Singapore

Overweight *(no change)*

Highlighted Companies

SIA Engineering
ADD, TP S$2.70, S$2.28 close

Upgrade to Add at a higher TP of S$2.70 as we think risk-reward dynamics have improved given a stronger 1-year earnings outlook (partially driven by GTF recalls) and decent valuation (17x CY25F P/E). Our TP is based on 19.5x CY25F P/E, pegged to 0.5 s.d. below its 2010-19 mean.

ST Engineering
ADD, TP S$4.36, S$3.77 close

Reiterate Add with a higher TP of S$4.36 as we roll forward our valuation year to CY25F, still based on equal-weight blended valuation (P/E, DCF, dividend yield). We cut our FY24-25F core EPS by 2-4% as we expect stronger MRO contribution and lower interest expenses to be offset by slower recovery in its Urban Solutions margins.

Summary Valuation Metrics

P/E (x)	Dec-23F	Dec-24F	Dec-25F
SIA Engineering	23.59	18.30	16.47
ST Engineering	21.11	17.19	14.97
P/BV (x)	**Dec-23F**	**Dec-24F**	**Dec-25F**
SIA Engineering	1.49	1.43	1.37
ST Engineering	4.79	4.45	4.02
Dividend Yield	**Dec-23F**	**Dec-24F**	**Dec-25F**
SIA Engineering	2.57%	3.13%	3.79%
ST Engineering	4.24%	4.24%	4.24%

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Airport Services

Every cloud has a silver lining

- We see a healthy outlook for MRO providers in 2024F as issues faced by newer generation aircraft/engines could drive heavier work content, we think.
- SIE should benefit most in 2024F given ESA's GTF expertise. Steady margin expansion over the coming quarters should re-rate the stock, in our view.
- STE is the longer-term play as strong US/China footprint and capacity additions should expand its global MRO market share.
- Key sector risks: labour shortages, supply chain issues. Upgrade SIE to Add with higher TP of S$2.70. Reiterate Add on STE with higher TP of S$4.36.

Airlines facing issues due to unreliability of newer equipment

We expect issues with newer generation aircraft and engines to continue to surface into 2024F, driven by 1) widespread recall of GTF engines, and 2) increased inspections of specific Boeing aircraft models (B737 MAX, B787). We believe these issues should result in increased grounding of aircraft as affected jets undergo inspections and repairs, likely disrupting capacity ramp-up for airlines. With airlines facing a combination of strong travel demand (IATA projects record-high passenger volumes globally in 2024F) and continued delays in new aircraft deliveries from OEMs, we expect airlines to make up for lost capacity by extending the service life of older aircraft and reinstating inactive aircraft. This should drive heightened MRO demand in 2024-25F given heavier work content for older jets, presenting tailwinds for both SIE and STE ahead, in our view.

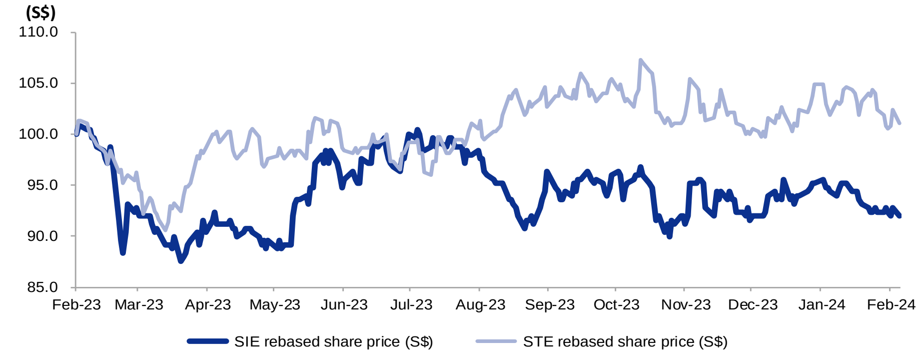
SIE: upgrade to Add on improving earnings outlook

We believe SIE is set for FY24-25F earnings boost from GTF issues as 49%-owned associate ESA could lead the inspection process for all Southeast Asia-based affected aircraft. We estimate GTF-related recalls could drive c.S$5m-10m in additional net profit p.a. for SIE over FY24-26F, premised on 1) ESA's higher pricing power as airlines try to prevent excessive capacity disruption, and 2) gradual easing of supply chain woes driving increased engine induction volumes. We relook our EBIT assumptions and raise our FY25-26F EBIT by 13-20% as stronger operating leverage and efficiency gains harnessed from transformation initiatives should help alleviate elevated staff cost pressures, in our view. With a more favourable earnings outlook and decent valuation of 17x CY25F P/E (1 s.d. below 2010-19 mean), we upgrade SIE to Add with a higher TP of S$2.70, based on 19.5x CY25F P/E (0.5 s.d. below 2010-19 mean).

STE: global presence accords stronger longer-term prospects

We think STE is well positioned to capture elevated MRO demand in the US and China, as they are regions with large proportions of affected A320neo/B737 MAX (details on page 11). Shifting market share in favour of LEAP engines could drive longer-term demand for STE's engine MRO services in Singapore given the group's positioning as the largest provider of end-to-end LEAP engine services in Asia. Improving PTF profitability is also a key driver of its aerospace segment margin expansion in the coming years, in our view.

Figure 1: Rebased share prices of SIE (-7%) and STE (+3%) over the past year



SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS, BLOOMBERG

Every cloud has a silver lining

Abbreviation list

ESA: Eagle Services Asia
FAA: Federal Aviation Administration
GTF: Geared Turbofan
IATA: International Air Transport Association
MRO: Maintenance, repair and overhaul
OEM: Original equipment manufacturer
P&W: Pratt & Whitney
PTF: Passenger-to-freighter
SAESL: Singapore Aero Engine Services
SIA: Singapore Airlines
SIE: SIA Engineering
STE: ST Engineering

Uncertainty clouding airline operations

Throughout 2H23 and into 2024F, airlines have seen increasing issues with usage of new-generation aircraft and engines, mainly involving certain Boeing (BA US, NR, CP: US$209.20) plane models (B787, B737 MAX) and newer generation aircraft engines (CFM LEAP, PW1100G). We expect these issues to continue to emerge in 2024F, likely throwing further uncertainty into global airline capacity scheduling, in our view.

Boeing: relentlessly hit by issue after issue

Over the past five years, Boeing has been steadily hit with quality issues as manufacturing defects have increasingly been found in both its B787 and B737 MAX models. Given this, coupled with supply chain tightness and Covid-19-related disruptions, Boeing aircraft deliveries have been materially delayed between 2019 and 2023. We provide a brief overview of key issues faced by operators below.

Boeing 787 Dreamliner (B787):

In 2019, several operators of the B787 – notably KLM Royal Dutch Airlines, owned by Air France-KLM Group (AF FP, NR, CP: EUR11.28) – warned of subpar quality issues, such as loose seats, incorrect installation of components and hydraulic malfunctions. Other structural issues that surfaced in 2020-21 included manufacturing flaws found in fuselages and horizontal stabilisers. As a result of these issues, B787 deliveries were repeatedly delayed over 2019-23.

Boeing 737 MAX (B737 MAX)

Following two fatal B737 MAX crashes in 2018-19 arising from flaws with the aircraft's flight stabilising software (abbreviated as MCAS), the B737 MAX was grounded globally through 2019-20 before gradually returning to service over 2021-23. In Aug 2023, Boeing highlighted engineering defects found in its aft pressure bulkheads (supplied by Spirit AeroSystems, SPR US, NR, CP: US$29.12). In Dec 2023, Boeing reported issues of a potential loose bolt in the rudder control system. Negative publicity on this aircraft model surged in Jan 2024 following the midair fuselage blowout on a B737 MAX 9 aircraft operated by Alaskan Airlines (ALK US, NR, CP: US$37.19). Both United Airlines (UAL US, NR, CP: US$42.33) and Alaska Airlines have subsequently found loose bolts in preliminary investigations following the blowout incident.

Newer generation engines not as reliable as hoped

Aircraft engine manufacturers have steadily rolled out more sophisticated and fuel-efficient engine designs for both narrowbody (e.g. LEAP, geared turbofan) and widebody (e.g. Trent) aircraft, yet these have presented their fair share of manufacturing flaws in recent years. We highlight two major issues that surfaced in 2023.

