

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

28 Feb 2022

BUY

Last Traded Price (25 Feb 2022): S\$3.77 (STI : 3,294.47)
Price Target 12-mth: S\$4.70 (25% upside) (Prev S\$4.60)

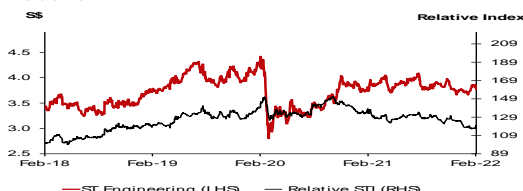
Analyst

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What's New

- 2H21 earnings beat expectations as commercial aerospace division recovers closer to pre-COVID level
- Transcore acquisition is on track; we expect contribution in FY21 to partially offset the c.S\$200m drop in government grants
- 16Scts total dividends from FY22, payable quarterly
- Medium term growth prospects intact; maintain BUY with a slightly higher TP of S\$4.70

Price Relative



Forecasts and Valuation

FY Dec (S\$m)	2020A	2021A	2022F	2023F
Revenue	7,158	7,693	9,274	9,943
EBITDA	957	1,077	1,244	1,415
Pre-tax Profit	534	638	728	855
Net Profit	522	571	575	682
Net Pft (Pre Ex.)	522	571	575	682
Net Pft Gth (Pre-ex) (%)	(11.9)	9.3	0.7	18.6
EPS (S cts)	16.7	18.3	18.4	21.8
EPS Pre Ex. (S cts)	16.7	18.3	18.4	21.8
EPS Gth Pre Ex (%)	(12)	9	1	19
Diluted EPS (S cts)	16.7	18.3	18.4	21.8
Net DPS (S cts)	15.0	15.0	16.0	16.0
BV Per Share (S cts)	73.4	77.3	80.7	86.5
PE (X)	22.6	20.6	20.5	17.3
PE Pre Ex. (X)	22.6	20.6	20.5	17.3
P/Cash Flow (X)	7.7	10.6	18.9	12.0
EV/EBITDA (X)	14.0	12.4	13.7	11.9
Net Div Yield (%)	4.0	4.0	4.2	4.2
P/Book Value (X)	5.1	4.9	4.7	4.4
Net Debt/Equity (X)	0.5	0.5	1.8	1.6
ROAE (%)	23.1	24.3	23.3	26.1
Earnings Rev (%):			3	1
Consensus EPS (S cts):			19.0	21.1
Other Broker Recs:		B: 10	S: 2	H: 0

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

Broad based growth levers in place

Investment Thesis:

Growth trajectory more exciting. We expect solid 10% CAGR in net profit over FY21-23, driven by inorganic growth (TransCore) and recovery in the commercial aerospace segment. However, the big story is that instead of revenue stagnation (between FY12-FY18), growth momentum will continue, built on the solid foundation established since 2018. With continued investments in R&D and strategic acquisitions, STE remains well on top of crucial global needs of digitalisation, urbanisation, sustainability, and security, driving robust organic growth across segments of 4-5% even further out to 2026. Key to this will be 1) the strong ramp-up in Passenger to Freighter (P2F) conversions, 2) continued traction in the smart city space – smart mobility, smart environment, and smart security, 3) expansion in digital businesses including cloud, AI analytics, and cybersecurity and 4) international defence contract wins, among others.

Record order backlog underpins earnings visibility. The order backlog for STE reached a new record of S\$19.3bn as at end-FY21, as new order wins surpassed expectations.

Inorganic ambitions can provide further impetus. STE can leverage its strong balance sheet to ensure more debt-funded acquisitions. Despite the expected increase in gearing, we envisage limited impact on funding costs.

Valuation:

Our TP is raised slightly to S\$4.70 toe factor in slightly higher dividends. The TP is based on a blended valuation framework (P/E, dividend yield, and DCF). Stock offers decent yield of 4.2% as well as potential to deliver stronger growth.

