

COMPANY RESULTS

Singapore Technologies Engineering (STE SP)

1H22: Core Profit Missed; Looking Forward To A Better 2H

STE's 1H22 headline net profit of S\$280m was helped by a number of one-off items. 1H22 core net profit of S\$202m was a miss, at 38% of our full-year forecast. 2H22 core performance should improve from 1H22, driven by the continued recovery of the CA segment and potential higher project delivery by the DPS segment. Cost pressure would weigh on STE's core profitability in the medium term. We cut 2022-24 core net profit forecasts by 7.4-9.6%. Maintain BUY with a lower target price of S\$4.40.

RESULTS

- 1H22 headline net profit helped by one-off items.** Singapore Technologies Engineering's (STE) 1H22 reported net profit of S\$280m (-5.5% yoy) was overall positively affected by a number of one-off items, with some major ones being: a) a S\$72m pension restructuring gain (pre-tax), b) favourable fair value changes on corporate venture investments and divestment gains on associates and property, plant and equipment (PPE) totalling S\$22.3m, c) S\$13.4m gain from disposal of subsidiaries, and d) transaction costs and integration expenses of S\$21m (pre-tax) related to TransCore (acquisition completed in Mar 22).
- Core performance below expectations.** Excluding all one-off gains/expenses, STE's core net profit of S\$202m (by our estimate) came in below expectations, at 38%/35% of our/consensus 2022 full-year projection. 1H22 was almost free of government support (only a minor S\$0.5m in 1H22 vs S\$125m in 1H21). On a yoy basis, core net profit (excluding government grants) rose 38.7% on the back of significant profitability recovery in the Commercial Aerospace (CA) segment, higher contribution from Defence & Public Security (DPS) segment, offset by weaker performance in the Urban Solutions & Satcom (USS) segment. Group revenue rose 17% yoy to S\$4.27b in 1H22 (1H21: S\$3.65b).
- Strong CA performance...** CA revenue rose 23.6% yoy to S\$1.40b in 1H22 (1H21: S\$1.14b), driven by increased Maintenance Repair and Overhaul (MRO) service volume and higher nacelle delivery as the CA segment continues to recover. Excluding the one-off pension restructuring gain, CA operating profit stood at S\$103m in 1H22, which exceeded our expectations at 88% of our full-year projection. The outperformance was due to the faster-than-expected recovery in operating margin (1H22: 7.3%), which was in turn driven by business volume recovery coupled with a favourable operating margin.
- ...offset by weakness in USS.** USS revenue rose 43.5% yoy to S\$0.76b in 1H22 (1H21: S\$0.53b), driven by fresh contribution from TransCore but partly offset by lower revenue contribution from STE's satcom business. Excluding one-off transaction and integration expenses related to TransCore, USS operating profit was S\$11m in 1H22, significantly below our expectations at only 11% of our full-year forecast. According to management, the group's satcom and IoT businesses were adversely impacted by the global chip shortage.

KEY FINANCIALS

Year to 31 Dec (\$m)	2020	2021	2022F	2023F	2024F
Net turnover	7,158	7,693	9,412	9,996	10,400
EBITDA	949	1,044	1,234.4	1,320.4	1,385.0
Operating profit	570	646	741	792	846
Net profit (reported)	522	571	541	568	603
Core net profit	182	321	476	568	603
EPS (S\$ cent)	17.1	16.8	15.2	18.1	19.2
Core PE (x)	70.1	39.6	26.7	22.4	21.1
P/B (x)	5.5	5.2	5.6	5.4	5.2
EV/EBITDA (x)	14.5	13.1	14.2	13.4	12.7
Dividend yield (%)	3.7	3.7	3.9	3.9	3.9
Net margin (%)	7.3	7.4	5.8	5.7	5.8
Net debt/(cash) to equity (%)	29.7	26.8	180.2	182.2	170.3
ROE (%)	23.1	24.3	23.1	24.7	25.2
Consensus net profit	-	-	575	661	720
UOBKH/Consensus (x)	-	-	0.83	0.86	0.84

Source: STE, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	S\$4.06
Target Price	S\$4.40
Upside	+8.5%
(Previous TP)	S\$4.60)

COMPANY DESCRIPTION

A global technology, defence and engineering group with a diverse portfolio of businesses across the aerospace, smart city, defence and public security segments.