Pratt & Whitney PW1100G engine:

The PW1100G, a GTF engine manufactured by P&W (subsidiary of RTX Corporation (RTX US, NR, CP: US$90.51), is one of two engine types used (the other is CFM LEAP 1-A) by aircraft from the Airbus (AIR FP, NR, CP: EUR150.52) A320neo family. In Sep 2023, RTX Corp announced the planned recall of c.3k PW1100G GTF engines as a result of microscopic cracks caused by contaminated powdered metal used during the manufacturing process. RTX projects the recall could result in c.350 aircraft being grounded per year over 2024-26F, with potentially up to 650 aircraft being grounded in 1H24F. Based on the FAA's latest airworthiness directive published in Dec 2023, affected parts susceptible to failing (e.g. turbine disks, rotors) are required to undergo inspection and accelerated replacement (if need be).

CFM LEAP 1-A/1-B engine:

The CFM LEAP family of engines is manufactured by CFM International, a JV between GE Aerospace (subsidiary of General Electric Co (GE US, NR, CP: US$139.28)) and Safran Aircraft Engines (subsidiary of Safran (SAF FP, NR, CP: EUR176.42)). The LEAP-1A engine powers aircraft from the A320neo family while the LEAP-1B engine is exclusively used to power aircraft from the B737 MAX family. Throughout 2023, several LEAP operators reported engine stalling incidents caused by high levels of non-synchronous vibration, which resulted in multiple aborted takeoffs and air turn-backs. Latest maintenance guidelines from the FAA require LEAP operators to monitor vibration levels and mandatorily replace affected components if the vibration thresholds are exceeded.

Figure 2: Timeline of key issues faced by airlines since 2019

Date	Manufacturer	Aircraft/engine affected	Details
Mar 2019	Boeing	B737 MAX family	Global grounding of the B737 MAX fleet following the fatal crash of Ethiopian Airlines Flight 302
Apr 2019	Rolls-Royce	Trent 1000 engine	Deterioration of high pressure turbine blades was faster than expected for some engines
Jun 2019	Boeing	B787-10	Issues with loose seats, incorrect installation of components, and hydraulic malfunctions
Jun 2019	Boeing	B787 family	Boeing warned airlines that an engine fire extinguisher system could malfunction in certain instances
Aug 2020	Boeing	B787 family	Boeing highlighted structural issues with improperly installed fuselage and horizonal stabilizers
Jul 2023	P&W	PW1100G-JM engine	P&W disclosed that a rare condition in powdered metal used to manufacture certain engine parts was identified, requiring an expedited fleet inspection
Aug 2023	Boeing	B737 MAX family	Certain aircraft were found with misaligned and duplicated holes on the aft pressure bulkhead. Spirit AeroSystems was the manufacturer of said bulkheads
Oct 2023	CFM	LEAP engine	In view of multiple aborted takeoffs and air turn-backs caused by high levels of engine non-synchronous vibration in LEAP engines, FAA now expects operators to monitor vibration levels and replace affected components if needed
Dec 2023	Boeing	B737 MAX family	Boeing urged airlines to inspect B737 MAX aircraft in view of a possible loose bolt in the rudder control system
Jan 2024	Boeing	B737 MAX-9	Fuselage of a B737 MAX-9 aircraft operated by Alaska Airlines was blown out mid-flight. Subsequent investigations by US airlines found loose bolts and installation issues on some aircraft

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

MRO providers set to benefit from groundings

We believe Boeing defects and engine-related issues (GTF primarily) should drive increased aircraft grounding globally in 2024F as airlines subject their affected aircraft to mandatory inspections and repairs. Various airlines from the US (Spirit Airlines, JetBlue), Europe (Lufthansa Group, Wizz Air), and Asia (Cebu Pacific, IndiGo) have announced expected capacity reductions in 2024F on the back of GTF-related grounding, and we expect more airlines to follow suit in the coming months.

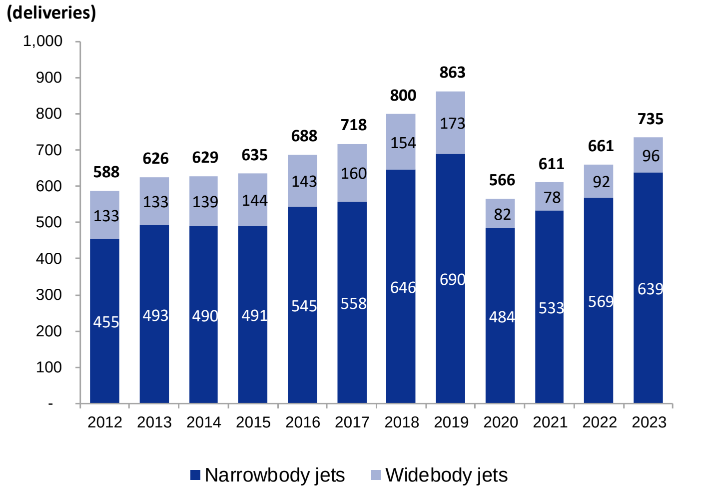
In order to capitalise on further air travel recovery and prevent excessive capacity disruption, we think airlines will probably have to 1) extend the service life of older aircraft, and/or 2) reinstate parked/stored aircraft into service. We hence believe that aviation MRO providers under our coverage (**SIE and STE**) could benefit from heightened near-term MRO demand in the coming quarters.

Aircraft deliveries still facing delays by OEMs…

Based on commentary from Airbus in its 3Q23 results announcement, supply chain challenges remain as the group continues to ramp up production. Boeing similarly highlighted (in its 3Q23 results announcement) that production was still being affected by supply chain disruptions and labour instability. Recent safety issues could lengthen the delivery schedules of affected aircraft (namely the A320neo family and B737 MAX).

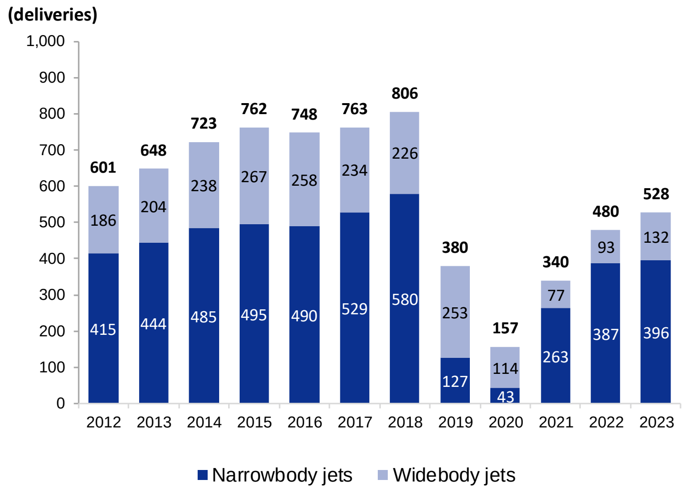
Our channel checks also found OEMs still being hindered by a shortage of spare parts as supply chains were adversely affected by both Covid-19 and the Russia-Ukraine conflict. While lead times have gradually improved, industry players still expect lead times in 2024F to be longer than pre-2020 levels, likely further pressuring aircraft deliveries and maintenance works, in our view.

Figure 3: Airbus aircraft deliveries (2012-23) still hampered by supply chain disruptions…



SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Figure 4: … while Boeing deliveries have been adversely impacted by various safety issues



SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

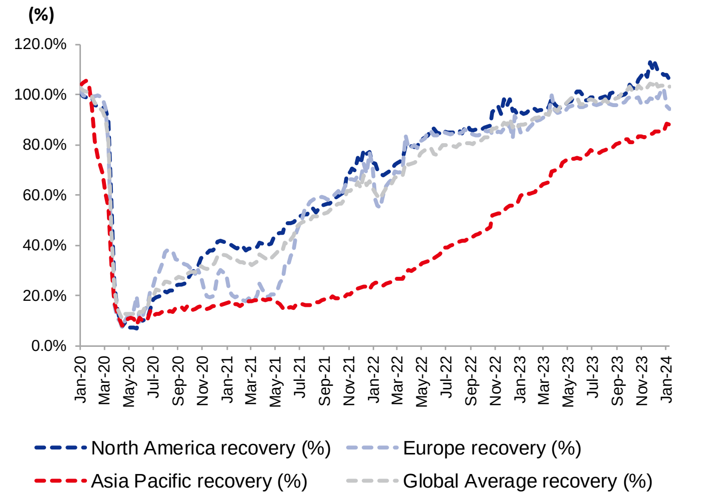
… while global air travel set to exceed pre-Covid-19 levels by end-2024F

Global international air travel (measured in seats) volumes, including both domestic and international flights, exceeded 2019 levels by 2% as at end Dec 2023, according to flight data provider CAPA. While global domestic flight volumes had already largely recovered to 2019 levels as at May 2023, international flight volumes have taken longer to catch up. As at end Dec 2023, international flight volumes out of Asia were still at 85% of 2019 levels while international flight volumes out of the US and Europe exceeded, at 109% and 102% respectively. Within Asia, notable laggards in terms of recovery in international flights volumes to 2019 levels include China, Hong Kong, and Thailand.