Where we differ:

We are more conservative on FY22F earnings compared to consensus (likely related to pace of aerospace recovery), but we are more bullish on the recovery thereafter.

Key Risks to Our View:

Slower than-expected demand recovery in international air travel could pose downside risk to earnings and valuations.

At A Glance

Issued Capital (m shrs)	3,113
Mkt. Cap (S\$m/US\$m)	11,735 / 8,671
Major Shareholders (%)	
Temasek Holdings Pte Ltd (%)	50.0
Capital Group Cos Inc/The	5.0
Free Float (%)	45.0
3m Avg. Daily Val (US\$m)	13.2

GIC Industry : Industrials / Capital Goods



Watchlist the stock on Insights Direct to receive prompt updates



Live more, Bank less

ST Engineering

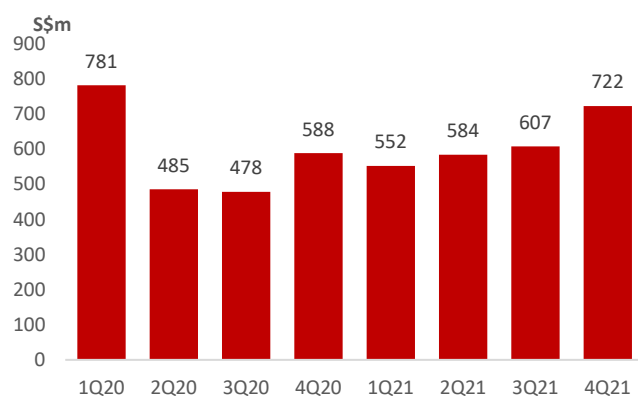
WHAT'S NEW

STE's earnings more than offsets drop in government grants in FY21 with a mix of cost cutting and business growth

2H21 beat our expectations due to stronger than expected recovery in commercial aerospace division. 2H21 earnings came in at S\$274.4m (+3.8% y-o-y, -7.3% h-o-h), bringing net profit for the full-year to S\$570.5m (up 9% y-o-y), which is slightly above our estimate of S\$553.0m. Cost savings and sustained business recovery across all segments enabled the Group to more than offset a c.\$150m gap in government grants in FY21 (government support reduced from c.\$350m in FY20 to c.\$200m in FY21).

Broad-based revenue rebound in 2H21, but commercial aerospace recovery shines. Group revenue came in at S\$4,042.0m (+12.7% y-o-y, +10.7% h-o-h) in 2H21, primarily driven by a considerable rebound in the commercial aerospace division, which saw its top line grow by 25% y-o-y. Meanwhile, the Urban Solutions & Satcom (USS) and Defence & Public Security (DPS) divisions both achieved revenue growth of 5% and 8% respectively during the period. In an encouraging sign, the commercial aerospace segment, which was the worst hit during the pandemic, registered revenue of S\$722m in 4Q21, representing 92.4% of pre-COVID 1Q20 level. This is likely due to the impact of growing volumes in the Passenger-to-Freighter (P2F) conversion business, as commercial MRO business is still some way away from full recovery. Demand for P2F remains strong, with STE's A330 P2F slots booked through 2025 and A320/321 slots fully booked through mid-2024.

