

Singapore Company Update

ST Engineering

Bloomberg: STE SP | Reuters: STEG.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

19 Nov 2020

BUY

Last Traded Price (18 Nov 2020): S\$3.84 (STI : 2,788.59)
Price Target 12-mth: S\$4.20 (9% upside) (Prev S\$3.80)

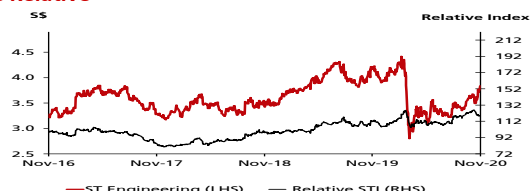
Analyst

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What's New

- Better than expected level of order wins in 3Q20, orderbook healthy at S\$15.8bn at end-3Q20
- Promising developments on the vaccine front should accelerate core earnings recovery in FY21F
- New organisational structure should sharpen business focus, improve visibility and resonate better with investors
- Maintain BUY with higher TP of S\$4.20

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2019A	2020F	2021F	2022F
Revenue	7,868	7,032	8,143	8,955
EBITDA	1,113	1,044	1,178	1,226
Pre-tax Profit	695	588	721	768
Net Profit	578	529	603	618
Net Pft (Pre Ex.)	592	529	603	618
Net Pft Gth (Pre-ex) (%)	12.4	(10.7)	14.0	2.6
EPS (S cts)	18.5	16.9	19.3	19.8
EPS Pre Ex. (S cts)	19.0	16.9	19.3	19.8
EPS Gth Pre Ex (%)	12	(11)	14	3
Diluted EPS (S cts)	18.5	16.9	19.3	19.8
Net DPS (S cts)	15.0	15.0	15.0	15.0
BV Per Share (S cts)	71.2	73.1	77.4	82.2
PE (X)	20.7	22.7	19.9	19.4
PE Pre Ex. (X)	20.2	22.7	19.9	19.4
P/Cash Flow (X)	20.3	12.9	13.7	12.8
EV/EBITDA (X)	12.7	13.4	11.7	11.1
Net Div Yield (%)	3.9	3.9	3.9	3.9
P/Book Value (X)	5.4	5.3	5.0	4.7
Net Debt/Equity (X)	0.8	0.7	0.6	0.5
ROAE (%)	25.9	23.5	25.6	24.8
Earnings Rev (%)		(11)	8	New
Consensus EPS (S cts)		16.7	17.2	19.7
Other Broker Recs:		B: 9	S: 1	H: 2

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Remains a safe haven pick

Investment Thesis:

Order wins better than expected. Order backlog for STE remained healthy at S\$15.8bn as at 3Q20, down marginally from S\$15.9bn in 2Q20. STE announced impressive contract wins of S\$1.7bn in 3Q20, with a particularly strong showing for the electronics division, which clinched S\$1.1bn worth of new orders, its best quarterly performance on record. Tendering activity for smart city projects is strong, as governments prioritise infrastructure spending to revive economic growth.

Government grants will aid earnings resilience. With additional Jobs Support Scheme grants accruing in FY20/21F, STE's earnings trajectory will likely not stray too far off FY19 levels despite the pandemic.

High certainty of c.4% dividend yield provides support. Balance sheet remains healthy and operating cash flows were strongly positive in 1H20, boosting confidence in steady annual dividend pay-out of 15Scts per share.

Valuation:

Our TP is revised up to S\$4.20 to factor in earnings upgrade for FY21, as well as higher valuation pegs in line with improved market sentiment related to promising developments on COVID-19 vaccine front. The TP is based on a blended valuation framework which factors in both earnings growth and the long-term cash-generative nature of STE's businesses.

Where we differ:

We are more bullish on earnings in FY21F compared to consensus as we are factoring in demand revival and additional grants likely to be received in FY21F.

