

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

15 Aug 2022

BUY

Last Traded Price (12 Aug 2022): S\$4.06 (STI : 3,269.27)

Price Target 12-mth: S\$4.70 (16% upside)

Analyst

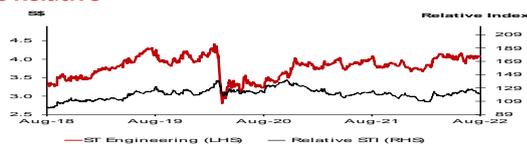
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What's New

- 1H22 results in line with estimates, absence of government grants offset by operating recovery and cost savings
- EBIT margins improve sequentially; commercial aerospace recovery on track
- TransCore acquisition will be accretive FY23 onwards, boosting growth trajectory
- Maintain BUY with TP of S\$4.70

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2020A	2021A	2022F	2023F
Revenue	7,158	7,693	8,995	9,733
EBITDA	957	1,077	1,254	1,405
Pre-tax Profit	534	638	737	845
Net Profit	522	571	582	674
Net Pft (Pre Ex.)	522	571	582	674
Net Pft Gth (Pre-ex) (%)	(11.9)	9.3	2.1	15.7
EPS (S cts)	16.7	18.3	18.7	21.6
EPS Pre Ex. (S cts)	16.7	18.3	18.7	21.6
EPS Gth Pre Ex (%)	(12)	9	2	16
Diluted EPS (S cts)	16.7	18.3	18.7	21.6
Net DPS (S cts)	15.0	15.0	16.0	16.0
BV Per Share (S cts)	73.4	77.3	80.9	86.5
PE (X)	24.3	22.2	21.8	18.8
PE Pre Ex. (X)	24.3	22.2	21.8	18.8
P/Cash Flow (X)	8.3	11.4	19.3	13.1
EV/EBITDA (X)	14.9	13.2	14.3	12.6
Net Div Yield (%)	3.7	3.7	3.9	3.9
P/Book Value (X)	5.5	5.3	5.0	4.7
Net Debt/Equity (X)	0.5	0.5	1.8	1.6
ROAE (%)	23.1	24.3	23.6	25.8
Earnings Rev (%)			1	(1)
Consensus EPS (S cts):			18.3	20.6
Other Broker Recs:		B: 11	S: 1	H: 2

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

Aerospace recovery encouraging

Investment Thesis

Growth trajectory becoming exciting. We expect a CAGR close to 10% 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 a 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 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.

Valuation:

Our unchanged TP of S\$4.70 is based on a blended valuation framework (P/E, dividend yield, and DCF). Stock offers decent yield of ~4% as well as potential to deliver stronger growth.

Where we differ:

We are more bullish on FY23F earnings compared to consensus (likely related to the pace of aerospace recovery), but we are more bullish on 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)	3,116
Mkt. Cap (\$m/US\$m)	12,652 / 9,224
Major Shareholders (%)	
Temasek Holdings Pte Ltd (%)	51.6
Capital Group Cos Inc/The	5.0
Free Float (%)	43.4
3m Avg. Daily Val (US\$m)	13.8
GIC Industry: Industrials / Capital Goods	



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WHAT'S NEW

1H22 in line, aerospace recovery encouraging

1H22 net profit of S\$279.9m (+2.0% h-o-h, -3.8% y-o-y) was broadly in line with expectations, accounting for 49% of the consensus's full-year estimate. If we were to exclude one-off costs, mainly related to TransCore transaction and integration costs, net profit would have been up 4.0% y-o-y to S\$307.0m. Group revenue in 1H22 was up by 17.0% y-o-y to S\$4,269.9m, driven by broad-based growth across all business divisions and start of contribution from TransCore (acquired in March-22).