Commercial aerospace revenues recovery trajectory



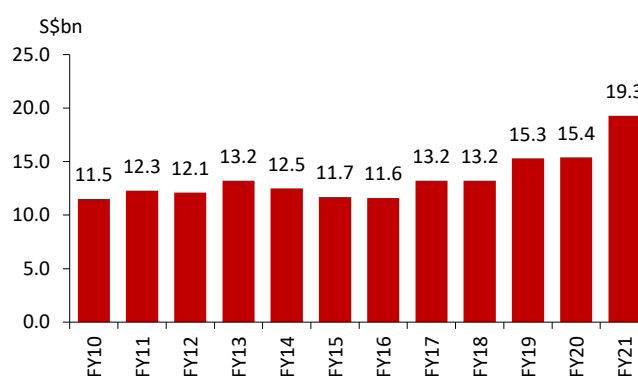
Source: Company, DBS Bank

Group EBIT (including associates and JVs) margin shrank slightly to 7.9% in 2H21, down from 9.7% in 1H21, but was higher compared to 2H20 (7.4%). Margin compression during the period can largely be attributed to a lower degree of government support received during the period (S\$66m in 2H21 vs S\$139m in 1H21) and transaction costs for the TransCore acquisition and project/production delays in the USS segment caused by the global semiconductor shortage. Excluding the one-off transaction costs and bottlenecks in the USS division, EBIT for the segment would have S\$20m higher.

Core EBIT margins (excluding government support) would have been around 7.2% in 2H21, a solid improvement from 5.9% in 1H21 and 1.8% in 2H20. For the full-year, core EBIT improved from S\$243m in FY20 to S\$469m in FY21. Management did highlight that the Group was experiencing some inflationary pressures on raw materials and logistics costs, and competition for manpower in certain growth areas is stiff, which would translate into wage inflation. Nonetheless, the Group should still be able to gradually widen its margins by realising greater economies of scale and focusing on enhancing cost efficiencies.

Orderbook marches to yet another new high of S\$19.3bn as of Dec-21, up from S\$18.2bn in Sep-21. In an encouraging sign, total new contracts clinched by the Group was S\$11.7bn in FY21, up from S\$8.2bn and S\$9.5bn in FY20 and FY19 respectively. STE expects to deliver S\$6.6bn from its orderbook in 2022.

ST Engineering orderbook trends



Source: Company, DBS Bank

ST Engineering

Final DPS of 10.0Scts in line with expectations, but changes to dividend policy is a pleasant surprise.

Consistent with the past few years, STE announced a final dividend of 10.0Scts per share, bringing total dividends for the year to 15.0Scts per share. The Board recently approved a change to the company's dividend policy, which will increase the frequency to quarterly distributions, and the absolute amount of dividends to 16.0Scts per share in FY22. We did not anticipate changes to STE's dividend distribution level over the next few years, given the Group's ambitious growth aspirations, and we are glad to see the management pro-actively taking measures to maximise shareholder returns.

Strong medium term growth prospects pits STE as a growth + yield stock. Over FY21-23, we are forecasting higher than usual growth in revenue and earnings, with the impact of inorganic growth from the acquisition of TransCore (expected to be completed by 1Q22), but even

organic growth beyond that should be better than its historical track record. STE should be able to pursue further inorganic growth opportunities as well, given that funding costs should not be materially affected even if credit ratings are downgraded a notch or two from its current AAA rating. Thus, STE is well on its way to be positioned as more of a growth story than just a defensive yield stock. Maintain BUY with higher TP of S\$4.70.

Company Background

ST Engineering (STE) is an integrated engineering group in the aerospace, smart city, defence, and public security sectors. The company has over the years diversified its businesses and geographies.

Interim Income Statement (\$m)

FY Dec	2H2020	1H2021	2H2021	% chg yoy	% chg hoh
Revenue	3,586	3,651	4,042	12.7	10.7
Cost of Goods Sold	(2,796)	(2,906)	(3,251)	16.3	11.9
Gross Profit	791	744	791	0.0	6.2
Other Oper. (Exp)/Inc	(543)	(401)	(471)	(13.2)	17.6
Operating Profit	248	344	319	29.0	(7.1)
Other Non Opg (Exp)/Inc	0	0	0	-	-
Associates & JV Inc	17	12	4	(73.5)	(62.0)
Net Interest (Exp)/Inc	(16)	(15)	(26)	(59.7)	(68.7)
Exceptional Gain/(Loss)	0	0	0	-	-
Pre-tax Profit	248	340	298	20.1	(12.4)
Tax	22	(46)	(24)	nm	(47.2)
Minority Interest	(6)	3	1	nm	(59.4)
Net Profit	264	296	274	3.8	(7.3)
Net profit bef Except.	264	296	274	3.8	(7.3)
EBITDA	447	542	512	14.5	(5.6)
Margins (%)					
Gross Margins	22.0	20.4	19.6		
Opg Profit Margins	6.9	9.4	7.9		
Net Profit Margins	7.4	8.1	6.8		