Looking ahead, the IATA projects strong air passenger volumes of 4.7bn for 2024F (+10% yoy), which will be a record high at 4% above 2019 levels (previous peak). We expect growth to be largely driven by:

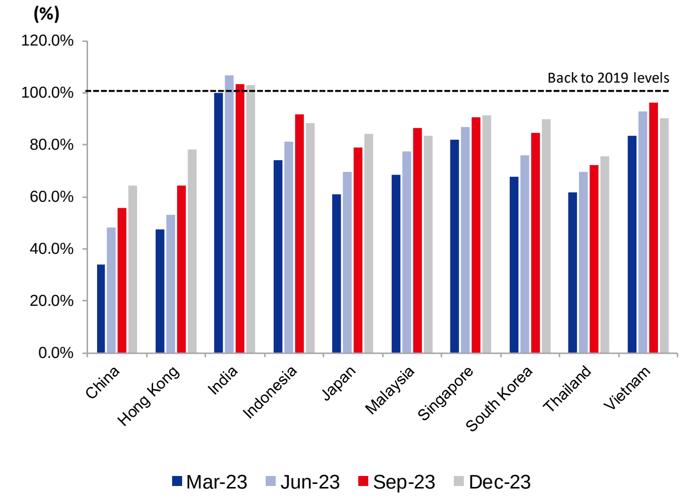
1) Changing travel habits. According to a passenger poll conducted by IATA in 4Q23, a third of respondents indicated that they are now travelling more vs. pre-Covid-19 levels while 49% of respondents indicated no change in travel habits vs. pre-Covid-19 levels. For 2024F, 44% of respondents expect to travel more in the next 12 months (compared with the previous 12 months).
2) Recovery in Asia passenger volumes. Following China's complete removal of Covid-19 travel restrictions in mid-2023, we see room for further outbound flight volume recovery in 2024F as current volumes (as at end-Dec 2023) are still at c.68% of 2019 levels, according to CAPA. Airlines should also accelerate their capacity restoration to capitalise on robust travel demand, particularly for China-related routes, in our view.
3) Gradual restoration in widebody airline routes. We expect healthy travel demand to drive a gradual recovery in medium-/long-haul flight capacity, which has lagged behind those of narrowbodies.

Figure 5: Global international flight volumes (measured in seats) as a % of 2019 levels. As of end-2023, flight activities in the US and Europe exceeded 2019 levels while Asia recovered comparatively slower



SOURCES: CGS-CIMB RESEARCH, CAPA

Figure 6: Asia international flight volumes (measured in seats) as a % of 2019 levels. Much of Asia's international flight volumes had yet to recover to 2019 levels as at end-Dec 2023, with notable laggards being China and Hong Kong



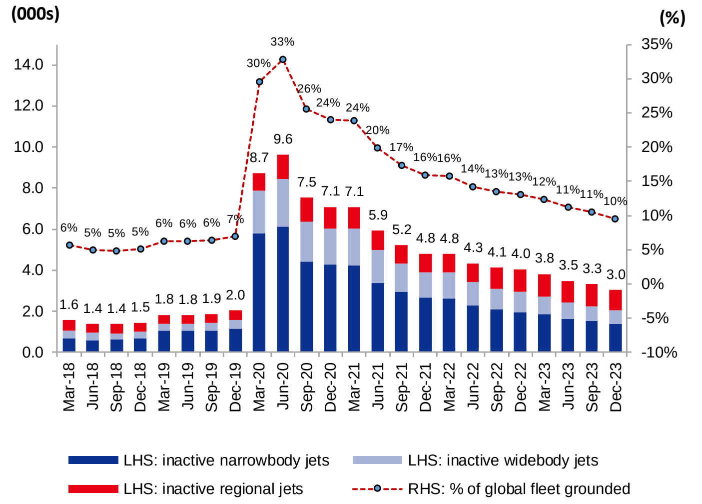
SOURCES: CGS-CIMB RESEARCH, CAPA

Airlines will be forced to ramp up older aircraft usage…

Faced with aircraft supply shortages and strong travel demand, we think airlines will have to make up for the lost capacity via extending the service life of older aircraft, reinstating grounded aircraft, and leasing aircraft from lessors. Over the past six months, we have already seen several major airlines (e.g. Lufthansa, IndiGo, Scoot) taking mitigatory steps to ensure minimal operational disruption.

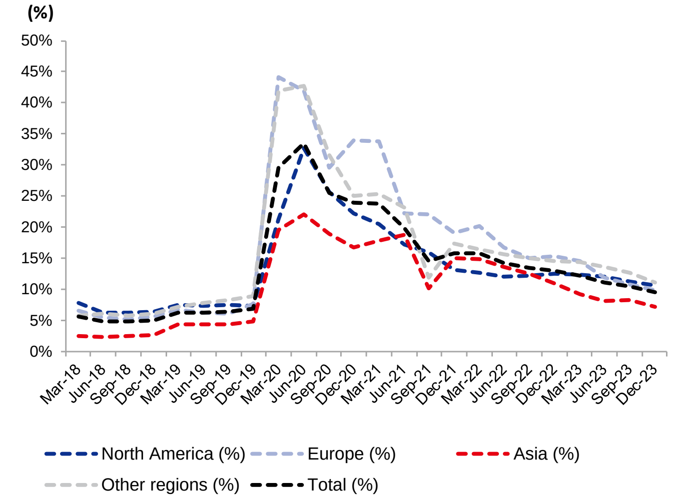
According to data from CAPA, airlines steadily reactivated their inactive fleet throughout 2023, with the proportion of global inactive aircraft (as a % of total global fleet) reducing from its peak of 33% in Jun 2020 to 10% as at end Dec 2023. With end-Dec 2023 inactive aircraft levels still c.50% higher vs. 2019 levels, we see room for reinstatement activities to pick up in 2024F as airlines grapple with strong travel demand and aircraft supply shocks.

Figure 7: We think reinstatement of inactive aircraft should continue in 2024-25F as airlines try to plug the shortfall in capacity from planes undergoing safety-related inspections



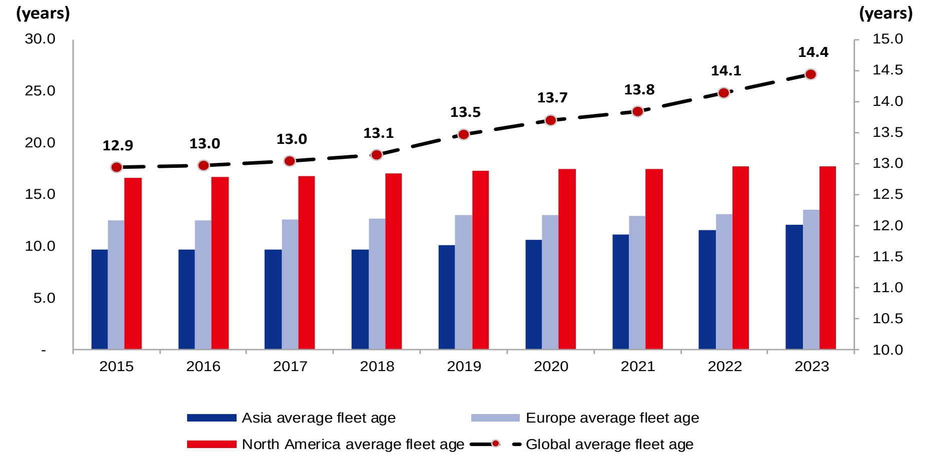
SOURCES: CGS-CIMB RESEARCH, CAPA

Figure 8: End-2023 inactive aircraft levels (as a % of total fleet) by region are still c.50% higher than 2019 levels



SOURCES: CGS-CIMB RESEARCH, CAPA

Figure 9: Average fleet age should continue inching upwards over 2024-26F as airlines delay aircraft retirement in view of strong travel demand and supply constraints



SOURCES: CGS-CIMB RESEARCH, CAPA

… driving heavier workloads for MRO providers

In our view, greater utilisation of older aircraft should positively impact global MRO demand as such aircraft typically require more intensive MRO services as opposed to newer models. Older aircraft are likely to undergo more routine checks to maintain airworthiness given the general wear-and-tear and material degradation. Maintenance man-hours required per check would also increase gradually over time. Compared with newer generation aircraft, older aircraft are more susceptible to unexpected faults, given their 1) less durable materials used, and 2) lower fuel efficiency. These factors should give rise to more line maintenance and base maintenance needs, directly benefitting airframe MRO service providers, we reckon.