STOCK DATA

GICS sector	Industrials
Bloomberg ticker:	STE SP
Shares issued (m):	3,116.3
Market cap (S\$ m):	12,652.2
Market cap (US\$m):	9,225.8
3-mth avg daily t'over (US\$m):	14.0

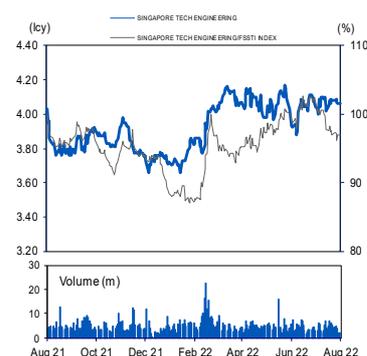
Price Performance (%)

52-week high/low	S\$ 4.17/S\$ 3.66				
1mth	3mth	6mth	1yr	YTD	
(1.0)	2.0	5.2	(0.5)	8.0	

Major Shareholders

Temasek Hldgs	51.7
FY22 NAV/Share (S\$)	0.73
FY22 Net Debt/Share (S\$)	1.64

PRICE CHART



Source: Bloomberg

ANALYST(S)

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- DPS profitability weighed by cost pressure.** DPS revenue rose 6.1% yoy to S\$2.11b in 1H22 (1H21: S\$1.99b), driven by higher contribution from Land Systems, Digital Systems & Cyber and Defence Aerospace subsegments but partly offset by slightly lower contribution from the Marine subsegment. DPS operating profit of S\$214m (+2.3% yoy) was below our expectations at 38% of our full-year forecast. We believe the miss was attributable to: a) timing of project delivery (we expect higher project delivery in 2H22), and b) lower-than-expected operating margin (9.3% in 1H22 vs our 2022 projection of 10.8%) due to cost pressures related to supply chain disruption and higher energy costs.
- Net gearing elevated post the TransCore acquisition.** Net gearing (excluding lease liabilities) stood at 194% at end-1H22 by our estimate vs 27% at end-21, due to the debt financing for the acquisition of TransCore (acquisition completed in Mar 22). According to management, 55% of the borrowings are based on fixed interest rates. Rising interest cost pressure for the floating portion has been duly reflected by our financial projection (we forecast interest expenses of S\$112m-142m in 2022-24, vs S\$45m in 2021).
- Second interim dividend of 4 S cents.** In line with the group's guided policy, STE declared a second interim dividend of 4 S cents per share, payable on 2 Sep 22.

STOCK IMPACT

- Record-high orderbook of S\$22.2b.** STE's orderbook rose further to S\$22.2b at end-1H22 (end-1Q22: S\$21.3b, end-2021: S\$19.3b). STE won S\$3.1b worth of contracts in 2Q22 (1Q22: S\$2.4b), comprising S\$1.2b contracts for CA, S\$0.4b for USS and S\$1.4b for DPS. We expect STE's revenue growth to be underpinned by its strong orderbook in the medium term.
- Expecting better core performance in 2H22.** We expect STE's core profitability to improve in 2H22, driven by: a) continued recovery in the CA (STE plans increase nacelle production to 53 sets per month by end-22 vs an average of 48 sets in 1H22), and b) expected higher project delivery by the DPS segment. STE guided to deliver S\$4.6b worth of projects from its orderbook in 2H22; this is S\$1b higher compared with its project delivery guidance for 2H21 a year ago.
- Some margin pressure likely in the near-medium term.** While we expect STE's core profitability to improve going forward driven by the CA business recovery/growth across all three segments, we note that supply chain issue and inflationary pressure would continue to weigh on STE's margins. Management guided that the group would also continue to incur integration costs of S\$10-20m p.a. in the next two years, related to the post-acquisition integration of TransCore.

