Yield (%) | 4.1 | 4.1 | 4.8 | 3.4 | 4.5 |
| EV/EBITDA (x) | 13.81 | 12.50 | 14.52 | 13.34 | 11.96 |
| Return on average equity (%) | 23.1 | 24.3 | 24.9 | 25.1 | 25.9 |
| Net debt to equity (%) | 51.1 | 48.7 | 210.5 | 206.5 | 180.6 |

*Source: Company data, RHB*


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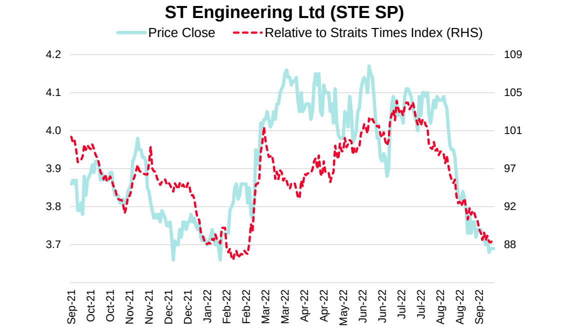
**Share Performance (%)**

| | YTD | 1m | 3m | 6m | 12m |
|---|---|---|---|---|---|
| Absolute | (1.9) | (4.9) | (4.9) | (10.0) | (4.4) |
| Relative | (6.4) | (4.9) | (10.4) | (7.4) | (11.5) |
| 52-wk Price low/high (SGD) | | | | | 3.66 – 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 greenhouse gas (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 nine are independent (69%) and two 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

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.

| Financial summary (SGD) | Dec-20 | Dec-21 | Dec-22F | Dec-23F | Dec-24F |
|---|---|---|---|---|---|
| Recurring EPS | 0.17 | 0.18 | 0.18 | 0.21 | 0.23 |
| DPS | 0.15 | 0.15 | 0.18 | 0.13 | 0.16 |
| BVPS | 0.74 | 0.77 | 0.78 | 0.86 | 0.93 |
| Return on average equity (%) | 23.1 | 24.3 | 24.9 | 25.1 | 25.9 |

| Valuation metrics | Dec-20 | Dec-21 | Dec-22F | Dec-23F | Dec-24F |
|---|---|---|---|---|---|
| Recurring P/E (x) | 22.04 | 20.14 | 20.82 | 17.81 | 15.84 |
| P/B (x) | 5.0 | 4.8 | 4.7 | 4.3 | 4.0 |
| FCF Yield (%) | 11.7 | 7.1 | 0.2 | 1.2 | 9.0 |
| Dividend Yield (%) | 4.1 | 4.1 | 4.8 | 3.4 | 4.5 |
| EV/EBITDA (x) | 13.81 | 12.50 | 14.52 | 13.34 | 11.96 |
| EV/EBIT (x) | 22.99 | 20.20 | 23.19 | 21.27 | 18.76 |

| Income statement (SGDm) | Dec-20 | Dec-21 | Dec-22F | Dec-23F | Dec-24F |
|---|---|---|---|---|---|
| Total turnover | 7,158 | 7,693 | 8,812 | 9,464 | 10,066 |
| Gross profit | 1,527 | 1,535 | 1,768 | 1,930 | 2,090 |
| EBITDA | 949 | 1,044 | 1,197 | 1,333 | 1,453 |
| Depreciation and amortisation | (379) | (398) | (448) | (497) | (527) |
| Operating profit | 570 | 646 | 749 | 836 | 926 |
| Net interest | (62) | (36) | (103) | (155) | (162) |
| Pre-tax profit | 534 | 638 | 708 | 754 | 848 |
| Taxation | (9) | (71) | (106) | (113) | (127) |
| Reported net profit | 522 | 571 | 606 | 645 | 725 |
| Recurring net profit | 522 | 571 | 552 | 645 | 725 |

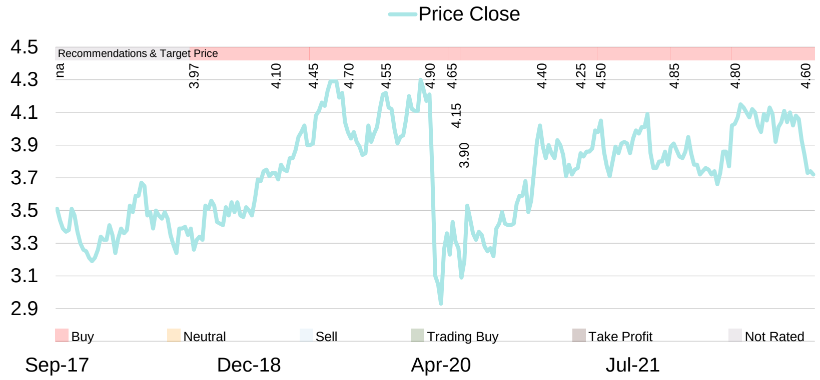
| Cash flow (SGDm) | Dec-20 | Dec-21 | Dec-22F | Dec-23F | Dec-24F |
|---|---|---|---|---|---|
| Change in working capital | 587 | 137 | (360) | (699) | (62) |
| Cash flow from operations | 1,533 | 1,114 | 806 | 618 | 1,365 |
| Capex | (192) | (296) | (780) | (480) | (330) |
| Cash flow from investing activities | (295) | (414) | (4,491) | (440) | (278) |
| Dividends paid | (468) | (468) | (560) | (397) | (516) |
| Cash flow from financing activities | (959) | (615) | 4,368 | (577) | (695) |
| Cash at beginning of period | 453 | 731 | 816 | 1,499 | 1,101 |
| Net change in cash | 279 | 86 | 683 | (398) | 392 |
| Ending balance cash | 731 | 817 | 1,499 | 1,101 | 1,492 |