Source of all data: Company, DBS Bank

ST Engineering

Valuation table (Blended valuation summary)

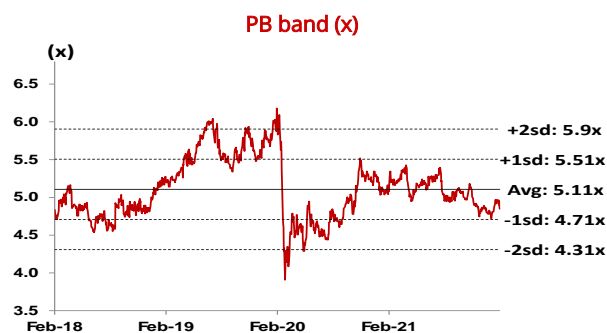
Method	Basis (FY22)	Parameter	Value (\$m)	Remarks
P/E	574.7	25.0	14,368	+2 S.D. valuations given record orderbook level
Div Yield	16.0	3.6	13,844	Based on STI dividend yield
DCF		WACC 6.0%	15,480	
Average			14,564	
No of shares			3,115	
Value per share			4.70	

Source: DBS Bank estimates

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	2021A	2022F	2023F
Commercial Aerospace	5.70	17.3	7.03
Urban Solutions &	8.17	63.6	14.3
Defence & Public	8.40	9.83	4.21

Segmental Breakdown

FY Dec	2020A	2021A	2022F	2023F
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Revenues (\$m)

Commercial Aerospace	2,332	2,465	2,891	3,094
Urban Solutions &	1,101	1,191	1,948	2,227
Defence & Public	3,725	4,038	4,435	4,622

Total	7,158	7,694	9,274	9,943
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EBIT (\$m)

Commercial Aerospace	80.9	182	159	186
Urban Solutions &	31.4	25.8	133	236
Defence & Public	484	466	524	541

Others

Total	596	674	816	962
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EBIT Margins (%)

Commercial Aerospace	3.5	7.4	5.5	6.0
Urban Solutions &	2.9	2.2	6.8	10.6
Defence & Public	13.0	11.5	11.8	11.7

Others

Total	8.3	8.8	8.8	9.7
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Includes 9-month contribution from Transcore acquisition

Income Statement (\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
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Revenue	7,868	7,158	7,693	9,274	9,943
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Cost of Goods Sold	(6,233)	(5,631)	(6,158)	(7,484)	(7,905)
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Gross Profit	1,635	1,527	1,535	1,790	2,038
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Other Opng (Exp)/Inc	(930)	(980)	(872)	(974)	(1,076)
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Operating Profit	706	548	663	816	962
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Other Non Opng (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
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Associates & JV Inc	39.0	30.4	16.0	24.0	28.8
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Net Interest (Exp)/Inc	(35.3)	(43.8)	(41.1)	(112)	(136)
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Exceptional Gain/(Loss)	(14.2)	0.0	0.0	0.0	0.0
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Pre-tax Profit	695	534	638	728	855
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Tax	(103)	(8.8)	(70.6)	(138)	(148)
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Minority Interest	(14.7)	(3.8)	3.57	(14.7)	(24.7)
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Preference Dividend	0.0	0.0	0.0	0.0	0.0
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Net Profit	578	522	571	575	682
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Net Profit before Except.	592	522	571	575	682
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EBITDA	1,113	957	1,077	1,244	1,415
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Growth