Older aircraft are also equipped with legacy engines that are less efficient compared to newer generation models. For example, reactivated older narrowbody models (e.g. A320, B737) could be equipped with CFM56 engines; comparing the newer generation LEAP engine with the CFM56 engine, the LEAP is 15% more fuel efficient and produces less carbon, according to manufacturer CFM International. Legacy engines also have a higher likelihood of having accumulated more engine cycles vs. newer generation engines, which could lead to increased maintenance requirements for operators, in our view.

Singapore MRO players: who could benefit more?

We believe both **SIE** and **STE** are set to benefit from heightened MRO demand over 2024-25F. Both MRO players should gain from underlying travel recovery trends but upside could differ slightly as both providers vary in geographical exposure, services offered, and specific airframe/engine specialisations. We provide a brief overview in Figure 10.

Figure 10: Overview of key differences between SIE and STE

	SIE	STE	Comments
Business model	Aerospace MRO	Aerospace MRO, Urban Solutions, Defence & Security	SIE is a pure-play MRO service provider STE offers services across MRO, Urban Solutions, and Defence & Public Security
Aerospace country exposure	Mostly Singapore, small proportion of Malaysia and Philippines	Asia, US and Europe	SIE derives the bulk of revenue and associate/JV profits from Singapore, with small exposure to Malaysia (via 75%-owned SR Technics Malaysia) and Philippines (Clark Air Base) STE derives its Aerospace revenue across Asia (China, Singapore), Europe (mainly Germany), and US
Aerospace services offered	MRO (airframe, engine)	MRO (airframe, engine), OEM (nacelles, composite floor panels), PTF	Both SIE and STE offer line maintenance, base maintenance, airframe overhaul, and engine & component services STE provides OEM (nacelle and composite floor panel production) and PTF conversion services, while SIE does not
Standout points	Dominant line maintenance market share in Singapore Strong exposure to Rolls-Royce Trent engines (via SAESL) and GTF engines (via ESA). ESA is the only engine MRO service provider in Southeast Asia specialised in GTF models	Singapore engine business is the first independent provider in Asia offering a full range of MRO solutions for the LEAP engine family Larger foreign MRO exposure via airframe hangars across China and US Diversified Aerospace revenue exposure via OEM and PTF business	

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Geographical exposure

SIE:

SIE does not provide a detailed breakdown of revenue by geography. We estimate SIE typically derives c.95% of its revenue from Singapore, with the remaining 5% from MRO services provided in Japan, Malaysia (via 75%-owned SR Technics Malaysia), the Philippines (MRO services offered at Clark Air Base) and the US. Similarly, the bulk of its JV and associate profits (breakdown undisclosed) is derived from Singapore.

As at end-2023, SIE operated six hangars (includes nine bays) in Singapore and three hangars (includes nine bays) in the Philippines for the provision of airframe maintenance services. The Singapore hangars have a total floor area of 56k sq m, servicing aircraft from both parent SIA and third-party airlines. Base maintenance services are mostly conducted at the hangars while line maintenance services can be conducted at the hangars or directly at the airport apron (for newer generation aircraft).

While SIE does provide its own engine and component maintenance services in Singapore (e.g. standard troubleshooting and repair, quick turn maintenance, engine testing), the bulk of its engine and component exposure comes from its associates and JVs. Recall that SIE's two largest associates/JVs are 1) SAESL (engine MRO services for Rolls-Royce Trent engines and components), and 2) ESA (engine MRO services for P&W engines and components); both associates/JVs are based in Singapore.

STE:

Based on STE's FY22 results, 50% of revenue was derived from Asia (bulk coming from Singapore and China), 25% from the US (both MRO and nacelle production), 18% from Europe, and the remaining 7% from other regions.

For airframe services, STE operated three hangar facilities in Singapore as at end-2023 and is in the process of constructing a fourth hangar facility (includes four bays), which STE expects will commence operations in 2H25F. In China, STE currently operates two airframe MRO facilities (one in Guangzhou, one in Shanghai) and is setting up a third airframe MRO facility at Ezhou, Hubei, which it expects will commence operations in 2025F. Outside of Asia, STE operates three airframe MRO facilities in the US (Mobile, Pensacola, San Antonio), and one facility in Europe (Dresden).

On the engine front, STE operates an engine MRO facility in Singapore (first MRO facility in Asia to offer a full range of engine services for the LEAP-1A/1B engines) and one engine MRO facility in China (Xiamen). In the US, STE offers engine wash services in Wethersfield.

For the non-airframe business, STE manufactures engine nacelle components via its Baltimore facility in the US, and provides PTF services in Singapore, China, US, and Germany.

Aircraft and engine expertise

SIE:

SIE predominantly provides airframe and engine MRO services in Singapore. The group's line maintenance business holds a dominant market share in terms of flight volumes at Singapore Changi Airport (c.85% as at end-Sep 2023, based on SIE's 2QFY3/24 results). Its airframe hangars service both narrowbody and widebody aircraft, with a slight tilt towards widebody aircraft given 1) more hangars (four out of six hangars) catering to widebody aircraft, and 2) parent SIA's (inclusive of Scoot) large fleet of widebody aircraft (73% of total fleet as at end-2023).

In addition to standard engine MRO services offered, SIE provides engine quick turn maintenance services focused on maintaining LEAP-1A/1B engines. SIE also operates engine testing services for high-performance engines (e.g. Trent engines, PW4000, GE90). More notably, we think SIE stands out via its JV/associates with engine OEMs, the two largest ones being SAESL and ESA. SAESL is a 50-50 JV operated with Rolls-Royce and provides a full range of engine MRO services for the entire Rolls-Royce Trent engine line (powers widebody aircraft). ESA is a 49%-owned JV operated with P&W and provides an extensive range of engine maintenance services for both the PW4000 and PW1100 (newer generation GTF engine powering the A320neo) family of engines. Both JVs combined typically contribute c.40-50% of SIE's net profit (based on FY18-20 average).

STE:

We understand that STE has minimal line maintenance exposure in Singapore and focuses more on heavier base maintenance works via hangars operated across Changi, Paya Lebar and Seletar. Compared to SIE, STE's airframe business has a more global presence, with operational hangars across China (Guangzhou, Shanghai) and the US (Mobile, Pensacola, San Antonio). Based on STE's past disclosures, we understand that its overseas hangars cater more to widebody aircraft while its Singapore business services both narrowbody and widebody aircraft.

For STE's Singapore engine business, we believe the group's main selling point is its status as the first independent provider in Asia offering a full range of MRO solutions for the LEAP engine family (as opposed to SIE, which offers mostly engine quick turn services). The group's China engine MRO business focuses on the CFM56 family of engines (powers A320 and B737 narrowbody aircraft) while its US business is smaller in size compared with its Singapore and China businesses.

A major key difference between STE and SIE lies in the OEM and PTF businesses. STE operates PTF conversion lines in Singapore, China, the US, and Germany while SIE has little exposure to the freighter conversion business (temporary cabin conversion service offered via 55%-owned subsidiary JAMCO Aero Design). On the OEM front, STE produces nacelle components (via wholly-owned US-based subsidiary Middle River Aerostructure Systems, MRAS) and composite floor panels (via 55%-owned Germany-based subsidiary Elbe Flugzeugwerke, EFW). while SIE has no direct exposure to the OEM business.