| Balance sheet (SGDm) | Dec-20 | Dec-21 | Dec-22F | Dec-23F | Dec-24F |
|---|---|---|---|---|---|
| Total cash and equivalents | 731 | 816 | 1,499 | 1,101 | 1,492 |
| Tangible fixed assets | 1,757 | 1,794 | 2,216 | 2,292 | 2,188 |
| Total investments | 469 | 483 | 454 | 414 | 362 |
| Total assets | 9,561 | 10,516 | 15,728 | 15,744 | 16,096 |
| Short-term debt | 496 | 560 | 0 | 0 | 0 |
| Total long-term debt | 1,551 | 1,555 | 7,173 | 7,173 | 7,173 |
| Total liabilities | 6,987 | 7,847 | 13,032 | 12,804 | 12,952 |
| Total equity | 2,575 | 2,668 | 2,696 | 2,940 | 3,145 |
| Total liabilities & equity | 9,561 | 10,516 | 15,728 | 15,744 | 16,096 |

| Key metrics | Dec-20 | Dec-21 | Dec-22F | Dec-23F | Dec-24F |
|---|---|---|---|---|---|
| Revenue growth (%) | (9.0) | 7.5 | 14.5 | 7.4 | 6.4 |
| Recurrent EPS growth (%) | (11.5) | 9.4 | (3.3) | 16.9 | 12.5 |
| Gross margin (%) | 21.3 | 20.0 | 20.1 | 20.4 | 20.8 |
| Operating EBITDA margin (%) | 13.3 | 13.6 | 13.6 | 14.1 | 14.4 |
| Net profit margin (%) | 7.3 | 7.4 | 6.9 | 6.8 | 7.2 |
| Dividend payout ratio (%) | 89.7 | 82.0 | 92.5 | 61.6 | 71.1 |
| Capex/sales (%) | 2.7 | 3.8 | 8.9 | 5.1 | 3.3 |
| Interest cover (x) | 8.00 | 13.53 | 6.09 | 4.47 | 4.95 |

*Source: Company data, RHB*

## Recommendation Chart

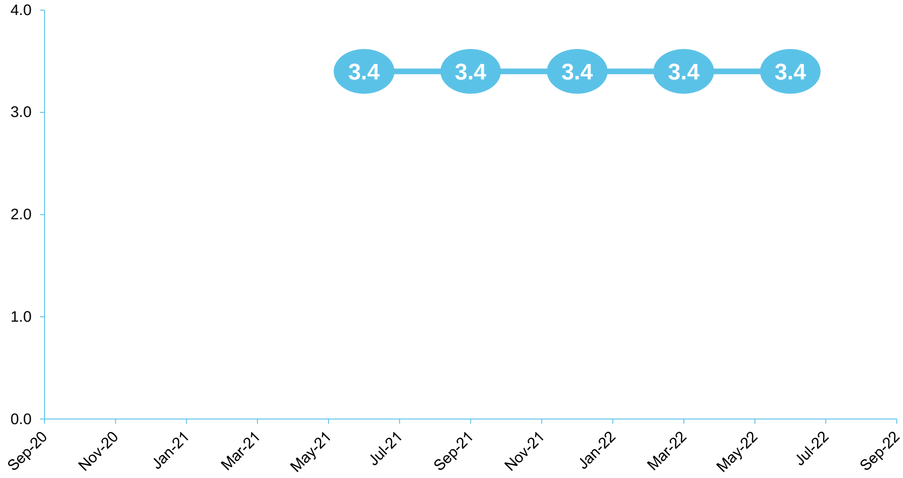



*Source: RHB, Bloomberg*

| Date | Recommendation | Target Price | Price |
|---|---|---|---|
| 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 |
| 2019-11-11 | Buy | 4.70 | 4.00 |
| 2019-10-14 | Buy | 4.70 | 4.04 |

*Source: RHB, Bloomberg*

## ESG Rating History




*Source: RHB*

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| | |
|---|---|
| **Buy:** | Share price may exceed 10% over the next 12 months |
| **Trading Buy:** | Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain |
| **Neutral:** | Share price may fall within the range of +/- 10% over the next 12 months |
| **Take Profit:** | Target price has been attained. Look to accumulate at lower levels |
| **Sell:** | Share price may fall by more than 10% over the next 12 months |
| **Not Rated:** | Stock is not within regular research coverage |

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