Revenue Gth (%)	17.5	(9.0)	7.5	20.6	7.2
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EBITDA Gth (%)	20.4	(14.0)	12.5	15.6	13.7
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Opg Profit Gth (%)	11.8	(22.4)	21.0	23.1	17.9
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Net Profit Gth (Pre-ex) (%)	12.4	(11.9)	9.3	0.7	18.6
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Margins & Ratio

Gross Margins (%)	20.8	21.3	20.0	19.3	20.5
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Opg Profit Margin (%)	9.0	7.7	8.6	8.8	9.7
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Net Profit Margin (%)	7.3	7.3	7.4	6.2	6.9
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ROAE (%)	25.9	23.1	24.3	23.3	26.1
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ROA (%)	6.8	5.4	5.6	4.5	4.5
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ROCE (%)	12.2	8.9	9.4	8.0	7.8
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Div Payout Ratio (%)	81.0	89.8	82.1	86.9	73.3
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Net Interest Cover (x)	20.0	12.5	16.1	7.3	7.1
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Source: Company, DBS Bank

ST Engineering

Interim Income Statement (\$\$m)

FY Dec	2H2019	1H2020	2H2020	1H2021	2H2021
Revenue	4,357	3,572	3,586	3,651	4,042
Cost of Goods Sold	(3,452)	(2,835)	(2,796)	(2,906)	(3,251)
Gross Profit	905	737	791	744	791
Other Oper. (Exp)/Inc	(515)	(437)	(543)	(401)	(471)
Operating Profit	390	300	248	344	319
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	17.3	13.8	16.6	11.6	4.40
Net Interest (Exp)/Inc	(27.4)	(27.7)	(16.2)	(15.3)	(25.8)
Exceptional Gain/(Loss)	(14.2)	0.0	0.0	0.0	0.0
Pre-tax Profit	366	286	248	340	298
Tax	(48.3)	(31.1)	22.3	(46.2)	(24.4)
Minority Interest	(8.6)	2.09	(5.9)	2.54	1.03
Net Profit	309	257	264	296	274
Net profit bef Except.	323	257	264	296	274
EBITDA	604	510	447	542	512

Growth

Revenue Gth (%)	24.1	(18.0)	0.4	1.8	10.7
EBITDA Gth (%)	18.3	(15.5)	(12.4)	21.4	(5.6)
Opg Profit Gth (%)	22.9	(23.0)	(17.6)	38.8	(7.1)
Net Profit Gth (%)	14.6	(16.6)	2.7	12.0	(7.3)

Margins

Gross Margins (%)	20.8	20.6	22.0	20.4	19.6
Opg Profit Margins (%)	8.9	8.4	6.9	9.4	7.9
Net Profit Margins (%)	7.1	7.2	7.4	8.1	6.8

Balance Sheet (\$\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	1,805	1,757	1,794	5,309	5,185
Invt in Associates & JVs	453	469	483	477	476
Other LT Assets	2,624	2,747	2,882	2,882	2,882
Cash & ST Invt	454	731	816	681	891
Inventory	2,558	2,825	2,988	3,602	3,862
Debtors	1,246	1,048	1,067	1,325	1,420
Other Current Assets	381	388	486	486	486
Total Assets	9,521	9,964	10,516	14,762	15,202
ST Debt	1,869	496	560	560	560
Creditor	2,013	2,218	2,613	2,898	3,107
Other Current Liab	1,565	1,574	1,507	1,747	1,771
LT Debt	469	1,551	1,555	5,155	5,155
Other LT Liabilities	1,115	1,550	1,612	1,612	1,612
Shareholder's Equity	2,222	2,293	2,413	2,519	2,701
Minority Interests	269	282	255	270	295
Total Cap. & Liab.	9,521	9,964	10,516	14,762	15,202
Non-Cash Wkg. Capital	608	468	421	768	890
Net Cash/(Debt)	(1,884)	(1,316)	(1,299)	(5,035)	(4,824)
Debtors Turn (avg days)	55.3	58.5	50.2	47.1	50.4
Creditors Turn (avg days)	119.6	147.0	153.1	142.1	146.5
Inventory Turn (avg days)	149.7	187.0	184.2	169.9	182.1
Asset Turnover (x)	0.9	0.7	0.8	0.7	0.7
Current Ratio (x)	0.9	1.2	1.1	1.2	1.2
Quick Ratio (x)	0.3	0.4	0.4	0.4	0.4
Net Debt/Equity (X)	0.8	0.5	0.5	1.8	1.6
Net Debt/Equity ex MI (X)	0.8	0.6	0.5	2.0	1.8
Capex to Debt (%)	57.3	9.8	14.0	68.6	5.2
Z-Score (X)	2.1	2.3	2.4	2.4	2.4

