

28 April 2020

Industrials | Aerospace & Defence

ST Engineering (STE SP)

Buy (Maintained)

Expect To Continue Outperforming STI; Keep BUY

Target Price (Return): SGD4.15 (+28%)
 Price: SGD3.24
 Market Cap: USD7,131m
 Avg Daily Turnover (SGD/USD) 25.4m/18.0m

- **Reiterate BUY, new SGD4.15 TP from SGD4.65, 28% upside and c.5% 2020F yield.** While 2020F profit is expected to decline amidst weak profits for Aerospace and potential delays in order delivery for other business segments, earnings should improve in 2021 as the global aviation industry starts to gradually recover. We maintain that ST Engineering will continue to outperform the STI, as its well-diversified business portfolio and a record-high orderbook will enable it to better withstand current economic weakness vs other large-cap stocks in Singapore.

- **Aerospace order wins to moderate.** STE announced SGD838m (-36% YoY, -24% QoQ) worth of order wins for Aerospace in 1Q20. The maintenance, repair and overhaul (MRO) contracts announced in the order win includes A320 heavy maintenance and CFM56-7B engine maintenance contracts from Chinese airlines, and a component maintenance-by-the-hour contract from an ASEAN airline to provide component maintenance services for its entire fleet of B737 and Bombardier Q400 fleet. The order win also included contracts that were announced during Singapore Airshow 2020. We expect order wins for Aerospace to moderate, as global airlines have cut their fleet in response to weak aviation traffic caused by the COVID-19 pandemic.

- **Electronics and land system to support near-term earnings.** For Electronics, STE announced SGD730m worth of contracts for products and solutions in smart mobility, cybersecurity, data analytics, as well as training and simulation. STE has expanded its footprint in India by clinching contracts to provide its mobility products and solutions for upcoming metro operations in Chennai and Mumbai. STE's Land Systems also secured a Phase 2 contract for the production and supply of the Hunter Armoured Fighting Vehicle from the Singapore Ministry of Defence. We expect growth in Electronics and Defence (Land Systems) to partially offset the weakness in aerospace business in 2020F.

- **Lowering earnings.** We cut FY20-22F earnings by 3-9%, largely to account for lower earnings from Aerospace. Aerospace earnings will decline in 2020F as global airlines that are in cash conservation mode, will defer MRO spending. Middle River Aerostructure Systems (MRAS) should also see a decline in production of nacelle components as Airbus, one of its key customers, has cut aircraft production by one-third, and is looking at deep job cuts in order to survive the current cash bleed.

- **Valuation basis.** Our SGD4.15 TP is based on blended valuations, ie 2020F 22.5x P/E, 5.5x P/BV, and 10.5x EV/EBITDA, as well as DCF (WACC: 7.0%, LTG: 1.5%). STE is trading at a 1-year forward P/E of 17.4x, below its 10-year average of 18.7x. Given expectations of earnings recovery in 2021, STE should trade above its historical average.

Analyst

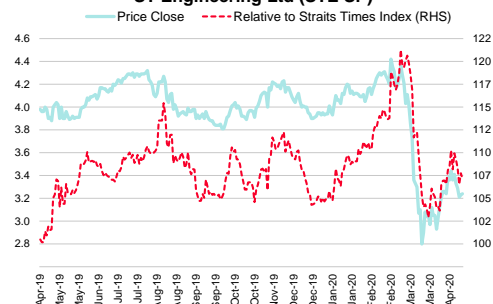
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(17.8)	6.2	(21.4)	(18.4)	(18.0)
Relative	3.1	5.4	(0.2)	1.6	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	7,957	8,506	9,229
Recurring net profit (SGDm)	527	589	560	646	746
Recurring net profit growth (%)	9.2	11.8	(5.0)	15.3	15.6
Recurring P/E (x)	19.16	17.14	18.07	15.67	13.56
P/B (x)	4.5	4.6	4.4	4.1	3.8
P/CF (x)	15.79	17.11	12.96	9.51	8.66
Dividend Yield (%)	4.6	4.6	4.6	4.7	5.4
EV/EBITDA (x)	12.85	11.98	11.77	10.34	9.07
Return on average equity (%)	22.2	25.9	24.7	26.9	28.9
Net debt to equity (%)	3.2	75.7	72.1	56.7	41.4

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (SGD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Singapore	Recurring EPS	0.17	0.19	0.18	0.21	0.24
Industrials	DPS	0.15	0.15	0.15	0.15	0.17
ST Engineering	BV/PS	0.72	0.71	0.74	0.79	0.85
STE SP	Return on average equity (%)	22.2	25.9	24.7	26.9	28.9
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)	19.16	17.14	18.07	15.67	13.56
	P/B (x)	4.5	4.6	4.4	4.1	3.8
	FCF Yield (%)	3.0	4.1	5.0	7.8	9.0
	Dividend Yield (%)	4.6	4.6	4.6	4.7	5.4
	EV/EBITDA (x)	12.85	11.98	11.77	10.34	9.07
	EV/EBIT (x)	18.35	18.72	18.60	15.80	13.44
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	7,957	8,506	9,229
ii. Contributions from MRAS and Newtec acquisitions	Gross profit	1,406	1,635	1,652	1,819	2,019
	EBITDA	814	1,022	1,042	1,159	1,287
	Depreciation and amortisation	(244)	(368)	(383)	(401)	(419)
	Operating profit	570	654	659	758	868
	Net interest	(34)	(37)	(65)	(65)	(58)
	Pre-tax profit	621	695	674	777	898
	Taxation	(104)	(103)	(99)	(115)	(132)
	Reported net profit	494	578	560	646	746
	Recurring net profit	527	589	560	646	746
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)	(250)	(73)	(90)
ii. Lower-than-expected contribution from acquisitions;	Cash flow from operations	639	590	781	1,063	1,168
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)	(226)	(220)	(208)
	Dividends paid	(468)	(468)	(468)	(476)	(549)
	Cash flow from financing activities	(1,161)	720	(542)	(550)	(623)
	Cash at beginning of period	999	416	453	466	760
	Net change in cash	(587)	37	13	294	337
	Ending balance cash	416	453	466	760	1,097
Company Profile	Balance sheet (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
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	416	453	466	760	1,097
	Tangible fixed assets	1,743	1,805	1,800	1,772	1,716
	Total investments	456	453	404	354	303
	Total assets	7,573	9,521	9,804	10,122	10,520
	Short-term debt	225	1,869	0	0	0
	Total long-term debt	270	469	2,338	2,338	2,338
	Total liabilities	5,038	7,030	7,207	7,339	7,521
	Total equity	2,535	2,491	2,597	2,783	2,999
	Total liabilities & equity	7,573	9,521	9,804	10,122	10,520
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	2.7	17.5	1.1	6.9	8.5
	Recurrent EPS growth (%)	9.2	11.8	(5.2)	15.3	15.6
	Gross margin (%)	21.0	20.8	20.8	21.4	21.9
	Operating EBITDA margin (%)	12.2	13.0	13.1	13.6	13.9
	Net profit margin (%)	7.4	7.3	7.0	7.6	8.1
	Dividend payout ratio (%)	94.7	81.0	83.7	73.7	73.6
	Capex/sales (%)	5.0	2.2	3.5	3.2	2.8
	Interest cover (x)	10.2	12.8	8.2	9.4	10.7

Source: Company data, RHB

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Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2019-08-15	Buy	4.70	4.07
2019-07-05	Buy	4.45	4.23

Source: RHB, Bloomberg

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