Figure 11: Comparison of airframe MRO capabilities between SIE and STE

Company	Country	Facility location	Status	No. of hangars	Narrow/wide body focus
SIE	Singapore	Changi	Operational	6	Both
	Philippines	Clark	Operational	3	Narrowbody
	Malaysia	Subang	Operational	2	Widebody
Company	**Country**	**Facility location**	**Status**	**No. of hangars***	**Narrow/wide body focus**
STE	Singapore	Changi	Operational	5	Both
	Singapore	Paya Lebar	Operational	3	Both
	Singapore	Seletar	Operational	5	Narrowbody
	Singapore	Changi	Constructing	1	Widebody
	China	Guangzhou	Operational	2	Widebody
	China	Shanghai	Operational	2	Both
	China	Hubei	Constructing	1	Narrowbody
	US	Mobile	Operational	9	Widebody
	US	Pensacola	Operational	2	Widebody
	US	San Antonio	Operational	1	Both

*Hangar count for STE is estimated based on relevant company disclosures

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Figure 12: Comparison of engine MRO capabilities between SIE and STE

Company	Country	Facility location	Comments
SIE	Singapore	Changi	Includes quick turn (focused on LEAP engines) and engine testing services
SIE (SAESL)	Singapore	Changi	Engine MRO services for all variants of the Rolls-Royce Trent engine
SIE (ESA)	Singapore	Changi	Engine MRO services for P&W engines (particularly GTF engines)
STE	Singapore	Changi	Includes full range of engine MRO services for LEAP engines
	China	Xiamen	Specialises in CFM56 engines
	US	Connecticut	Provides engine washing services

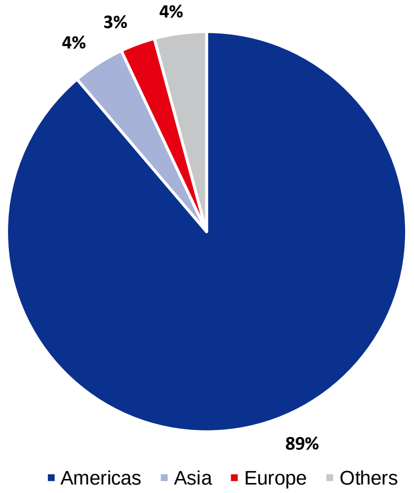
SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

SIE benefits more in the near term from GTF exposure…

Between SIE and STE, we argue that SIE could benefit more in 2024F from aviation market uncertainties given its high exposure to GTF via 49%-owned JV ESA. Recall that ESA historically contributed c.15-20% to SIE's group net profit (over FY18-20). As ESA operates the only P&W GTF MRO workshop located in Southeast Asia (it has six other Asia-based workshops located across China, Japan, Korea, and Taiwan), we think affected airlines from the region (namely Scoot and airlines across the Philippines, Vietnam, and New Zealand) would likely select ESA as their service provider for GTF-related maintenance services. We expect ESA to record strong profits from 1QCY24F onwards as its engine induction volumes ramp up, and we estimate c.S$5m-10m in additional net profit p.a. over FY24-26F. Note that STE does not service the GTF engine and likely has no direct exposure to GTF engine recalls, in our view.

We also see potential for engine issues to drive heavier airframe MRO workloads for SIE as widespread aircraft groundings could prompt Asia-based airlines to reinstate older aircraft and/or extend the service life of older aircraft. In view of Asia forming a large proportion of the A320neo global fleet, we think SIE is well positioned to capture any increase in demand for base maintenance and airframe overhaul (e.g. cabin retrofits) services given its strong track record in Singapore and longstanding relationships with regional airlines.

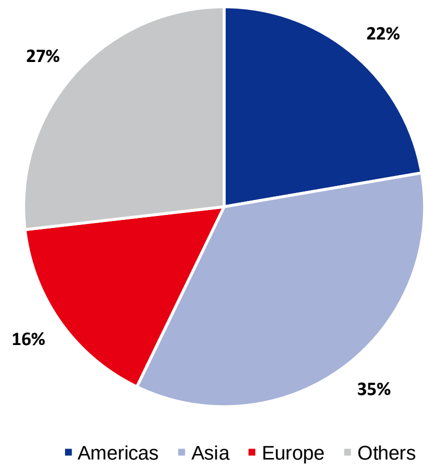
Figure 13: Proportion of B737 MAX-9 fleet by region. Bulk of B737 MAX-9 aircraft (89% of global fleet) is used by US-based airlines as at end-2023



* Global B737-MAX 9 fleet of 214 aircraft. 171 aircraft are currently grounded

SOURCES: CGS-CIMB RESEARCH, CAPA

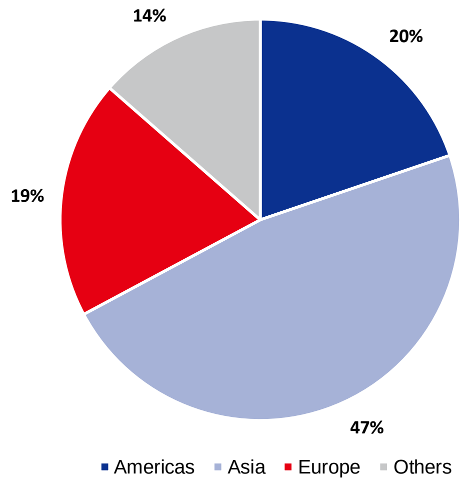
Figure 14: Proportion of B787 fleet by region. Fleet is broadly well spread across all regions as at end-2023



* Global B787 fleet of c.1k aircraft

SOURCES: CGS-CIMB RESEARCH, CAPA

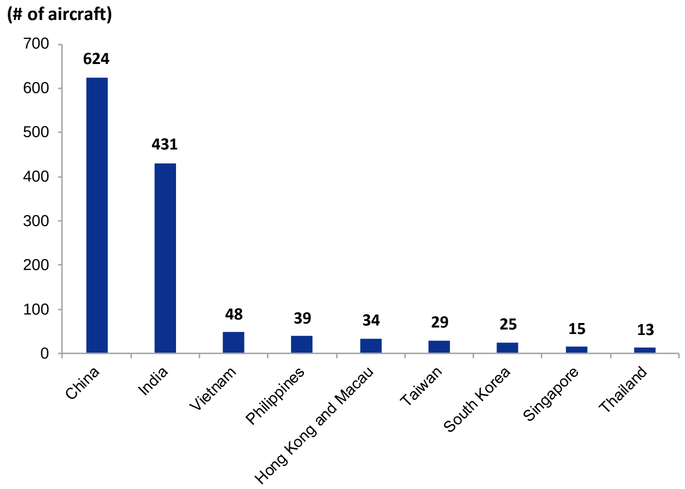
Figure 15: Proportion of A320neo fleet by region as at end-2023. A significant proportion of the global A320neo fleet is based in Asia



* Global A320neo fleet of c.3k aircraft
** A320neo are either equipped with GTF or LEAP engines

SOURCES: CGS-CIMB RESEARCH, CAPA

Figure 16: Within Asia, most of the A320neo fleet is headquartered in China and India as at end-2023



SOURCES: CGS-CIMB RESEARCH, CAPA

… while tailwinds for STE are more indirect and longer term

STE does not service GTF engines and hence will likely not directly benefit from P&W's engine recalls through 2024-26F. However, similar to SIE, we think STE could benefit from broader MRO tailwinds as the service life of older aircraft lengthens. Based on data from CAPA, the bulk of A320neo aircraft operate in the US and China, with each region forming c.20% of the global fleet as at end-2023. Similarly, 89% of the global B737 MAX-9 fleet are based in the US as at end-2023, according to CAPA. As STE operates MRO facilities in both the US and China, we think the group could capture some of the heavier work content arising from airlines increasing utilisation of older aircraft. STE is working on capacity expansion via new hangars in China (Guangzhou, Hubei), Singapore (Changi), and the US (Pensacola), which should lead to MRO market share gains from 2026F onwards, in our view.

We think STE should benefit more (compared with SIE) from continued recovery in widebody aircraft utilisation as STE's China and US businesses are more focused on servicing widebody aircraft, in our view. Lower reliability of GTF engines (compared with LEAP) could drive airlines to power their new A320neo aircraft with LEAP engines instead; we opine that this could result in gradual market share gain for LEAP (c.49% of the global A320neo fleet is equipped with LEAP engines as at end Sep 2023, according to latest RTX disclosures) over the longer term (likely 5-10 years horizon, in our view) potentially benefitting STE's engine induction volumes in Singapore given the group's full range of LEAP MRO services offered.

Key sector downside risks

Industry labour shortages. The global MRO industry faced a shortage of MRO technicians over 2020-23, driven by 1) skilled workers leaving the industry during Covid-19 and now working in different industries, 2) accelerated retiring of senior technicians during Covid-19, and 3) difficulty in attracting and retaining younger workers. Based on management commentary from latest results briefing of SIE (2QFY24) and STE (3Q23), we understand that labour supply remains tight, exacerbated by intense competition for talent from both MRO providers and airlines. As a result, MRO providers have had to incur higher staff costs to attract and retain skilled staff, resulting in dampened MRO operating margins. Both SIE and STE are working on growing their labour pipeline (e.g. working with schools and government agencies) and driving productivity per headcount.