Absence of government grants support not felt. Business recovery and cost savings of S\$104m, coupled with a one-off pension restructuring gain of S\$72m in 1HFY22 more than offset the absence of the S\$125m in government grants related to COVID-19-related support measures received by STE in 1H21. Excluding transaction and integration costs for TransCore, government support and one-off pension restructuring gain, group core EBIT would have been S\$333m in 1HFY22, up 45% y-o-y, which is an encouraging sign of recovery, especially driven by the Commercial Aerospace division. The pension restructuring gain also occurred in an overseas subsidiary in the Commercial Aerospace division, but even without this impact, Commercial Aerospace margins were tracking above our estimates (core EBIT margin of around 8% compared to our expectations of around 6%). This helped offset the lack of growth momentum in Urban Solutions & Satcoms division performance in 1H22.

The group appears to be coping well with rising cost pressures. Core EBIT margin climbed sequentially to 7.7% in 1HFY22 (from 5.9% in 2HFY21 and 6.2% in 1HFY21).

Commercial aerospace segment saw significant top line growth to S\$730m (+25% y-o-y) in 2QFY22, representing 93.4% of the pre-pandemic levels. Momentum in the division continues to be strong, given robust demand in STE's OEM operations (nacelles and P2F); MRO revenue has been recovering at a relatively slower pace, especially on the engines and components MRO side, but should continue to rebound as global flight traffic continues to normalise to pre-COVID19 levels.

TransCore comes into the picture in 2Q22 but earnings accretion won't be felt until FY23. Urban Solutions & Satcoms division revenue grew by 54.8% q-o-q and 74.2%

y-o-y to S\$460m in 2QFY22, driven by the full quarter contribution of TransCore during the period, though tempered by lower revenue from STE's satcom business due to semiconductor chip shortages.

Defence & Public Security (DPS) segment revenue was flat q-o-q at S\$1,046m in 2QFY22; defence aerospace, digital systems and cyber and land systems sub-segments registered healthy 7-12% growth, but the marine segment saw a marginal decline due to supply chain bottlenecks.

Order backlog of S\$22.2bn as of June-22 represents yet another new high for the group, with an implied book-to-bill ratio of 2.6x. Management guided for S\$4.6bn worth of contracts to be delivered in 2H22, which suggests there could be a slight upside to consensus' revenue and earnings estimates for FY22F. STE clinched S\$3.1bn worth of new contracts in 2Q22, bringing YTD contract wins to S\$5.5bn and tracking well to beat FY21 full year order wins of S\$11.7m, given the usually stronger second half.

Quarterly dividend of 4.0Scts per share was announced, as per changes to their dividend policy to quarterly distributions from semi-annual distributions. Full-year DPS of 16.0Scts per share in FY22 represents a dividend yield of around 4% based on current share price levels. Despite higher capex and related borrowings to fund the TransCore acquisition, STE continues to maintain high credit ratings, implying relatively low funding costs (spreads) in a high interest rate environment. STE can also choose to access equity capital markets if debt funding window is unfavourable for long.

More than just a safe haven stock. ST Engineering has historically often been considered a safe haven stock, outperforming volatile markets like we are in today, owing to its defensive nature. And that story still holds, with a secure dividend yield of around 4% at current prices. But the added kicker now is the growth. We see two big drivers to 2023 and beyond – inorganic growth (TransCore) and the recovery we are seeing in commercial aerospace – and growth momentum won't stall beyond that. With continued investments in R&D and strategic acquisitions, STE remains well on top of crucial global needs of sustainability, digitalisation, urbanisation, and security, which will drive growth via 1) Passenger to

ST Engineering

Freighter (P2F) conversions pipeline, 2) smart city projects, 3) expansion in cloud, AI analytics, and cybersecurity and 4) international defence contract wins. **Maintain BUY with an unchanged TP of S\$4.70.**

security sectors. The company has over the years diversified its businesses and geographies.

