

Singapore

ADD (no change)

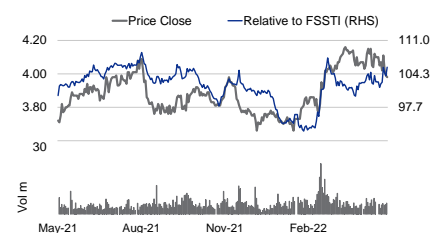
Consensus ratings*: Buy 9 Hold 1 Sell 2

Current price:	S\$3.98
Target price:	S\$4.70
Previous target:	S\$4.70
Up/downside:	18.1%
CGS-CIMB / Consensus:	6.7%
Reuters:	STEG.SI
Bloomberg:	STE SP
Market cap:	US\$8,894m
	S\$12,410m
Average daily turnover:	US\$16.11m
	S\$21.93m
Current shares o/s:	3,122m
Free float:	49.0%

*Source: Bloomberg

Key changes in this note

- FY22-24F EPS cut by 2-3%.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	-2	3.1	7
Relative (%)	3	10.8	5.7

Major shareholders

	% held
Temasek Holdings	50.0
Capital Group	5.0
BlackRock	1.8

Analyst(s)



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ST Engineering

Defensive giant in trying times

- 1Q22 revenue returned to pre-Covid-19 levels of S\$2bn. Transcore acquisition bearing fruit with S\$1.6bn addition to STE's S\$21.3bn order book.
- Active product redesign, supply chain management and some cost pass-through to customers mitigate inflationary and chip shortage pressures.
- S\$0.04 quarterly DPS declared. Catalysts: quicker global border reopening and strong orders in digital/smart city. Add; blended valuation TP at S\$4.70.

Transcore added S\$1.6bn of orders to S\$21.3bn order book

1Q22 order wins were decent at S\$2.4bn (-25% qoq, +54% yoy) with the largest portion (S\$1.3bn) coming from Defence and Public Security (contracts include AI systems and digital solutions), followed by Commercial Aerospace (S\$900m) and Urban Solutions/Satellite Comms (S\$200m). The consolidation of Transcore from 17 Mar also contributed S\$1.6bn of orders into STE's order book, now at a new high of S\$21.3bn (4Q21: S\$19.3bn), of which c.27% are expected by STE to be delivered by end-FY22F. Group revenue of S\$2.0bn (+14% yoy) was in line and formed 23% of our FY22F forecast and Bloomberg consensus.

Commercial Aerospace 86% of pre-Covid, steady flow of PTF orders

Commercial Aerospace (CA) revenue rose to S\$674m (+22% yoy) in 1Q22. Airframe MRO has seen full recovery from strong execution of passenger-to-freighter (PTF) orders while components and engines are operating at 80% of pre-Covid-19 capacity with better recovery from 2H22 as borders reopen. The demand for PTF has normalised with some orders still seen in 1Q22 for A330 PTF from DHL and CDB Aviation. Nacelle production remains steady with 43 units/month YTD (1Q21: 40 units/month) with a target to ramp up to 53 units/month by end 2022. We expect defence and commercial aerospace revenue to recover to pre-Covid-19 levels by end 2023F.

Focus on digital business growth

Defence and Public Security (DPS) revenue grew 9% yoy to S\$1.06bn on the back of strong growth from its digital systems and cyber business. Revenue from this segment grew from S\$166m in FY20 to S\$250m in FY21 and is on track to achieve more than S\$500m by FY26F (upside potential if more projects are won). STE's advantage lies in its end-to-end system integration capabilities for mission critical government and defence projects, that can be cross-sold to large commercial enterprises.

Active management to protect rising costs

STE issued US\$1bn bonds (US\$700m due in 2027 and US\$300m due in 2032) to refinance USCP for the acquisition of Transcore and with favourable settlement of Treasury Locks gain of c.US\$91m (to be amortised over the periods of the bonds), resulting in weighted average interest cost of 1.8% p.a. We cut FY22-24F EPS by 2-3% to factor in inflation and rising interest rates although STE sees minimal impact for now. Our blended valuations TP is based on 20.7x FY23F P/E, DCF, and 4% dividend yield.