Supply chain disruptions. The supply chains for key materials and spare parts were hamstrung by a myriad of factors, including Covid-19, the Russia-Ukraine conflict, and labour issues. MRO providers resultingly faced extended lead times (for both raw materials and components) and higher material prices, negatively impacting the pace of revenue recognition. We think the lead times for key components should ease slightly in 2024F as OEMs ramp up production, but still likely to remain prolonged (compared with pre-pandemic levels) due to exceptionally strong MRO demand from increased aircraft utilisation and issues with newer generation aircraft/engines. The potential outbreak of conflicts and wars will severely extend the lead times further, in our view.

Recession fears. A global economic slowdown could crimp travel demand and lower aircraft utilisation, dampening both airframe and engine MRO volumes, we believe. In a recessionary environment, we think SIE will be more heavily affected given Singapore's status as a travel hub while STE will be less impacted given its exposure to domestic flights in the US and China, which we think are more resilient compared with international flights.

Sector, Company Briefs OR Appendices…

CGSCIMB

UPGRADE

B
Refinitiv ESG Combined Score

Shariah Compliant

Company Note

Airport Services | Singapore | February 12, 2024

Singapore

ADD *(previously HOLD)*

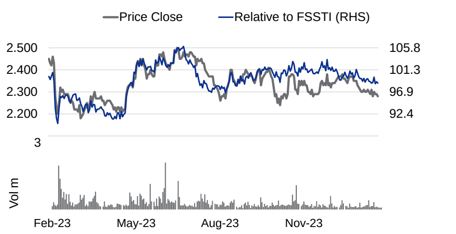
Consensus ratings*:	Buy 2	Hold 1	Sell 0

Current price:	S$2.28
Target price: ▲	S$2.70
Previous target:	S$2.51
Up/downside:	18.4%
CGS-CIMB / Consensus:	-2.4%
Reuters:	SIAE.SI
Bloomberg:	SIE SP
Market cap:	US$1,901m
	S$2,560m
Average daily turnover:	US$0.26m
	S$0.35m
Current shares o/s:	1,121m
Free float:	22.4%

Source: Bloomberg

Key changes in this note

- FY25-26F EPS raised by 8%.



Source: Bloomberg

Price performance	*1M*	*3M*	*12M*
Absolute (%)	-3.4	-3.8	-8.1
Relative (%)	-1.5	-3.9	-1.5

Major shareholders	% held
Singapore Airlines	77.6

SIA Engineering

Risk-reward turning more attractive

- We upgrade SIE to Add with a higher TP of S$2.70 (19.5x CY25F P/E), backed by a clearer earnings outlook and decent valuation (17x CY25F P/E).
- We expect steady EBIT margin expansion in the coming quarters, helped by strong operating leverage and efficiency gains.
- Near-term boost to assoc profits likely given ESA's leading role in GTF recalls. Group revenue could rise with heavier MRO works on older aircraft.

3QFY3/24F EBIT likely returned to profitability

We expect SIE to report its 3QFY3/24F results in the second week of Feb 2024, with net profit likely at S$31m (-3% qoq, +145% yoy) and revenue at S$259m (+3% qoq, +24% yoy) as increased commercial flight arrivals during the quarter (+c.25% yoy based on Changi Airport statistics) drove healthy line maintenance and engine revenue growth for SIE. It likely returned to profitability in 3QFY24F, with EBIT of S$1.9m (2QFY24: -S$0.3m, 3QFY23: -S$12.5m) though its stronger operating leverage was likely partially offset by elevated staff costs and FX losses.

Assoc profit boost likely to be more apparent in coming quarters

We see elevated FY25F net profit from 49%-owned Eagle Services Asia (ESA) as airlines finalise their GTF engine recall schedules. Given that ESA is the only engine MRO service provider in Southeast Asia that is part of P&W's GTF network, we think the group is set to capture the bulk of repairs from affected airlines operating in the region; based on our analysis, ESA will likely service airlines from New Zealand, the Philippines, and Vietnam. In our view, gradual easing of supply chain woes would drive engine induction volumes, and be a key driver of its associates' FY25F profit growth (we estimate +13% yoy).

Healthy revenue growth should lift operating leverage

With SIE holding dominant line maintenance market share at Changi Airport (85% as at end-Sep 2023, see Fig. 3) we expect FY25F group revenue to rise in tandem with flight volumes. Upside to our revenue estimates could come from GTF issues as fleet grounding could prompt airlines to reinstate and extend the service life of older aircraft, benefitting MRO demand for both SIE's base/line and engine maintenance services. We think SIE could also start reaping the benefits of its 2-year digital transformation (finished in May 2023) from FY25F as the group likely progressively optimised its processes through FY24F. We believe stronger operating leverage and efficiency gains realised should help alleviate some staff cost pressures, and raise our FY25-26F EBIT by 13-20% accordingly.

Upgrade to Add on better risk-reward dynamics, TP raised to S$2.70

Our TP rises to S$2.70 as we lift our FY25-26F EPS estimates and roll forward our valuation to CY25F, now pegged to 19.5x P/E (22.0x previously), 0.5 s.d. below its 10-year historical mean (page 3). Re-rating catalysts: strong profits from ESA and easing of labour cost pressures. Downside risks: lower travel demand from an economic slowdown impacting MRO volumes, and margin erosion from inability to pass on elevated staff costs.

Financial Summary	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Revenue (S$m)	566	796	1,044	1,176	1,242
Operating EBITDA (S$m)	41.5	37.7	69.5	93.1	103.4
Net Profit (S$m)	67.6	66.4	122.6	145.2	158.8
Core EPS (S$)	0.05	0.06	0.11	0.13	0.14
Core EPS Growth	51.6%	17.1%	95.5%	18.4%	9.4%
FD Core P/E (x)	47.77	40.81	20.88	17.63	16.12
DPS (S$)	-	0.055	0.060	0.075	0.090
Dividend Yield	0.00%	2.41%	2.63%	3.29%	3.95%
EV/EBITDA (x)	36.13	39.42	20.50	14.45	12.23
P/FCFE (x)	67.63	57.23	39.23	32.22	27.72
Net Gearing	(38.4%)	(37.6%)	(36.2%)	(35.0%)	(33.8%)
P/BV (x)	1.59	1.54	1.48	1.42	1.36
ROE	3.41%	3.83%	7.22%	8.22%	8.62%
% Change In Core EPS Estimates			0.03%	7.89%	8.01%
EPS/Consensus EPS (x)			0.99	0.96	0.98

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

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Risk-reward turning more attractive

Abbreviation list

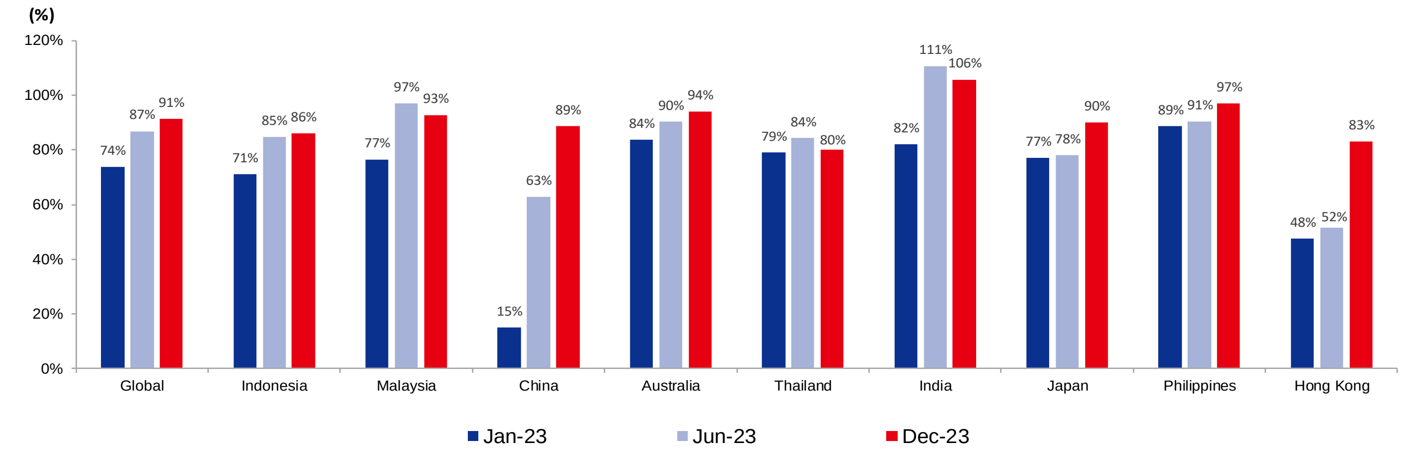
CAPA: Centre for Aviation
ESA: Eagle Services Asia
GTF: Geared turbofan
IATA: International Air Transport Association
MRO: Maintenance, repair and overhaul
P&W: Pratt & Whitney
SIE: SIA Engineering

Flight volumes steadily reaching pre-Covid-19 levels

Singapore outbound flights recovered to 91% of 2019 levels as of end-Jan 2024, according to CAPA. The organisation also expects Asia-Pacific air travel volumes to fully recover to pre-Covid-19 levels in early-2024F. We believe Singapore outbound flight volumes should recover and exceed 2019 levels by end-2025F, driven by continued travel demand recovery and ramp-up in airline routes (particularly routes to China, Hong Kong). This should positively translate to continued line maintenance revenue growth over FY25-26F given SIE's dominant market share at Changi Airport (85% as at end-Sep 2023 based on SIE's 2QFY24 results) in our view.