Company Background

ST Engineering (STE) is an integrated engineering group in the commercial aerospace, smart city, defence, and public

Interim Income Statement (S\$m)

FY Dec	1H2021	2H2021	1H2022	% chg y-o-y	% chg h-o-h
Revenue	3,651	4,042	4,270	17.0	5.6
Cost of Goods Sold	(2,906)	(3,251)	(3,421)	17.7	5.2
Gross Profit	744	791	849	14.0	7.4
Other Oper. (Exp)/Inc	(401)	(471)	(475)	18.5	0.8
Operating Profit	344	319	374	8.8	17.1
Other Non Opg (Exp)/Inc	0	0	0	-	-
Associates & JV Inc	12	4	11	(5.6)	148.3
Net Interest (Exp)/Inc	(15)	(26)	(33)	(118.8)	(29.7)
Exceptional Gain/(Loss)	0	0	0	-	-
Pre-tax Profit	340	298	351	3.3	17.9
Tax	(46)	(24)	(69)	48.6	181.7
Minority Interest	3	1	(2)	nm	nm
Net Profit	296	274	280	(5.4)	2.0
Net profit bef Except.	296	274	280	(5.4)	2.0
EBITDA	542	512	612	12.9	19.6
Margins (%)					
Gross Margins	20.4	19.6	19.9		
Opg Profit Margins	9.4	7.9	8.8		
Net Profit Margins	8.1	6.8	6.6		

Source of all data: Company, DBS Bank

Valuation table (Blended valuation summary)

Method	Basis (FY22/23)	Parameter	Value (S\$m)	Remarks
P/E	628.1	24.0	15,074	+2 S.D. valuations given record orderbook
Div Yield	16.0	3.6	13,844	Based on STI dividend yield
DCF		WACC 6.0%	15,199	
Average			14,706	
No of shares			3,115	
Value per share			4.70	

Source: DBS Bank estimates

ST Engineering

Segmental Breakdown

FY Dec	2020A	2021A	2022F	2023F
Revenues (\$m)				
Commercial Aerospace	2,332	2,465	2,814	3,015
Urban Solutions & Defence & Public	1,101	1,191	1,796	2,098
	3,725	4,038	4,385	4,621
Others				
Total	7,158	7,694	8,995	9,733
EBIT (\$m)				
Commercial Aerospace	80.9	182	297	241
Urban Solutions & Defence & Public	31.4	25.8	79.2	212
	484	466	449	499
Others				
Total	596	674	825	952
EBIT Margins (%)				
Commercial Aerospace	3.5	7.4	10.6	8.0
Urban Solutions & Defence & Public	2.9	2.2	4.4	10.1
	13.0	11.5	10.2	10.8
Others				
Total	8.3	8.8	9.2	9.8

Includes nine-month contribution from TransCore acquisition

Includes S\$72m gains on pension restructuring

Income Statement (\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	7,868	7,158	7,693	8,995	9,733
Cost of Goods Sold	(6,233)	(5,631)	(6,158)	(7,259)	(7,738)
Gross Profit	1,635	1,527	1,535	1,736	1,995
Other Opng (Exp)/Inc	(930)	(980)	(872)	(911)	(1,043)
Operating Profit	706	548	663	825	952
Other Non Opng (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	39.0	30.4	16.0	24.0	28.8
Net Interest (Exp)/Inc	(35.3)	(43.8)	(41.1)	(112)	(136)
Exceptional Gain/(Loss)	(14.2)	0.0	0.0	0.0	0.0
Pre-tax Profit	695	534	638	737	845
Tax	(103)	(8.8)	(70.6)	(140)	(147)
Minority Interest	(14.7)	(3.8)	3.57	(14.9)	(24.4)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	578	522	571	582	674
Net Profit before Except.	592	522	571	582	674
EBITDA	1,113	957	1,077	1,254	1,405
Growth					
Revenue Gth (%)	17.5	(9.0)	7.5	16.9	8.2
EBITDA Gth (%)	20.4	(14.0)	12.5	16.4	12.1
Opg Profit Gth (%)	11.8	(22.4)	21.0	24.5	15.4
Net Profit Gth (Pre-ex) (%)	12.4	(11.9)	9.3	2.1	15.7
Margins & Ratio					
Gross Margins (%)	20.8	21.3	20.0	19.3	20.5
Opg Profit Margin (%)	9.0	7.7	8.6	9.2	9.8
Net Profit Margin (%)	7.3	7.3	7.4	6.5	6.9
ROAE (%)	25.9	23.1	24.3	23.6	25.8
ROA (%)	6.8	5.4	5.6	4.6	4.5
ROCE (%)	12.2	8.9	9.4	8.1	7.7
Div Payout Ratio (%)	81.0	89.8	82.1	85.8	74.2
Net Interest Cover (x)	20.0	12.5	16.1	7.4	7.0

