

# 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

14 Nov 2023

### BUY

Last Traded Price (10 Nov 2023): S\$3.76 (STI : 3,106.68)

Price Target 12-mth: S\$4.50 (20% upside) (Prev S\$4.20)

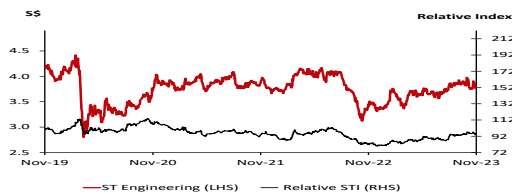
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#### What's New

- 3Q23 revenue topped expectations slightly
- Trim FY23F net profit by 1.3% as satcom division to weigh on near-term profits
- Earnings momentum to accelerate from FY24F across all segments
- Maintain BUY with higher TP of S\$4.50

#### Price Relative



#### Forecasts and Valuation

FY Dec (S\$m)	2022A	2023F	2024F	2025F
Revenue	9,035	9,906	10,396	10,872
EBITDA	1,265	1,469	1,653	1,789
Pre-tax Profit	597	711	850	987
Net Profit	535	574	686	797
Net Pft (Pre Ex.)	548	574	686	797
Net Pft Gth (Pre-ex) (%)	(3.9)	4.6	19.6	16.1
EPS (S cts)	17.1	18.4	22.0	25.5
EPS Pre Ex. (S cts)	17.6	18.4	22.0	25.5
EPS Gth Pre Ex (%)	(4)	5	20	16
Diluted EPS (S cts)	17.1	18.4	22.0	25.5
Net DPS (S cts)	16.0	16.0	16.0	18.0
BV Per Share (S cts)	76.8	79.2	85.1	94.7
PE (X)	21.9	20.5	17.1	14.7
PE Pre Ex. (X)	21.4	20.5	17.1	14.7
P/Cash Flow (X)	17.4	9.3	10.9	9.1
EV/EBITDA (X)	14.2	12.0	10.6	9.5
Net Div Yield (%)	4.3	4.3	4.3	4.8
P/Book Value (X)	4.9	4.7	4.4	4.0
Net Debt/Equity (X)	2.2	2.1	1.9	1.5
ROAE (%)	22.2	23.6	26.7	28.4
Earnings Rev (%)		(1)	0	N/A
Consensus EPS (S cts):		18.8	21.5	24.2
Other Broker Recs:		B: 11	S: 0	H: 3

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

### Satcom weakness to weigh on near-term profits

#### Investment Thesis:

STE remains well on top of crucial global needs of digitalisation, urbanisation, sustainability, and security. With continued investments in R&D and strategic acquisitions, key focus will be on 1) the strong ramp-up in Airbus 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; project double digit earnings CAGR over the medium-term. STE's order backlog held steady at S\$27.5bn (up 20% from end-FY22 levels) as of Sep-23, on healthy new order wins of S\$11.8bn in 9M23. Despite the drag to earnings from higher interest expenses, we expect STE's net earnings to grow at a 13% CAGR between FY22-25. This growth is expected to be driven by inorganic growth from TransCore and organic expansion across all business segments, along with strengthening operating margins as STE benefits from increased operational leverage and portfolio high-grading & optimisation.

#### No longer just a defensive play, but also a compelling growth story.

Historically perceived as a defensive stalwart with stable dividends and limited growth, STE has transformed its narrative post-2018. The group has not only pursued strategic M&A to enhance and diversify its offerings but has also intensified its own organic investments into future growth areas. These proactive steps position STE to achieve mid-single-digit revenue growth over the long haul, in our view.

Maintain BUY with higher TP of S\$4.50. While STE's share price has been trending sideways for some time, we believe it is on the cusp of a breakout as the company shifts back into growth mode starting from FY24F (net profit growth of 15-20% vs 3-5% in FY23F). A potential increase in its dividends could also catalyse a re-rating.

#### Key Risks

1) Deeper than expected recession scenario in the developed economies of the west could dent earnings outlook, as STE derives a significant amount of revenue from the US (23%) and Europe (20%), and 2) prolonged normalisation of air traffic could impede recovery in its commercial aerospace segment.