Key Risks to Our View:

Slower than-expected demand recovery in Aerospace and Electronics segments could pose downside risk to earnings and valuations.

At A Glance

Issued Capital (m shrs)	3,115
Mkt. Cap (S\$m/US\$m)	11,963 / 8,913
Major Shareholders (%)	
Temasek Holdings Pte Ltd (%)	49.9
Free Float (%)	50.1
3m Avg. Daily Val (US\$m)	10.9
GIC Industry : Industrials / Capital Goods	



Live more, Bank less

WHAT'S NEW**Order backlog remains strong, focus on vaccine hopes and organisational rejig in 2021**

Order backlog healthy at S\$15.8bn as at 3Q20, down marginally from S\$15.9bn in 2Q20. STE announced impressive contract wins of S\$1.7bn for the quarter, with a particularly strong showing for the electronics division, which clinched S\$1.1bn worth of new orders, its best quarterly new order win performance on record. Management shared that while contracting momentum in the aerospace division remains sluggish, tendering activity for smart city projects continues to be strong, as governments are prioritising infrastructure spending to revive economic growth.

Narrowed revenue guidance range in line with our expectations. The management also shared that they now expect the y-o-y decline in FY20F revenue to be closer to the midpoint of their earlier guidance of 5-15%, which is consistent with our existing estimate of a 10.6% revenue decline in FY20F. We expect revenue to bounce back 16% in FY21F.

Cost-cutting measures, recovery in demand, and new business opportunities to offset impact of lower government grants in 2021. STE indicated that around 50% of the impact of the lower quantum of government grants in FY21F will be moderated by its efficiency and productivity initiatives, with the remainder split evenly between a turnaround in demand, and new demand arising from COVID-19 fallout like Passenger-to-Freight (P2F) conversions and cybersecurity and sensors.

MRO demand should have bottomed; vaccine breakthrough bolsters visibility on earnings recovery. STE shared that overall utilisation in its hangars in 3Q20 was stable at c.66.0%, essentially flat q-o-q. Consistent with the global aircraft fleet mix (75% narrow-body and 25% wide-body), STE has high exposure to the narrow-body aftermarket, which is seeing decent traction due to a swift turnaround in domestic air traffic and robust freighter demand. Looking ahead, we believe that recent developments on the vaccine front could translate into a rebound in international travel activity by 2H2021F, which bodes well for MRO work volumes in 2021 – note that airlines have to perform bridging checks to ensure the airworthiness of parked planes before bringing them back into service. The workload is proportionate to the amount of time the aircraft is parked. In the meantime, P2F conversions should boost hangar utilisation.

Electronics division's prospects appear brighter, with most defence and government projects back on track after facing COVID-19 induced delays in the previous two quarters. Demand for satcom solutions will also benefit from the vaccine tailwind due to STE's strong satcom presence in commercial aviation/cruise lines and sports events.

Organisational structure changes should be well received by shareholders. STE plans on making organisational changes to position the Group towards its aspiration to become a global technology, defence and engineering powerhouse. Effective 1 January 2021, ST Engineering will be reorganised as Commercial (2/3 of revenue) and Defence & Public Security clusters (1/3 of revenue), replacing the sector-structure of Aerospace, Electronics, Land Systems and Marine. The Commercial cluster will comprise Commercial Aerospace, Urban Solutions and Satellite Communications domains. So essentially, apart from the commercial MRO, the commercial Smart City solutions, which was spread across all sectors previously, will now come into one unit. The Defence & Public Security cluster will comprise Digital Systems and Cyber, Land Systems, Marine and Defence Aerospace. While the group's core strategy remains unchanged, we believe that this organisational rejig will resonate well with investors, as it i) will better enable the group to execute their global growth strategy, and pursue smart city and international business opportunities, and ii) simplify the group's reporting structure and help investors better understand the group.