Financial Summary

	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Revenue (S\$m)	7,158	7,693	8,903	9,423	9,866
Operating EBITDA (S\$m)	949	1,044	1,152	1,380	1,441
Net Profit (S\$m)	521.8	570.5	586.6	687.1	745.5
Core EPS (S\$)	0.17	0.18	0.19	0.22	0.24
Core EPS Growth	(9.6%)	9.3%	2.8%	17.1%	8.5%
FD Core P/E (x)	23.78	21.75	21.15	18.06	16.64
DPS (S\$)	0.15	0.15	0.16	0.16	0.16
Dividend Yield	3.77%	3.77%	4.02%	4.02%	4.02%
EV/EBITDA (x)	14.27	12.91	14.76	12.19	11.53
P/FCFE (x)	13.84	16.45	49.43	16.22	15.68
Net Gearing	51%	49%	175%	158%	139%
P/BV (x)	5.41	5.14	4.96	4.62	4.23
ROE	23.1%	24.3%	23.9%	26.5%	26.5%
% Change In Core EPS Estimates			(2.30%)	(2.72%)	(3.33%)
CGS-CIMB/Consensus EPS (x)			1.01	1.06	1.02

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

USS revenue reaches pre-Covid-19 levels; TransCore cash positive in FY22F

Revenue from Urban Solutions & Satcom (USS) increased 12% yoy to S\$297m on the back of higher smart city project deliveries. The group's acquisition of TransCore was completed on 17 Mar 22, and we expect revenue contribution to be more apparent from 2Q22F onwards while earnings accretion will start in FY23F with positive EBITDA contribution in FY22F.

Examples of how STE mitigates inflationary pressures

USS: Satcom division faces chip shortage the most and some of the measures to mitigate this include product (e.g. modems) redesign to reduce dependency on a single chip maker and renegotiate comprehensively with suppliers to get priority in deliveries.

Marine: The S\$2.6bn Polar Security Cutter project is currently in the design phase and due to start construction in 2H22. There are clauses to share cost increases in the contract.

Defence contracts: Long-lead items including engines, parts and steel are locked in with vendors in advance with some renegotiations to pass through costs, including aluminum and steel.

Aerospace: Wage inflation and a competitive labour market are wide spread in addition to a tight supply chain (shipments of PTF kits). STE established apprenticeship programmes during the Covid-19 period to retain talent. We believe supply chain management can partially be mitigated by a recovery in MRO.

Data centre management: There are clauses for natural hedging including electricity costs and to share cost increases. There are also material pass-through clauses in both defence and private sectors.

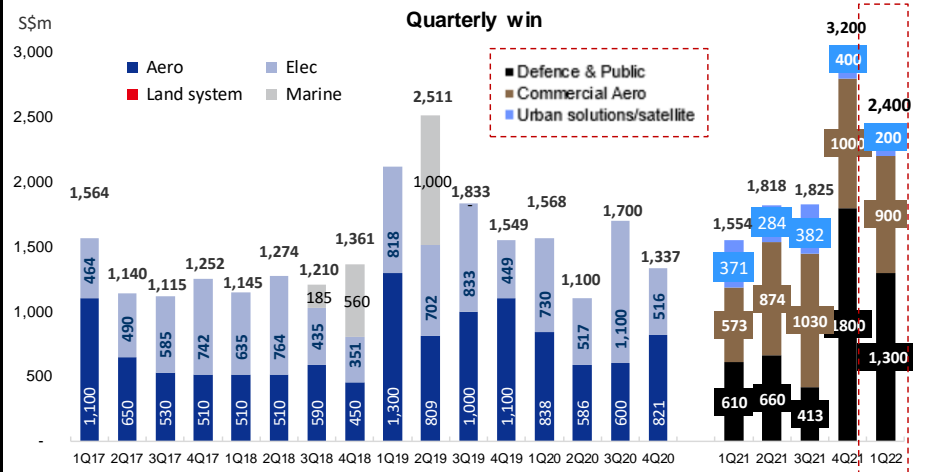
Downside risks include border closures, uncontrolled global pandemic or project costs overrun.