#### At A Glance

Issued Capital (m shrs)	3,118
Mkt. Cap (S\$m/US\$m)	11,725 / 8,618
Major Shareholders (%)	
Temasek Holdings Pte Ltd	51.1
Free Float (%)	48.3
3m Avg. Daily Val (US\$m)	10.8
GIC Industry: Industrials / Capital Goods	

**WHAT'S NEW****3Q23 revenue slightly above expectations; satcom to weigh on FY23F earnings**

**Slightly better-than-expected top line growth.** Group revenue came in at S\$2.43bn (-5.5% q-o-q, +13.0% y-o-y), with 9MFY23 revenue of S\$7.3bn representing 75% of the street's full-year estimate, marginally exceeding expectations. Growth was seen across all three segments, with the commercial aerospace segment achieving the strongest growth of 26.5% y-o-y to S\$982m in 3QFY23, propelled by growth in both MRO and OEM businesses. The urban solutions and satcom division also registered healthy top-line growth of 12.5% y-o-y, driven by inorganic growth from TransCore, but offset from sustained softness in its satcom business. Meanwhile, the defence and public security segment booked a modest gain of 2.2% y-o-y.

**Orderbook remained near its peak with 3Q23 contract wins of S\$2.2bn.** STE experienced a slight decrease in its order book to S\$27.5bn as of September 2023, down from S\$27.7bn in the previous quarter, reflecting a return to normalcy following an exceptionally strong first half of the year. Management has guided for S\$2.5bn to be executed from the order book in 4Q23, which signals potential for exceeding the consensus' full-year revenue forecast of S\$9.8bn, especially considering the high likelihood of additional spot work during the period.

**Commercial aerospace segment poised for further growth as air traffic continues to rebound.** While STE's hangars have been operating at maximum capacity for some time, several new hangars are scheduled to come online in the next few years, including one in Guangzhou in 1Q24, and others in Ezhou and Changi Creek in 2025, as well as Pensacola in 2025-2026. Unfortunately, the issues with P&W GTF engines are unlikely to result in significant additional work for STE. However, utilisation for the group's engine and component shops should continue to increase as air traffic volumes grow. STE's OEM business is also performing in line with expectations, as the group scales up nacelle production to meet Airbus's requirements. Management has indicated that segment margins are improving due to greater economies of scale, and its passenger-to-freighter conversion program is on track to turn EBIT positive this year and may achieve a mid-to-high single-digit margin by next year. Nonetheless, competitive pricing and inflationary pressures, affecting both labor and the supply of parts and components, continue to pose challenges for margin enhancement.

**Urban solutions & satcom (USS) division to achieve lower EBIT compared to FY22 due to satcom weakness.** TransCore's New York Congestion project is progressing well, and remains on track to become earnings accretive in FY24F. Nevertheless, STE has revised its EBIT forecast for this segment, expecting it to remain profitable but at a lower level than in 2022 due to ongoing challenges in the satcom business. Management has noted that revenue growth in satcom has fallen short of expectations, which they attribute to an unpredictable demand landscape. Additionally, the group is still actively pursuing restructuring and transformation of the business to maximise efficiency and reduce costs.

**More international defence wins on the horizon?** The group has secured international defence contract wins of c.S\$250m in 9M2023, and continues to see numerous opportunities as more countries look to raise their defence spending in light of recent geopolitical tensions. In particular, management has observed a trend of customers seeking to bolster their defence inventories, a need amplified by the ongoing strain on supply chains.

**Trim FY23F net profit estimate; raise TP to S\$4.50.** We revise our FY23F net profit estimates down marginally by 1.3% to account for near-term weakness in STE's satcom division. Nonetheless, we're increasing our target price to S\$4.50 following an update of our discounted cash flow assumptions. STE's shares have dipped by 5.5% from their peak in 2023, presenting a favourable opportunity for entry. With STE shifting into a higher earnings growth trajectory in FY24-25F—with net profits expected to surge by approximately 15-20% compared to 3-5% in FY23F—the stock is at an inflection point for a breakout, in our view.