EARNINGS REVISION/RISKS

- Lower 2022-24 core net profit forecasts by 7.4-9.6%.** The cuts were mainly due to lower profit forecasts for USS (due to integration costs of TransCore) and DPS (lowered margin assumptions due to inflation pressure), partly offset by higher profit forecast for CA (raised steady-state margin assumptions).

EARNINGS FORECAST UPDATE

S\$m	Old			New			Change		
	FY22F	FY23F	FY24F	FY22F	FY23F	FY24F	FY22F	FY23F	FY24F
Core EBIT	729	866	920	678	792	846	-6.9%	-8.5%	-8.0%
- CA	117	221	256	221	253	286	+89.9%	+14.3%	+11.8%
- USS	100	123	133	43	89	93	-57.3%	-27.3%	-30.2%
- DPS	512	522	531	437	450	468	-14.7%	-13.8%	-12.0%
Core net profit	526	614	651	476	568	603	-9.6%	-7.4%	-7.4%
Reported net profit	526	614	651	541	568	603	+2.9%	-7.4%	-7.4%

Source: UOB Kay Hian

- Risks include** negative margin surprises due to project cost overrun and failure to pass down inflationary cost pressure.

VALUATION/RECOMMENDATION

- Maintain BUY with a lower DCF-based target price of S\$4.40.** STE's current price of S\$4.06 implies 2023F core PE 22.4x, or 0.6SD above its historical mean of 21.3x.

SHARE PRICE CATALYST

- Core profitability growth on CA business recovery/growth and higher DPS project deliveries.**

SUMMARY OF 1H22 RESULTS

Year to 31 Dec (S\$m)	1H22	1H21	yoy % chg	prev. FY22 proj.	1H22 as % of prev. FY22 proj.
Revenue	4,270	3,651	+17.0	9,557	44.7%
- CA	1,404	1,136	+23.6	2,950	47.6%
- USS	757	528	+43.5	1,864	40.6%
- DPS	2,108	1,987	+6.1	4,743	44.5%
Core EBIT	287	323	-11.2	729	39.4%
- CA	103	4	+27x	117	88.3%
- USS	11	13	-11.5	100	11.3%
- DPS	195	191	+2.3	512	38.1%
Headline net profit	280	296	-5.4	526	53.2%
Core net profit	202	145	+38.7	526	38.3%
Core EBIT margin (%)	6.7	8.9	-2.1ppt	7.6	
- CA	7.3	0.3	+7.0ppt	3.9	
- USS	1.5	2.4	-0.9ppt	5.4	
- DPS	9.3	9.6	-0.3ppt	10.8	
Core net profit margin	4.7	4.0	+0.7ppt	5.5	

* Core figures exclude government grants and other one-off items
Source: STE, UOB Kay Hian

ORDERBOOK AT HISTORICAL HIGH



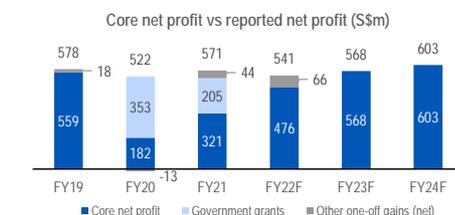
Source: STE

CONTRACT WINS



Source: STE

DECOMPOSING PROFITABILITY BETWEEN CORE AND ONE-OFFS



Source: STE, UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (\$m)	2021	2022F	2023F	2024F
Net turnover	7,692.9	9,411.9	9,995.8	10,400.0
EBITDA	1,044.0	1,234.4	1,320.4	1,385.0
Deprec. & amort.	398.1	493.6	528.3	538.5
EBIT	645.9	740.8	792.1	846.5
Total other non-operating income	11.7	13.4	0.0	0.0
Associate contributions	16.0	22.0	30.0	39.0
Net interest income/(expense)	(36.0)	(107.3)	(125.8)	(137.5)
Pre-tax profit	637.6	668.8	696.2	748.0
Tax	(70.6)	(122.9)	(113.3)	(120.5)
Minorities	3.6	(4.7)	(14.7)	(24.7)
Net profit	570.5	541.2	568.3	602.7
Net profit (adj.)	321.4	475.5	568.3	602.7