Source: Company, DBS Bank

ST Engineering

Interim Income Statement (\$m)

FY Dec	1H2020	2H2020	1H2021	2H2021	1H2022
Revenue	3,572	3,586	3,651	4,042	4,270
Cost of Goods Sold	(2,835)	(2,796)	(2,906)	(3,251)	(3,421)
Gross Profit	737	791	744	791	849
Other Oper. (Exp)/Inc	(437)	(543)	(401)	(471)	(475)
Operating Profit	300	248	344	319	374
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	13.8	16.6	11.6	4.40	10.9
Net Interest (Exp)/Inc	(27.7)	(16.2)	(15.3)	(25.8)	(33.5)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	286	248	340	298	351
Tax	(31.1)	22.3	(46.2)	(24.4)	(68.7)
Minority Interest	2.09	(5.9)	2.54	1.03	(2.4)
Net Profit	257	264	296	274	280
Net profit bef Except.	257	264	296	274	280
EBITDA	510	447	542	512	612

Growth

Revenue Gth (%)	(18.0)	0.4	1.8	10.7	5.6
EBITDA Gth (%)	(15.5)	(12.4)	21.4	(5.6)	19.6
Opg Profit Gth (%)	(23.0)	(17.6)	38.8	(7.1)	17.1
Net Profit Gth (%)	(16.6)	2.7	12.0	(7.3)	2.0

Margins

Gross Margins (%)	20.6	22.0	20.4	19.6	19.9
Opg Profit Margins (%)	8.4	6.9	9.4	7.9	8.8
Net Profit Margins (%)	7.2	7.4	8.1	6.8	6.6

Balance Sheet (\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	1,805	1,757	1,794	5,309	5,185
Invts in Associates & JVs	453	469	483	477	476
Other LT Assets	2,624	2,747	2,882	2,882	2,882
Cash & ST Invts	454	731	816	715	912
Inventory	2,558	2,825	2,988	3,493	3,780
Debtors	1,246	1,048	1,067	1,285	1,390
Other Current Assets	381	388	486	486	486
Total Assets	9,521	9,964	10,516	14,648	15,112
ST Debt	1,869	496	560	560	560
Creditor	2,013	2,218	2,613	2,811	3,042
Other Current Liab	1,565	1,574	1,507	1,712	1,746
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	2,527	2,701
Minority Interests	269	282	255	270	295
Total Cap. & Liab.	9,521	9,964	10,516	14,648	15,112
Non-Cash Wkg. Capital	608	468	421	741	869
Net Cash/(Debt)	(1,884)	(1,316)	(1,299)	(5,001)	(4,804)
Debtors Turn (avg days)	55.3	58.5	50.2	47.7	50.2
Creditors Turn (avg days)	119.6	147.0	153.1	144.4	146.0
Inventory Turn (avg days)	149.7	187.0	184.2	172.6	181.5
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

ST Engineering

Cash Flow Statement (\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	695	534	638	737	845
Dep. & Amort.	368	379	398	404	424
Tax Paid	(103)	(78.0)	(112)	(140)	(147)
Assoc. & JV Inc/(loss)	(39.0)	(30.4)	(16.0)	(24.0)	(28.8)
Chg in Wkg.Cap.	(439)	598	137	(321)	(127)
Other Operating CF	107	131	69.6	0.0	0.0
Net Operating CF	590	1,533	1,114	657	967
Capital Exp.(net)	(1,340)	(200)	(296)	(3,920)	(300)
Other Invt.(net)	0.0	(7.3)	(14.3)	0.0	0.0
Invt. 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	(101)	197
Opg CFPS (S cts)	33.0	30.0	31.3	31.3	35.0
Free CFPS (S cts)	(24.0)	42.7	26.2	(104)	21.3

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
4:	28 Feb 22	3.82	4.70	BUY
5:	19 Mar 22	4.07	4.70	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

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

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