**Company Background**

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

## ST Engineering

### Valuation table

Valuation Methodology	Basis	Parameters	Price per share (\$)
DCF	-	7.4% WACC, terminal growth rate of 2.0%	4.73
P/E	S\$630m (Blended FY23/24F)	21.5x (+0.5 standard deviations of five-year average)	4.34
<b>Average</b>			<b>4.50</b>

Source: DBS Bank

### 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	2022A	2023F	2024F	2025F
Commercial Aerospace	5.70	21.3	26.1	3.32	4.88
Urban Solutions &	8.17	48.8	7.06	9.18	5.43
Defence & Public	8.40	5.80	(0.8)	4.51	3.90

### Segmental Breakdown

FY Dec	2021A	2022A	2023F	2024F	2025F
<b>Revenues (\$m)</b>					
Commercial Aerospace	2,465	2,991	3,771	3,896	4,086
Urban Solutions &	1,191	1,772	1,897	2,071	2,184
Defence & Public	4,038	4,272	4,238	4,428	4,601
<b>Total</b>	<b>7,694</b>	<b>9,035</b>	<b>9,906</b>	<b>10,396</b>	<b>10,872</b>
<b>EBIT (\$m)</b>					
Commercial Aerospace	182	301	362	382	413
Urban Solutions &	25.8	29.2	9.57	121	175
Defence & Public	466	405	521	551	580
<b>Total</b>	<b>674</b>	<b>735</b>	<b>892</b>	<b>1,054</b>	<b>1,168</b>
<b>EBIT Margins (%)</b>					
Commercial Aerospace	7.4	10.1	9.6	9.8	10.1
Urban Solutions &	2.2	1.6	0.5	5.8	8.0
Defence & Public	11.5	9.5	12.3	12.4	12.6
<b>Total</b>	<b>8.8</b>	<b>8.1</b>	<b>9.0</b>	<b>10.1</b>	<b>10.7</b>

### Income Statement (\$m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenue	7,693	9,035	9,906	10,396	10,872
Cost of Goods Sold	(6,158)	(7,336)	(7,826)	(8,130)	(8,502)
<b>Gross Profit</b>	<b>1,535</b>	<b>1,699</b>	<b>2,080</b>	<b>2,266</b>	<b>2,370</b>
Other Opng (Exp)/Inc	(877)	(984)	(1,188)	(1,212)	(1,202)
<b>Operating Profit</b>	<b>658</b>	<b>715</b>	<b>892</b>	<b>1,054</b>	<b>1,168</b>
Other Non Opng (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	16.0	33.3	39.9	41.9	44.0
Net Interest (Exp)/Inc	(36.0)	(138)	(221)	(246)	(225)
Exceptional Gain/(Loss)	0.0	(13.3)	0.0	0.0	0.0
<b>Pre-tax Profit</b>	<b>638</b>	<b>597</b>	<b>711</b>	<b>850</b>	<b>987</b>
Tax	(70.6)	(54.1)	(128)	(153)	(178)
Minority Interest	3.57	(8.3)	(8.9)	(10.7)	(12.4)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>571</b>	<b>535</b>	<b>574</b>	<b>686</b>	<b>797</b>
Net Profit before Except.	571	548	574	686	797
EBITDA	1,072	1,265	1,469	1,653	1,789
<b>Growth</b>					
Revenue Gth (%)	7.5	17.4	9.6	5.0	4.6
EBITDA Gth (%)	12.0	18.1	16.1	12.5	8.2
Opg Profit Gth (%)	20.0	8.7	24.8	18.1	10.8
Net Profit Gth (Pre-ex) (%)	9.3	(3.9)	4.6	19.6	16.1
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	20.0	18.8	21.0	21.8	21.8
Opg Profit Margin (%)	8.5	7.9	9.0	10.1	10.7
Net Profit Margin (%)	7.4	5.9	5.8	6.6	7.3
ROAE (%)	24.3	22.2	23.6	26.7	28.4
ROA (%)	5.6	4.2	3.8	4.5	5.1
ROCE (%)	9.3	7.7	7.0	8.4	9.4
Div Payout Ratio (%)	82.1	93.4	87.1	72.8	70.5
Net Interest Cover (x)	18.2	5.2	4.0	4.3	5.2