Figure 1: Revenue back to 100% of pre-Covid-19 levels

FYE Dec (S\$)	1Q22	1Q21	yoy % chg	1Q20	1Q22 % of pre-covid	FY22F	FY21	yoy % chg	Prev FY22F	Comments
Commercial Aerospace	674	552	22	781	86	2,775	2,465	13	2,775	Gradual MRO recovery, strong PTF demand
Urban Solutions & Satcom	297	264	13	236	126	1,800	1,191	51	1,642	More smart city projects delivered
Defence & Public Security	1,062	976	9	1,026	104	4,328	4,038	7	4,328	Strong growth from digital systems & cyber business
Total revenue	2,033	1,792	13	2,043	100	8,903	7,693	16	8,745	

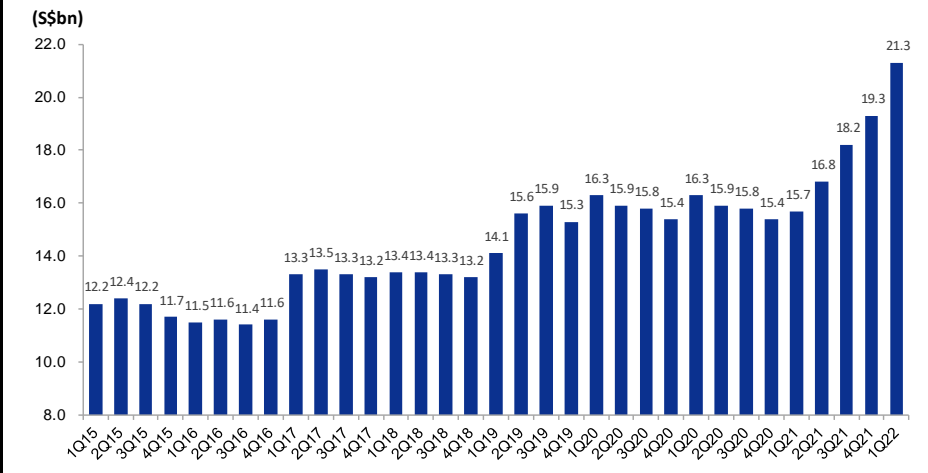
SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Figure 2: 1Q22 order wins came in solid at S\$2.4bn



SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Figure 3: Order book hit a new high of S\$21.3bn (including S\$1.6bn from Transcore)



SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Figure 4: Blended valuations

Method	Value per share (S\$)	Basis
P/E	4.56	20.7x CY23F earnings
DCF	5.54	WACC 6.3%, LTG 2%
Dividend yield (%)	4.00	4% net yield on FY22F DPS
Average	4.70	

SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS

Figure 5: Earnings revision

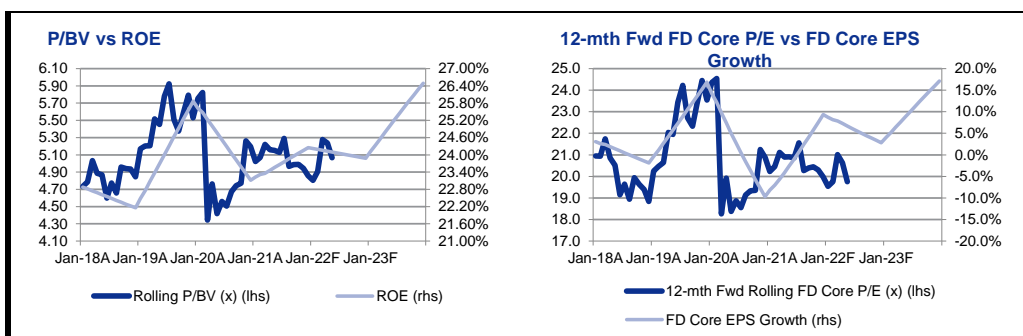
FYE Dec (S\$)	New			Old			% change		
	FY22F	FY23F	FY24F	FY22F	FY23F	FY24F	FY22F	FY23F	FY24F
Revenue	8,903.2	9,423.0	9,865.8	8,745.4	9,249.4	9,674.8	1.8%	1.9%	2.0%
Gross profit	1,895.6	2,089.7	2,218.0	1,862.3	2,061.2	2,195.2	1.8%	1.4%	1.0%
Gross profit margin (%)	21.3%	22.2%	22.5%	21.3%	22.3%	22.5%	0.0%	-0.5%	0.0%
EBIT	748.2	874.7	945.4	735.4	868.8	947.5	1.7%	0.7%	-0.2%
Net profit	586.6	687.1	745.5	600.4	706.3	771.2	-2.3%	-2.7%	-3.3%
NPM (%)	6.6%	7.3%	7.6%	6.9%	7.6%	8.0%	-4.0%	-4.5%	-5.2%
Core EPS (Scts)	18.8	22.0	23.9	19.3	22.7	24.7	-2.3%	-2.7%	-3.3%

SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS

ESG in a nutshell		Refinitiv ESG Scores					
ESG		A- ESG Score	A+ ESG Controversies Score	A- ESG Combined Score	A+ ESG Environment Pillar Score	A- ESG Social Pillar Score	B- ESG Government Pillar Score
<p>We think STE's transformation over the years, steering its focus towards aerospace, smart city, defence and public security segments, has lifted its overall ESG standing, away from the historical misconception of being associated with the production of antipersonnel landmines/cluster munitions. Accordingly, it has improved its ESG combined score by Refinitiv from a B- since 2015 to A- in 2020. The current score of A- is split into E: A+ (weightage 23.7%); S: A- (weightage 43.9%); and G: B- (weightage 32.4%). Being a Temasek-linked company, we believe that STE plays a role in helping Singapore to achieve its 2030 Green Plan.</p>							
<p>Keep your eye on</p> <p>Being involved in the defence industry, transparency of information could be limited at times for contract wins/ tender pipeline. Order book amount disclosed includes defence contracts but details are not disclosed.</p>	<p>Implications</p> <p>We do not forecast our financials by commercial/defence in nature but based on historical trend of revenue and margin by segments. Significant wins/cancellations of defence contracts could be an upside/downside risk as STE announces its end order book.</p>						
<p>ESG highlights</p> <p>Refinitiv ranked STE slightly better vs. its Singapore industrial peers (KEP: B+, SCI: B-) in 2020. STE scored particularly well in Environment (A+) which we believe was due to its emission reduction target achievement. In 2019, its Singapore operations achieved a reduction of 39% in Greenhouse Gas (GHG) emission intensity, which surpassed our target of 36% reduction on a business-as-usual basis by 2030F, with 2010 as base year. In 2020, the reduction continued with -44%, and -30% in 2021.</p> <p>However, Refinitiv ranked STE B- for Governance in 2020 (KEP: A- , SCI: A) which we believe was due to the number of independent directors in the board. We note that this has improved in 2021 (9 of STE's current 12 board of directors are independent, or 75%) as compared to 58% in 2020, vs. peers (KEP: c.87% and SCI: 90%).</p>	<p>Implications</p> <p>STE generally appears to fare well in corporate governance amongst Singapore corporates with little controversy in recent years and can be valued at a premium by some investors. We believe that this ties in with our above Singapore market P/E in our fundamental valuations.</p>						
<p>Trends</p> <p>STE improved in Environment pillar, based on Refinitiv rankings in 2020, with a score of A+ vs. 2018's B+ which was attributed to better resource efficiency (less energy use/million revenue), and lower Co2 emissions. It also improved in Social pillar in 2019 with a score of A- vs. C+ in the previous year (mainly due to the disclosure of human rights policy – with zero tolerance for unethical labour practices such as child labour, forced labour, slavery and human trafficking in its operations), and maintained its A-score in 2020.</p>	<p>Implications</p> <p>As STE ramps up projects in smart cities, it could gain more interest from funds which focus on high E and S scores.</p>						