Maintain BUY with higher TP of S\$4.20 on higher earnings. We are raising our FY21F earnings projections by 8% as we are pushing back some of the JSS grants recognition from FY20F to FY21F and taking into account potential vaccine tailwinds in 2H21F. Accordingly, we revise up our TP to S\$4.20 to factor in the earnings upgrade for FY21F, as well as higher valuation pegs in line with improved market sentiments related to promising developments on COVID-19 vaccine front.

Company Background

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 geographies.

ST Engineering

Valuation table

Method	Basis (FY21)	Parameter	Value (\$m)
P/E	602.6	24.0	14462
Div Yield	15.0	4.2	11152
DCF		WACC 6.6%	13640
Average			13085
No of shares			3122
Value per share			4.20

Source of all data: Company, DBS Bank

Historical PE and PB band



Source: Bloomberg Finance L.P., DBS Bank estimates



Source: Bloomberg Finance L.P., DBS Bank estimates

ST Engineering

Key Assumptions

FY Dec	2018A	2019A	2020F	2021F	2022F
Aerospace sales growth	4.41	30.3	(17.1)	10.8	12.1
Electronics sales growth	6.56	6.49	(11.2)	22.3	7.95
Land Systems sales	3.10	11.4	(2.3)	10.6	4.58
Marine sales growth (%)	(10.0)	12.7	5.62	29.0	17.9

Segmental Breakdown

FY Dec	2018A	2019A	2020F	2021F	2022F
Revenues (\$\$m)					
Aerospace	2,647	3,450	2,861	3,170	3,553
Electronics	2,143	2,282	2,026	2,478	2,675
Land Systems	1,282	1,428	1,395	1,543	1,613
Marine	574	647	683	882	1,040
Others	52.0	61.0	67.1	70.5	74.0
Total	6,698	7,868	7,032	8,143	8,955
PBT (\$\$m)					
Aerospace	320	333	67.0	240	313
Electronics	225	227	136	234	283
Land Systems	62.3	88.6	62.7	115	123
Marine	50.3	60.8	35.8	46.4	63.3
Others	(36.6)	(13.5)	(13.4)	(14.1)	(14.8)
Total	621	695	288	621	767
PBT Margins (%)					
Aerospace	12.1	9.6	2.3	7.6	8.8
Electronics	10.5	9.9	6.7	9.4	10.6
Land Systems	4.9	6.2	4.5	7.4	7.6
Marine	8.8	9.4	5.2	5.3	6.1
Others	(70.4)	(22.0)	(20.0)	(20.0)	(20.0)
Total	9.3	8.8	4.1	7.6	8.6

Income Statement (\$\$m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Revenue	6,698	7,868	7,032	8,143	8,955
Cost of Goods Sold	(5,292)	(6,233)	(5,584)	(6,449)	(7,110)
Gross Profit	1,406	1,635	1,449	1,694	1,845
Other Opng (Exp)/Inc	(774)	(930)	(840)	(965)	(1,077)
Operating Profit	631	706	609	729	767
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	49.1	39.0	27.3	35.5	37.2
Net Interest (Exp)/Inc	(27.0)	(35.3)	(48.5)	(43.1)	(37.9)
Exceptional Gain/(Loss)	(32.6)	(14.2)	0.0	0.0	0.0
Pre-tax Profit	621	695	588	721	768
Tax	(104)	(103)	(57.1)	(109)	(133)
Minority Interest	(22.2)	(14.7)	(2.0)	(10.0)	(15.9)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	494	578	529	603	618
Net Profit before Except.	527	592	529	603	618
EBITDA	924	1,113	1,044	1,178	1,226
Growth					
Revenue Gth (%)	2.7	17.5	(10.6)	15.8	10.0
EBITDA Gth (%)	9.2	20.4	(6.2)	12.9	4.1
Opg Profit Gth (%)	8.8	11.8	(13.7)	19.6	5.3
Net Profit Gth (Pre-ex) (%)	4.8	12.4	(10.7)	14.0	2.6
Margins & Ratio					
Gross Margins (%)	21.0	20.8	20.6	20.8	20.6
Opg Profit Margin (%)	9.4	9.0	8.7	8.9	8.6
Net Profit Margin (%)	7.4	7.3	7.5	7.4	6.9
ROAE (%)	22.2	25.9	23.5	25.6	24.8
ROA (%)	6.3	6.8	5.6	6.3	6.3
ROCE (%)	12.2	12.2	9.2	10.3	10.6
Div Payout Ratio (%)	94.8	81.0	88.6	77.7	75.8
Net Interest Cover (x)	23.4	20.0	12.5	16.9	20.3

