

11 October 2022

Industrials | Aerospace & Defence

ST Engineering (STE SP)

Buy (Maintained)

Long-Term Defensive Pick; Keep BUY

Target Price (Return): SGD4.10 (20.2%)
 Price (Market Cap): SGD3.41 (USD7,428m)
 ESG score: 3.40 (out of 4)
 Avg Daily Turnover (SGD/USD) 19.8m/14.1m

• **Keep BUY with lower SGD4.10 TP from SGD4.60, 20% upside and c.5% yield.** As part of analyst briefings to view the commercial aerospace operations, we visited ST Engineering's Paya Lebar and Seletar facilities. We are positive about the business outlook for MRO and passenger-to-freighter (P2F). We did note concerns on skilled labour availability, as well as labour and materials inflation. We also expect STE to see higher interest expenses from 2023 amidst rising rates. We lower 2022-2024 earnings by 3-4%, yet remain confident of its defensive business.

• **Key takeaways from our recent aerospace hangar visit.** Globally there are 120-140 passenger to freighter (P2F) conversions being undertaken and STE is ramping up its capacity to account for about a third of these annual global conversions. The wide body hangars at Paya Lebar were busy with B767 P2F conversions and STE can complete six wide body P2F conversions annually at its Paya Lebar facility. The narrow body hangars at Seletar were busy with A320 P2F conversions and STE can complete 12 narrow body P2F conversions annually at its Seletar facility.

• **There are concerns around labour availability and inflation.** Given the macroeconomic concerns, there is a likelihood of some moderation in P2F business in the near term. While the situation seems to be improving, there are still challenges on the labour, raw materials, and supply chain front. STE is experiencing labour shortage of c.10% vs what's needed and a labour cost inflation of high-single to double digits. With respect to contract price readjustment in response to rising costs, STE noted that it has an option for price escalations in older contracts. However, historically airlines have preferred a fixed price escalation and for contracts that have variable price escalation, the escalations tend to be capped.

• **Adjusting our interest rate expectations higher.** We assess that as at end-1H22 about half of STE's debt will be exposed to rising interest rates. With an additional USD700m of debt to be brought onboard to fund the Transcore acquisition, we see a likelihood of higher interest expenses for STE from 2023. We have increased the adjusted annual interest rate for STE's debt to 2.75% from 2023, from our current estimate of 2.4%

• **Outlook still solid and defensive.** We expect STE's strong orderbook to support earnings growth beyond 2022 and estimate its 2023-2024 profit growth at 13-14% given a record-high orderbook, growing defence revenue, and Urban Solutions & Satcom Security's potentially sharp recovery. STE reported its highest order backlog of SGD22.2bn, which implies a book-to-bill ratio of 2.7 years and SGD4.6bn of this orderbook is expected to be delivered in 2H22, representing 100% of our 2H22 revenue estimates.

Analyst

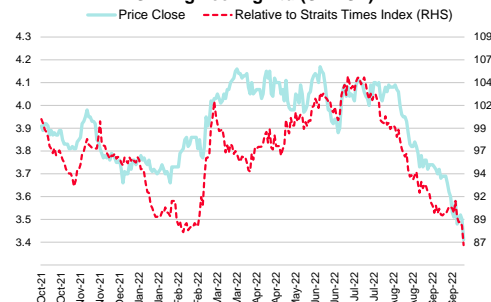
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(9.3)	(8.3)	(16.6)	(15.8)	(12.1)
Relative	(10.0)	(6.3)	(17.1)	(8.2)	(13.5)
52-wk Price low/high (SGD)	3.41 – 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 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%).

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	545	616	705
Recurring net profit growth (%)	(11.4)	9.3	(4.5)	13.1	14.4
Recurring P/E (x)	20.37	18.62	19.49	17.23	15.06
P/B (x)	4.6	4.4	4.4	4.0	3.7
P/CF (x)	6.93	9.53	13.25	17.32	7.83
Dividend Yield (%)	4.4	4.4	5.2	3.7	4.6
EV/EBITDA (x)	12.89	11.66	13.88	12.78	11.39
Return on average equity (%)	23.1	24.3	24.7	24.2	25.5
Net debt to equity (%)	51.1	48.7	211.2	209.8	183.4