SOURCES: CGS-CIMB RESEARCH, REFINITIV

BY THE NUMBERS



Profit & Loss

(\$m)	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Total Net Revenues	7,158	7,693	8,903	9,423	9,866
Gross Profit	1,527	1,535	1,896	2,090	2,218
Operating EBITDA	949	1,044	1,152	1,380	1,441
Depreciation And Amortisation	(379)	(398)	(404)	(505)	(495)
Operating EBIT	570	646	748	875	945
Financial Income/(Expense)	(62)	(36)	(78)	(80)	(82)
Pretax Income/(Loss) from Assoc.	30	16	19	19	19
Non-Operating Income/(Expense)	(4)	12	0	0	0
Profit Before Tax (pre-EI)	534	638	689	814	882
Exceptional Items	0	0	0	0	0
Pre-tax Profit	534	638	689	814	882
Taxation	(9)	(71)	(96)	(120)	(131)
Exceptional Income - post-tax					
Profit After Tax	526	567	593	693	752
Minority Interests	(4)	4	(6)	(6)	(6)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	522	571	587	687	746
Recurring Net Profit	522	571	587	687	746
Fully Diluted Recurring Net Profit	522	571	587	687	746

Cash Flow

(\$m)	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
EBITDA	949	1,044	1,152	1,380	1,441
Cash Flow from Inv. & Assoc.	(30)	(16)	(19)	(19)	(19)
Change In Working Capital	598	137	(330)	(113)	(181)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	160	105	107	110	113
Net Interest (Paid)/Received	(65)	(44)	(78)	(80)	(82)
Tax Paid	(78)	(112)	(96)	(120)	(131)
Cashflow From Operations	1,533	1,114	736	1,158	1,141
Capex	(200)	(312)	(350)	(250)	(200)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(95)	(102)	(3,335)	(143)	(150)
Cash Flow From Investing	(295)	(414)	(3,685)	(393)	(350)
Debt Raised/(repaid)	(341)	54	3,200	0	0
Proceeds From Issue Of Shares	0	0	0	0	0
Shares Repurchased	(29)	(33)	0	0	0
Dividends Paid	(468)	(468)	(500)	(500)	(500)
Preferred Dividends					
Other Financing Cashflow	(120)	(168)	(88)	(91)	(94)
Cash Flow From Financing	(959)	(615)	2,612	(591)	(593)
Total Cash Generated	279	86	(337)	174	198
Free Cashflow To Equity	897	754	251	765	791
Free Cashflow To Firm	1,309	748	(2,861)	856	885

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

BY THE NUMBERS... cont'd

Balance Sheet

(S\$m)	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Total Cash And Equivalents	731	816	479	653	851
Total Debtors	1,048	1,067	1,268	1,342	1,406
Inventories	1,269	1,261	1,459	1,527	1,592
Total Other Current Assets	1,943	2,213	2,206	2,174	2,148
Total Current Assets	4,991	5,356	5,412	5,697	5,997
Fixed Assets	1,757	1,794	3,405	3,314	3,183
Total Investments	492	519	538	557	576
Intangible Assets	1,946	1,993	3,663	3,641	3,627
Total Other Non-Current Assets	778	854	854	854	854
Total Non-current Assets	4,973	5,159	8,460	8,366	8,239
Short-term Debt	496	560	560	560	560
Current Portion of Long-Term Debt					
Total Creditors	2,218	2,613	2,688	2,712	2,619
Other Current Liabilities	1,574	1,507	1,495	1,468	1,483
Total Current Liabilities	4,289	4,680	4,743	4,740	4,662
Total Long-term Debt	1,551	1,555	4,755	4,755	4,755
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	1,550	1,612	1,612	1,612	1,612
Total Non-current Liabilities	3,100	3,168	6,368	6,368	6,368
Total Provisions	0	0	0	0	0
Total Liabilities	7,389	7,847	11,110	11,108	11,030
Shareholders' Equity	2,293	2,413	2,500	2,687	2,933
Minority Interests	282	255	261	267	273
Total Equity	2,575	2,668	2,761	2,955	3,207