BALANCE SHEET

Year to 31 Dec (\$m)	2021	2022F	2023F	2024F
Fixed assets	2,352.4	2,458.9	2,514.6	2,572.5
Other LT assets	2,806.8	6,446.1	6,386.2	6,326.4
Cash/ST investment	453.8	730.6	815.9	679.4
Other current assets	4,902.7	4,837.5	4,970.9	5,138.5
Total assets	10,515.7	14,473.1	14,687.7	14,716.8
ST debt	559.9	574.5	574.5	574.5
Other current liabilities	4,119.8	4,218.8	4,395.6	4,512.0
LT debt	1,555.3	5,255.9	5,225.5	5,025.5
Other LT liabilities	1,612.5	1,911.3	1,911.3	1,911.3
Shareholders' equity	2,412.8	2,269.0	2,339.0	2,443.6
Minority interest	255.5	243.6	241.8	249.9
Total liabilities & equity	10,515.7	14,473.1	14,687.7	14,716.8

CASH FLOW

Year to 31 Dec (\$m)	2021	2022F	2023F	2024F
Operating	1,114.3	1,129.8	967.4	1,269.5
Pre-tax profit	637.6	668.8	696.2	748.0
Tax	(112.4)	(122.9)	(113.3)	(120.5)
Deprec. & amort.	398.1	493.6	528.3	538.5
Associates	(16.0)	(22.0)	(30.0)	(39.0)
Working capital changes	137.5	0.0	(244.7)	0.0
Other operating cashflows	69.6	112.3	130.8	142.5
Investing	(413.7)	(4,044.9)	(421.7)	(424.9)
Capex (maintenance)	(428.8)	(433.2)	(451.7)	(463.9)
Investments	(7.3)	(3,633.6)	0.0	0.0
Others	22.5	22.0	30.0	39.0
Financing	(615.0)	2,778.5	(748.5)	(929.8)
Dividend payments	(467.9)	(685.0)	(498.2)	(498.2)
Proceeds from borrowings	900.7	3,665.0	0.0	0.0
Loan repayment	(877.0)	0.0	(30.4)	(200.0)
Others/interest paid	(170.9)	(201.5)	(220.0)	(231.7)
Net cash inflow (outflow)	85.6	(136.5)	(202.8)	(85.3)
Beginning cash & cash equivalent	729.5	815.9	679.4	476.5
Changes due to forex impact	0.9	0.0	0.0	0.0
Ending cash & cash equivalent	815.9	679.4	476.5	391.2

KEY METRICS

Year to 31 Dec (%)	2021	2022F	2023F	2024F
Profitability				
EBITDA margin	13.6	13.1	13.2	13.3
Pre-tax margin	8.3	7.1	7.0	7.2
Net margin	7.4	5.8	5.7	5.8
ROA	5.6	4.3	3.9	4.1
ROE	24.3	23.1	24.7	25.2
Growth				
Turnover	7.5	22.3	6.2	4.0
EBITDA	10.1	18.2	7.0	4.9
Pre-tax profit	19.3	4.9	4.1	7.4
Net profit (reported)	9.3	(5.1)	5.0	6.1
Core net profit	77.0	48.0	19.5	6.1
EPS	77.0	48.1	19.5	6.1
Leverage				
Debt to total capital	44.2	69.9	69.2	67.5
Debt to equity	79.3	232.0	224.7	207.9
Net debt/(cash) to equity	26.8	180.2	182.2	170.3
Interest cover (x)	29.0	11.7	10.7	10.2

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