Source: Company, DBS Bank

## ST Engineering

### Balance Sheet (\$m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Net Fixed Assets	1,794	2,076	2,039	1,883	1,706
Invt in Associates & JVs	483	468	478	490	504
Other LT Assets	2,882	6,292	6,292	6,292	6,292
Cash & ST Invt	816	602	489	496	517
Inventory	2,988	3,784	4,149	4,354	4,553
Debtors	1,067	1,152	1,263	1,326	1,387
Other Current Assets	486	589	589	589	589
<b>Total Assets</b>	<b>10,516</b>	<b>14,964</b>	<b>15,300</b>	<b>15,430</b>	<b>15,548</b>
ST Debt	560	3,628	3,228	3,028	2,628
Creditor	2,613	2,826	3,099	3,252	3,401
Other Current Liab	1,507	1,551	1,932	1,910	1,970
LT Debt	1,555	2,907	2,907	2,907	2,907
Other LT Liabilities	1,612	1,399	1,399	1,399	1,399
Shareholder's Equity	2,413	2,398	2,472	2,659	2,956
Minority Interests	255	255	264	274	287
<b>Total Cap. &amp; Liab.</b>	<b>10,516</b>	<b>14,964</b>	<b>15,300</b>	<b>15,430</b>	<b>15,548</b>
Non-Cash Wkg. Capital	421	1,148	971	1,106	1,158
Net Cash/(Debt)	(1,299)	(5,933)	(5,645)	(5,439)	(5,018)
Debtors Turn (avg days)	50.2	44.8	44.5	45.5	45.5
Creditors Turn (avg days)	153.1	145.6	148.4	153.1	153.2
Inventory Turn (avg days)	184.2	181.2	198.6	204.9	205.1
Asset Turnover (x)	0.8	0.7	0.7	0.7	0.7
Current Ratio (x)	1.1	0.8	0.8	0.8	0.9
Quick Ratio (x)	0.4	0.2	0.2	0.2	0.2
Net Debt/Equity (X)	0.5	2.2	2.1	1.9	1.5
Net Debt/Equity ex MI (X)	0.5	2.5	2.3	2.0	1.7
Capex to Debt (%)	14.0	11.4	8.2	6.7	7.2

Source: Company, DBS Bank

### Cash Flow Statement (\$m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Pre-Tax Profit	638	597	711	850	987
Dep. & Amort.	398	517	537	557	577
Tax Paid	(112)	(108)	(128)	(153)	(178)
Assoc. & JV Inc/(loss)	(16.0)	(33.3)	(39.9)	(41.9)	(44.0)
Chg in Wkg.Cap.	137	(442)	177	(136)	(51.6)
Other Operating CF	69.6	142	0.0	0.0	0.0
<b>Net Operating CF</b>	<b>1,114</b>	<b>673</b>	<b>1,257</b>	<b>1,076</b>	<b>1,291</b>
Capital Exp.(net)	(296)	(743)	(500)	(400)	(400)
Other Invt.(net)	(14.3)	16.1	0.0	0.0	0.0
Invt in Assoc. & JV	(9.9)	(74.3)	(5.0)	(5.0)	(5.0)
Div from Assoc & JV	24.3	40.5	35.0	35.0	35.0
Other Investing CF	(118)	(3,811)	0.0	0.0	0.0
<b>Net Investing CF</b>	<b>(414)</b>	<b>(4,571)</b>	<b>(470)</b>	<b>(370)</b>	<b>(370)</b>
Div Paid	(468)	(686)	(500)	(500)	(500)
Chg in Gross Debt	(14.6)	4,451	(400)	(200)	(400)
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(134)	(67.2)	0.0	0.0	0.0
<b>Net Financing CF</b>	<b>(616)</b>	<b>3,698</b>	<b>(900)</b>	<b>(700)</b>	<b>(900)</b>
Currency Adjustments	0.86	(13.6)	0.0	0.0	0.0
Chg in Cash	85.3	(214)	(113)	6.45	21.0
Opg CFPS (S cts)	31.3	35.7	34.6	38.8	43.0
Free CFPS (S cts)	26.2	(2.2)	24.2	21.7	28.5

Source: Company, DBS Bank

**Target Price & Ratings 12-mth History**



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	05 Dec 22	3.45	4.10	BUY
2:	27 Feb 23	3.54	4.20	BUY
3:	14 Aug 23	3.85	4.20	BUY

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

Source: DBS Bank

Analyst: Jason SUM, CFA  
Suvro SARKAR

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: 14 Nov 2023 11:10:53 (SGT)  
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Sources for all charts and tables are DBS Bank unless otherwise specified.

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## ST Engineering

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