Source: Company, DBS Bank

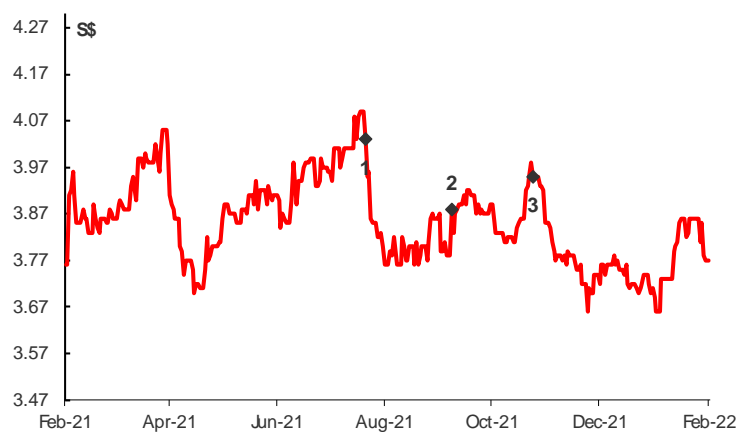
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Cash Flow Statement (\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	695	534	638	728	855
Dep. & Amort.	368	379	398	404	424
Tax Paid	(103)	(78.0)	(112)	(138)	(148)
Assoc. & JV Inc/(loss)	(39.0)	(30.4)	(16.0)	(24.0)	(28.8)
Chg in Wkg.Cap.	(439)	598	137	(347)	(122)
Other Operating CF	107	131	69.6	0.0	0.0
Net Operating CF	590	1,533	1,114	623	980
Capital Exp.(net)	(1,340)	(200)	(296)	(3,920)	(300)
Other Invs.(net)	0.0	(7.3)	(14.3)	0.0	0.0
Invs in Assoc. & JV	(28.8)	(4.9)	(9.9)	(5.0)	(5.0)
Div from Assoc & JV	47.8	13.3	24.3	35.0	35.0
Other Investing CF	48.3	(96.0)	(118)	0.0	0.0
Net Investing CF	(1,273)	(295)	(414)	(3,890)	(270)
Div Paid	(468)	(468)	(468)	(468)	(500)
Chg in Gross Debt	1,401	(399)	(14.6)	3,600	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(213)	(91.6)	(134)	0.0	0.0
Net Financing CF	720	(959)	(616)	3,132	(500)
Currency Adjustments	0.32	(1.5)	0.86	0.0	0.0
Chg in Cash	37.5	277	85.3	(135)	210
Opg CFPS (S cts)	33.0	30.0	31.3	31.1	35.3
Free CFPS (S cts)	(24.0)	42.7	26.2	(106)	21.8

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	16 Aug 21	4.03	4.36	BUY
2:	04 Oct 21	3.88	4.55	BUY
3:	19 Nov 21	3.95	4.60	BUY

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

Source: DBS Bank

Analyst: Suvro SARKAR

Jason SUM, CFA

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

Completed Date: 28 Feb 2022 11:21:47 (SGT)

Dissemination Date: 28 Feb 2022 14:33:00 (SGT)

Sources for all charts and tables are DBS Bank unless otherwise specified.

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