Singapore will be holding its biennial Airshow during 20-25 Feb. We highlight that SIE has announced several contract awards over the past seven airshows since 2010 (Fig. 2). Announcement of large contracts could boost investor sentiment in 2024F, in our view.

Figure 1: Singapore's international flight capacity (as measured by seats) as a % of pre-Covid-19 (2019) levels



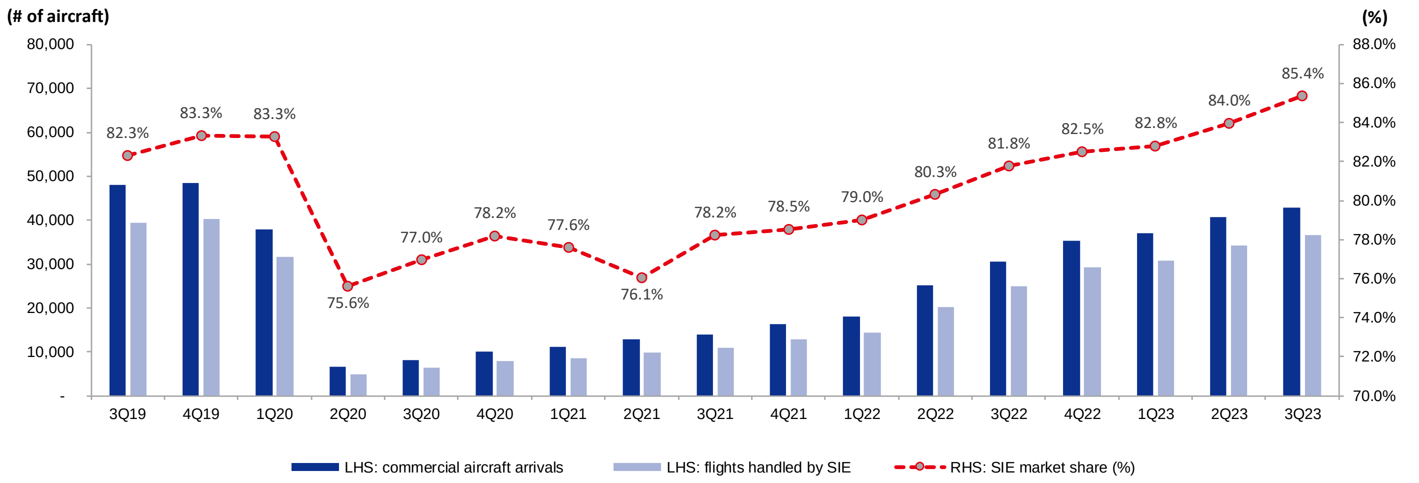
SOURCES: CGS-CIMB RESEARCH, CENTRE FOR AVIATION

Figure 2: SIE typically announces several contracts during the biennial Singapore Airshow

Year	Airshow date	Counterparty	Contracts
2010	2-7 Feb	Panasonic Avionics	JV with Panasonic Avionics to service in-flight entertaiment and communications systems and components
2012	14-19 Feb	Messier-Bugatti-Dowty	Provision of MRO services for Messier-Bugatti-Dowty wheels and brakes
		Scoot	New services agreement with Scoot to provide MRO services for its B777 fleet
		VietJet Air	New services agreement with VietJet Air to provide inventory technical management services for its A320 fleet
2014	11-16 Feb	SilkAir	New services agreement with SilkAir to provide MRO and fleet management services for its B737NG fleet
2016	16-21 Feb	Rolls-Royce	Appointed as on-wing services provider for Trent family of engines
		Airbus	JV with Airbus providing airframe services for A380/A350/A330 aircraft
		Moog	JV with Moog to provide MRO services for Moog's products on newer generation aircraft
		Tigerair Taiwan	Renewal of fleet management programme
2018	6-11 Feb	GE Aviation	JV with GE Aviation to provide engine overhaul services for the GE90 and GE9x engines
		Safran	Collaboration with Safran in using data analytics in the aviation industry
		Stratasys	JV with Stratasays to provide 3D printed parts for use in commercial aviation
		CaseBank Technologies	Collaboration with CaseBank in using advanced diagnostic software in the aviation industry
2020	11-16 Feb	Pos Aviation	Acquisition of 49% stake in Pos Aviation Engineering
		Air Innovation Korea	JV with Air Innovation Korea to provide line maintenance services in Korea
2022	15-18 Feb	SR Technics Switzerland	Acquisition of 75% stake in SR Technics Malaysia
		Jamco Aero Design & Engineering	Joint establishment of a flammability test aviation laboratory and data center

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Figure 3: We expect further air traffic recovery to drive FY25-26F revenue growth, given SIE's dominant line maintenance market share at Changi Airport



** Market share measured using flights handled by SIE as a % of total commercial aircraft arrivals at Changi Airport*
*** Quarters stated in calendar format (as opposed to SIE's FYE March)*

SOURCES: CGS-CIMB RESEARCH, CHANGI AIRPORT GROUP

P&W engine recalls gaining traction

Recall that RTX Corp (RTX US, NR) had in Sep 2023 announced the planned recall of c.3k Pratt & Whitney PW1100G GTF engines as a result of metal contamination issues with its engines. These engines are predominantly used in the A320neo family line of aircraft (mostly A320neo and A321neo). With RTX expecting inspections in 2024F to be more front-loaded, we think SIE's 49%-owned JV Eagle Services Asia (ESA) should start to benefit from increased work volumes from 4QFY24F onwards. SIE had also previously confirmed this during its 2QFY24 analyst brief, during which it said it expected increased engine induction volumes for ESA in 1HCY24F.

Among the seven engine MRO workshops in Asia that are part of P&W's GTF MRO network, ESA is the only workshop located in Southeast Asia, with the remaining six workshops located across China, Japan, Korea, and Taiwan. As such, we surmise that ESA will mainly service airlines operating A320neos that are located in/near Southeast Asia; these are namely Scoot, Cebu Pacific, Philippine Airlines, VietjetAir, Vietnam Airlines, and Air New Zealand. We assume

ESA will not service any GTF engines from airlines headquartered in North Asia, Europe and US.

We estimate that GTF recalls could contribute c.S$5m-10m in additional net profit p.a. to SIE over FY24-26F, premised on stronger associate profits (via ESA) from 1) higher pricing power as airlines try to prevent excessive disruption to their in-service fleets, and 2) slight margin expansion (vs. FY23 margins) from stronger operating leverage.

In addition, widespread grounding of affected aircraft could prompt airlines to 1) reinstate aircraft that are not using GTF engines, and 2) extend the service life of older aircraft. This could benefit SIE as older aircraft will require relatively more base and line maintenance services as compared to newer generation aircraft, in our view.