Source: Company, DBS Bank

ST Engineering

Interim Income Statement (\$\$m)

FY Dec	1H2018	2H2018	1H2019	2H2019	1H2020
Revenue	3,298	3,400	3,511	4,357	3,572
Cost of Goods Sold	(2,622)	(2,671)	(2,781)	(3,452)	(2,835)
Gross Profit	676	730	730	905	737
Other Oper. (Exp)/Inc	(391)	(424)	(413)	(515)	(431)
Operating Profit	284	306	317	390	306
Other Non Op (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	27.9	21.2	21.6	17.3	13.8
Net Interest (Exp)/Inc	(22.2)	(4.7)	(9.3)	(27.4)	(33.1)
Exceptional Gain/(Loss)	0.0	3.77	0.0	(14.2)	0.0
Pre-tax Profit	290	326	330	366	286
Tax	(53.2)	(51.1)	(54.3)	(48.3)	(31.1)
Minority Interest	(6.0)	(16.2)	(6.1)	(8.6)	2.09
Net Profit	231	259	269	309	257
Net profit bef Except.	231	255	269	323	257
EBITDA	428	456	511	604	515

Growth

Revenue Gth (%)	0.7	3.1	3.3	24.1	(18.0)
EBITDA Gth (%)	(5.9)	6.6	12.0	18.3	(14.6)
Opp Profit Gth (%)	(10.3)	7.7	3.6	22.9	(21.6)
Net Profit Gth (%)	(21.1)	12.2	4.0	14.6	(16.6)

Margins

Gross Margins (%)	20.5	21.5	20.8	20.8	20.6
Opp Profit Margins (%)	8.6	9.0	9.0	8.9	8.6
Net Profit Margins (%)	7.0	7.6	7.7	7.1	7.2

Balance Sheet (\$\$m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Net Fixed Assets	1,743	1,805	1,697	1,583	1,463
Invts in Associates & JVs	456	453	451	456	463
Other LT Assets	1,277	2,624	2,624	2,624	2,624
Cash & ST Invts	416	454	647	685	630
Inventory	2,254	2,558	2,286	2,647	2,911
Debtors	1,138	1,246	1,172	1,357	1,492
Other Current Assets	289	381	381	381	381
Total Assets	7,573	9,521	9,259	9,734	9,966
ST Debt	225	1,869	369	269	18.8
Creditor	1,830	2,013	1,799	2,083	2,291
Other Current Liab	1,796	1,565	1,454	1,601	1,709
LT Debt	270	469	1,969	1,969	1,969
Other LT Liabilities	917	1,115	1,115	1,115	1,115
Shareholder's Equity	2,246	2,222	2,283	2,417	2,567
Minority Interests	288	269	271	281	297
Total Cap. & Liab.	7,573	9,521	9,259	9,734	9,966
Non-Cash Wkg. Capital	55.2	608	587	702	786
Net Cash/(Debt)	(79.6)	(1,884)	(1,690)	(1,552)	(1,358)
Debtors Turn (avg days)	56.6	55.3	62.7	56.7	58.1
Creditors Turn (avg days)	124.0	119.6	134.4	117.4	119.3
Inventory Turn (avg days)	154.6	149.7	170.8	149.2	151.6
Asset Turnover (x)	0.9	0.9	0.7	0.9	0.9
Current Ratio (x)	1.1	0.9	1.2	1.3	1.3
Quick Ratio (x)	0.4	0.3	0.5	0.5	0.5
Net Debt/Equity (X)	0.0	0.8	0.7	0.6	0.5
Net Debt/Equity ex MI (X)	0.0	0.8	0.7	0.6	0.5
Capex to Debt (%)	67.8	57.3	12.8	13.4	15.1
Z-Score (X)	2.7	2.1	2.3	2.4	2.4