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	25.5
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 free cash flows.	Recurring P/E (x)	20.37	18.62	19.49	17.23	15.06
	P/B (x)	4.6	4.4	4.4	4.0	3.7
	FCF Yield (%)	12.6	7.7	0.2	1.3	9.7
	Dividend Yield (%)	4.4	4.4	5.2	3.7	4.6
	EV/EBITDA (x)	12.89	11.66	13.88	12.78	11.39
	EV/EBIT (x)	21.45	18.85	22.25	20.46	17.86
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	8,812	9,464	10,066
ii. Contributions from acquisitions	Gross profit	1,527	1,535	1,761	1,922	2,090
	EBITDA	949	1,044	1,190	1,325	1,453
	Depreciation and amortisation	(379)	(398)	(448)	(497)	(527)
	Operating profit	570	646	742	828	926
	Net interest	(62)	(36)	(103)	(178)	(182)
	Pre-tax profit	534	638	700	720	824
	Taxation	(9)	(71)	(105)	(108)	(124)
	Reported net profit	522	571	599	616	705
	Recurring net profit	522	571	545	616	705
Key risks	Cash flow (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. Slower revival in commercial aerospace sector	Change in working capital	587	137	(357)	(699)	(64)
ii. Lower than expected contribution from acquisitions	Cash flow from operations	1,533	1,114	801	613	1,356
iii. Delay in the implementation of Singapore's smart nation initiative	Capex	(192)	(296)	(780)	(480)	(330)
	Cash flow from investing activities	(295)	(414)	(4,492)	(443)	(284)
	Dividends paid	(468)	(468)	(560)	(392)	(493)
	Cash flow from financing activities	(959)	(615)	4,368	(945)	(1,036)
	Cash at beginning of period	453	731	816	1,493	718
	Net change in cash	279	86	677	(775)	36
	Ending balance cash	731	817	1,493	718	754
Company Profile	Balance sheet (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
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.	Total cash and equivalents	731	816	1,493	718	754
	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	15,367	15,369
	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	12,457	12,252
	Total equity	2,575	2,668	2,689	2,910	3,118
	Total liabilities & equity	9,561	10,516	15,724	15,367	15,369
	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	(4.5)	13.1	14.4
	Gross margin (%)	21.3	20.0	20.0	20.3	20.8
	Operating EBITDA margin (%)	13.3	13.6	13.5	14.0	14.4
	Net profit margin (%)	7.3	7.4	6.8	6.5	7.0
	Dividend payout ratio (%)	89.7	82.0	93.6	63.6	69.9
	Capex/sales (%)	2.7	3.8	8.9	5.1	3.3
	Interest cover (x)	8.00	13.53	6.03	3.93	4.62

Source: Company data, RHB

Recommendation Chart

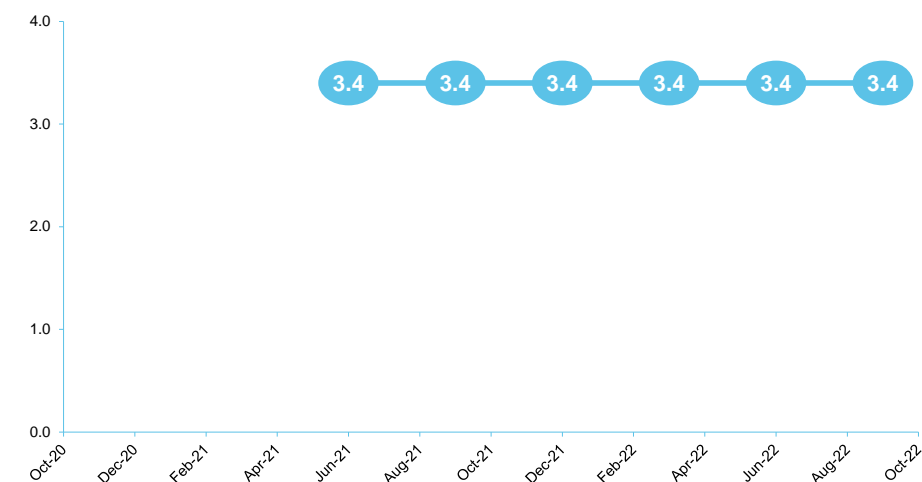


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2019-11-11	Buy	4.70	4.00

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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