Key Ratios

	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Revenue Growth	(9.0%)	7.5%	15.7%	5.8%	4.7%
Operating EBITDA Growth	(10.4%)	10.1%	10.3%	19.8%	4.4%
Operating EBITDA Margin	13.3%	13.6%	12.9%	14.6%	14.6%
Net Cash Per Share (S\$)	(0.42)	(0.42)	(1.55)	(1.50)	(1.43)
BVPS (S\$)	0.74	0.77	0.80	0.86	0.94
Gross Interest Cover	8.00	13.53	8.46	9.60	10.08
Effective Tax Rate	1.6%	11.1%	14.0%	14.8%	14.8%
Net Dividend Payout Ratio	89.8%	82.1%	85.2%	72.7%	67.0%
Accounts Receivables Days	58.64	50.17	47.87	50.57	50.97
Inventory Days	83.88	74.99	70.84	74.31	74.64
Accounts Payables Days	136.6	143.2	138.0	134.4	127.6
ROIC (%)	11.2%	11.6%	12.7%	8.6%	9.3%
ROCE (%)	12.3%	14.0%	11.8%	10.8%	11.4%
Return On Average Assets	6.02%	5.85%	5.41%	5.45%	5.81%

Key Drivers

	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Commercial Aerospace sales growth	N/A	0.1	0.1	0.1	0.0
Urban Solutions & Satcom sales growth	N/A	0.1	0.5	0.1	0.1
Defence & Public Security sales growth	N/A	0.1	0.1	0.0	0.0

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

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Description:	Excellent	Very Good	Good	N/A	N/A

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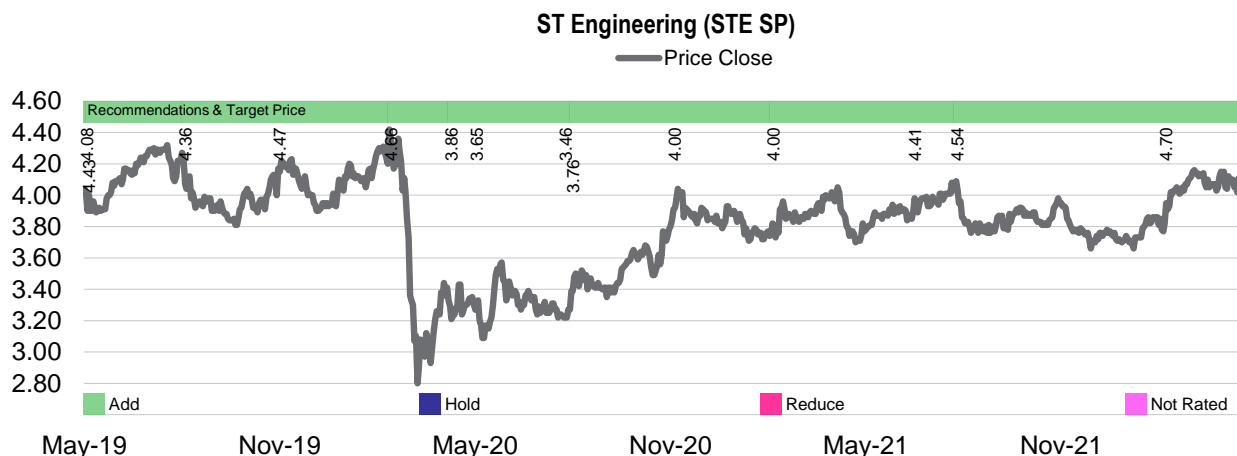
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632 companies under coverage for quarter ended on 31 March 2022		
	Rating Distribution (%)	Investment Banking clients (%)
Add	70.3%	0.8%
Hold	22.0%	0.0%
Reduce	7.8%	0.2%

Spitzer Chart for stock being researched (2 year data)



Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (Thai IOD) in 2021, Anti-Corruption 2021