Source: Company, DBS Bank

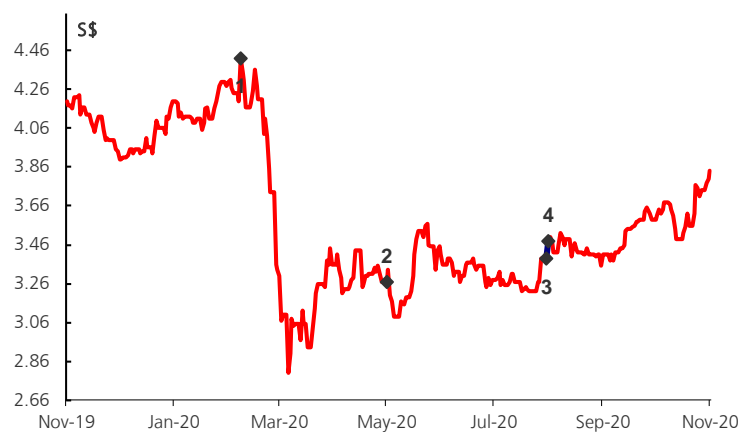
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Cash Flow Statement (\$m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Pre-Tax Profit	621	695	588	721	767
Dep. & Amort.	244	368	408	414	420
Tax Paid	(99.2)	(103)	(57.1)	(109)	(133)
Assoc. & JV Inc/(loss)	(49.1)	(39.0)	(27.3)	(35.5)	(37.2)
Chg in Wkg.Cap.	(166)	(439)	20.9	(115)	(83.9)
Other Operating CF	88.8	107	0.0	0.0	0.0
Net Operating CF	639	590	932	876	933
Capital Exp.(net)	(336)	(1,340)	(300)	(300)	(300)
Other Invt.(net)	334	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	(34.3)	(28.8)	(5.0)	(5.0)	(5.0)
Div from Assoc & JV	61.1	47.8	35.0	35.0	35.0
Other Investing CF	(90.0)	48.3	0.0	0.0	0.0
Net Investing CF	(65.2)	(1,273)	(270)	(270)	(270)
Div Paid	(468)	(468)	(468)	(468)	(468)
Chg in Gross Debt	(636)	1,401	0.0	(100.0)	(250)
Capital Issues	(4.4)	0.0	0.0	0.0	0.0
Other Financing CF	(53.2)	(213)	0.0	0.0	0.0
Net Financing CF	(1,161)	720	(468)	(568)	(718)
Currency Adjustments	3.87	0.32	0.0	0.0	0.0
Chg in Cash	(583)	37.5	194	37.9	(55.1)
Opg CFPS (S cts)	25.8	33.0	29.2	31.7	32.6
Free CFPS (S cts)	9.72	(24.0)	20.2	18.5	20.3

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	25 Feb 20	4.42	4.60	BUY
2:	18 May 20	3.27	3.40	HOLD
3:	17 Aug 20	3.39	3.40	HOLD
4:	18 Aug 20	3.48	3.80	BUY

Note: Share price and Target price are adjusted for corporate actions.

Source: DBS Bank

Analyst: Suvro SARKAR

Jason SUM

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Compensation for investment banking services:

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168. Directorship/trustee interests:


Sim S. LIM, a member of DBS Group Management Committee, is a Independent non-executive director of ST Engineering as of 02 Nov 2020.



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