ADVANC – Excellent, Certified, **AMATA** – Excellent, Certified, **ANAN** – Excellent, n/a, **AOT** – Excellent, n/a, **AP** – Excellent, Certified, **ASP** – Excellent, n/a, **AWC** – Excellent, Declared, **AU** – Good, n/a, **BAM** – Very Good, Certified, **BAY** – Excellent, Certified, **BBL** – Excellent, Certified, **BCH** – Very Good, Certified, **BCP** - Excellent, Certified, **BCPG** – Excellent, Certified, **BDMS** – Excellent, n/a, **BEAUTY** – Good, n/a, **BEM** – Excellent, n/a **BH** - Good, n/a, **BJC** – Very Good, n/a, **BLA** – Very Good, Certified, **BTS** - Excellent, Certified, **CBG** – Very Good, n/a, **CCET** – n/a, n/a, **CENTEL** – Excellent, Certified, **CHAYO** – Very Good, n/a, **CHG** – Very Good, n/a, **CK** – Excellent, n/a, **COM7** – Excellent, Certified, **CPALL** – Excellent, Certified, **CPF** – Excellent, Certified, **CPN** - Excellent, Certified, **CPNREIT** – n/a, n/a, **CRC** – Excellent, Declared, **DELTA** - Excellent, Certified, **DDD** – Excellent, n/a, **DIF** – n/a, n/a, **DOHOME** – Very Good, Declared, **DREIT** – n/a, n/a, **DTAC** – Excellent, Certified, **ECL** – Excellent, Certified, **EGCO** - Excellent, Certified, **EPG** – Excellent, Certified, **ERW** – Very Good, Certified, **GFPT** - Excellent, Certified, **GGC** – Excellent, Certified, **GLOBAL** – Excellent, n/a, **HANA** - Excellent, Certified, **HMPRO** - Excellent, Certified, **HUMAN** – Good, n/a, **ICHI** – Excellent, Certified, **III** – Excellent, Declared, **INTUCH** - Excellent, Certified, **IRPC** – Excellent, Certified, **ITD** – Very Good, n/a, **IVL** - Excellent, Certified, **JASIF** – n/a, n/a, **JKN** – n/a, Certified, **JMT** – Very Good, n/a, **KBANK** - Excellent, Certified, **KCE** - Excellent, Certified, **KEX** – Very Good, Declared, **KKP** – Excellent, Certified, **KSL** – Excellent, Certified, **KTB** - Excellent, Certified, **KTC** – Excellent, Certified, **LH** - Excellent, n/a, **LPN** – Excellent, Certified, **M** – Very Good, Certified, **MAKRO** – Excellent, Certified, **MC** – Excellent, Certified, **MEGA** – Very Good, n/a, **MINT** - Excellent, Certified, **MTC** – Excellent, Certified, **NETBAY** – Very Good, n/a, **NRF** – Very Good, Declared, **OR** – Excellent, n/a, **ORI** – Excellent, Certified, **OSP** – Excellent, n/a, **PLANB** – Excellent, Certified, **PRINC** – Very Good, Certified, **PR9** – Excellent, Declared, **PSH** – Excellent, Certified, **PTT** - Excellent, Certified, **PTTEP** – Excellent, n/a, **PTTGC** - Excellent, Certified, **QH** – Excellent, Certified, **RAM** – n/a, n/a, **RBF** – Very Good, n/a, **RS** – Excellent, Declared, **RSP** – Good, n/a, **S** – Excellent, n/a, **SAK** – Very Good, Declared, **SAPPE** – Very Good, Certified, **SAWAD** – Very Good, n/a, **SCB** - Excellent, Certified, **SCC** – Excellent, Certified, **SCGP** – Excellent, Declared, **SECURE** – n/a, n/a, **SHR** – Excellent, n/a, **SIRI** – Excellent, Certified, **SPA** – Very Good, n/a, **SPALI** - Excellent, Certified, **SPRC** – Excellent, Certified, **SSP** - Good, Certified, **STEC** – Excellent, n/a, **SVI** – Excellent, Certified, **SYNEX** – Very Good, Certified, **TCAP** – Excellent, Certified, **THANI** – Excellent, Certified, **TIDLOR** – n/a, Certified **TISCO** - Excellent, Certified, **TKN** – Very Good, n/a, **TOP** - Excellent, Certified, **TRUE** – Excellent, Certified, **TTB** - Excellent, Certified, **TU** – Excellent, Certified, **TVO** – Excellent, Certified, **VGI** – Excellent, Certified, **WHA** – Excellent, Certified, **WHART** – n/a, n/a, **WICE** – Excellent, Certified, **WORK** – Good, n/a.

- CG Score 2021 from Thai Institute of Directors Association (IOD)

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Add	The stock's total return is expected to exceed 10% over the next 12 months.
Hold	The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
Reduce	The stock's total return is expected to fall below 0% or more over the next 12 months.
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Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.
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Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.