Figure 4: Among regional airlines operating A320neo family aircraft, we think SIE could likely service an estimated 115 GTF engines over 2024-26F

Airline	Country of origin	Estimated affected GTF engine fleet	Serviced by ESA	GTF engines serviced by ESA
Scoot	Singapore	15	Likely	15
Cebu Pacific	Philippines	31	Likely	31
Philippine Airlines	Philippines	8	Likely	8
VietJet Air	Vietnam	24	Likely	24
Vietnam Airlines	Vietnam	20	Likely	20
Air New Zealand	New Zealand	17	Likely	17
Total				**115**
Airlines from China*	China	179	Unlikely	-
Airlines from Hong Kong*	Hong Kong	16	Unlikely	-
Airlines from India*	India	68	Unlikely	-
Airlines from Korea*	Korea	9	Unlikely	-
Airlines from Taiwan*	Taiwan	6	Unlikely	-
Total				**0**

* Airlines from China include Air China, China Airlines, China Eastern, China Southern, Chongqing Airlines, GX Airlines, Juneyao Air, Lucky Air, Shenzhen Airlines, Spring Airlines, Xiamen Airlines

* Airlines from HongKong include Air Macau, Cathay Pacific, HK Express

* Airlines from India include Air India, IndiGo, Vistara

* Airlines from Korea include Air Busan, Asiana Airlines, Korean Air

* Airlines from Taiwan include Starlux Airlines, Tigerair Taiwan

SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS, CAPA

Valuation and recommendation

We analyse SIE's historical 12-month rolling forward core P/E multiple trend. We highlight three notable periods of re-rating/de-rating.

1) Jan 2012-July 2014. SIE's forward P/E multiple re-rated from 14x to 30x on the back of robust commercial flight arrivals and tourism receipts in Singapore (both hit a record high in 2013), resulting in strong optimism over future MRO demand, in our view.
2) July 2014-Dec 2018. SIE's forward P/E multiple de-rated from 30x to 13x on concerns over headwinds impacting revenue and associates' profits (newer generation planes and engines requiring less MRO work).
3) Dec 2018-end-2019. SIE's forward P/E multiple re-rated from 13x to >30x on media reports on the potential of it being taken private by parent Singapore Airlines (SIA SP, TP: S$6.91), and an improving operating environment (helped by elevated associate contribution from Trent engine repairs).

We raise our FY25-26F EPS by 8% as we expect stronger operating leverage (from revenue recovery) and efficiency gains harnessed from its transformation programme (concluded in May 2023) to drive better-than-expected EBIT margins compared to our previous forecasts.

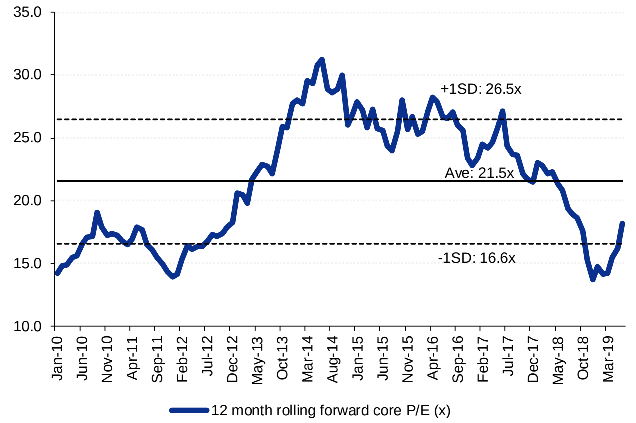
We think SIE is likely set for a three-year earnings upcycle over FY24-26F as the worst (in terms of operational and financial performance) is likely over, in our view. We expect healthy flight volume recovery at Changi Airport (exceeding pre-Covid 19 levels by FY25F, in our view) and positive spill over from issues with newer aircraft/engines to drive SIE's FY24-26F revenue and associate profits growth. Efficiency gains harnessed from its transformation programme (conducted through 2021-23) could drive improved labour productivity in the coming years as workflows and processes are increasingly optimised, in our view.

However, we think that the group's margin profile has changed compared to pre-Covid levels. SIE now faces elevated labour costs on the back of industry shortage of skilled mechanics (resulting in greater challenges in attracting and retaining workers), as well as tougher cost passthrough to airlines. Staff costs (as a % of revenue) have remained above 50% since 2HFY22, compared to the group's FY15-19 average of c.45%.

Hence, in our view, it is fair to peg SIE to 19.5x CY25F P/E, based on 0.5 s.d. below its 10-year pre-Covid-19 historical mean (2010-19). This also implies a 10% discount to its long-term (2010-19) average of 21.5x. Our TP is raised to S$2.70 on account of higher EPS estimates and the rolling forward of our valuation year to CY25F.

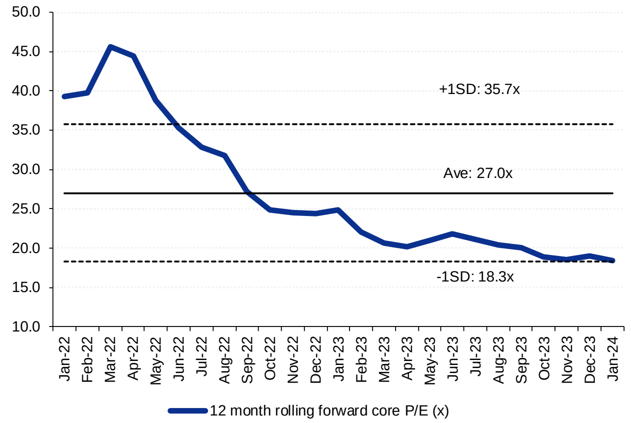
Having maintained our Hold call since Feb 2023, we think it is timely for us to upgrade our recommendation to Add against the backdrop of an improving earnings outlook. Re-rating catalysts include strong profits from ESA, labour cost pressures easing, and strong revenue growth from increased MRO works on older aircraft. Downside risks include lower travel demand from an economic slowdown impacting its MRO volumes, and margin erosion from inability to pass on elevated staff costs.

Figure 5: SIA Engineering's 12-month rolling forward core P/E (x) from 2010-19. Trading bands in 2HCY19 omitted due to the sharp re-rating due to newsflow on the potential of it being taken private



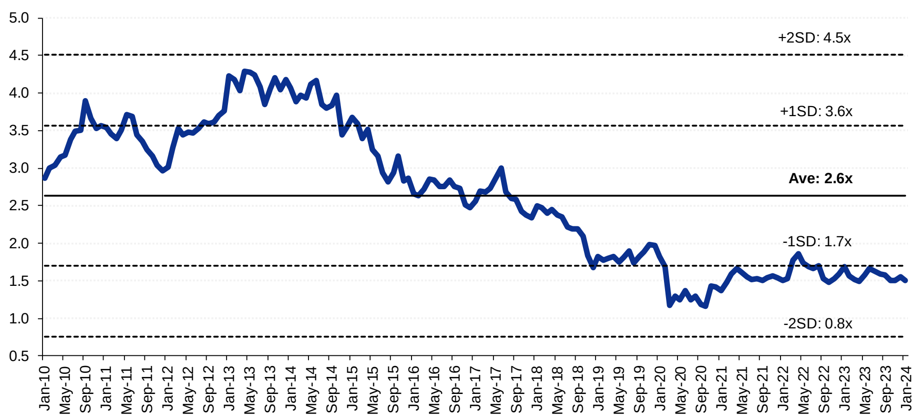
SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS, BLOOMBERG

Figure 6: SIA Engineering's 12-month rolling forward core P/E (x) from 2022 to present



SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS, BLOOMBERG

Figure 7: SIA Engineering P/BV (x)



SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS, BLOOMBERG

Figure 8: Earnings revision

	New			Old			% change		
FYE Mar (S$m)	FY24F	FY25F	FY26F	FY24F	FY25F	FY26F	FY24F	FY25F	FY26F
Revenue	1,044.5	1,175.7	1,242.2	1,043.9	1,177.0	1,243.4	0.1%	-0.1%	-0.1%
Operating profit	5.5	27.3	35.7	5.4	22.7	31.6	0.7%	20.3%	13.1%
Assoc & JVs	103.4	116.7	124.7	103.4	116.7	124.7	0.0%	0.0%	0.0%
Core net profit	122.6	145.2	158.8	122.5	134.5	147.0	0.0%	7.9%	8.0%
Core EPS (Scts)	10.9	12.9	14.1	10.9	12.0	13.1	0.0%	7.9%	8.0%

SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS

Figure 9: Peers Comparison

Company	Bbg Ticker	Recom.	Price (lcl curr)	Target Price (lcl curr)	Market Cap (US$ m)	Core P/E (x) CY24F	Core P/E (x) CY25F	P/BV (x) CY24F	Recurring ROE (%) CY24F	Recurring ROE (%) CY25F	Dividend Yield (%) CY24F
SIA Engineering	SIE SP	Add	2.28	2.70	1,901	18.3	16.5	1.43	8.0%	8.5%	3.1%
ST Engineering	STE SP	Add	3.77	4.36	8,716	17.2	15.0	4.45	27.0%	28.2%	4.2%
SATS Ltd	SATS SP	Add	2.72	3.44	3,011	41.9	22.2	1.90	4.5%	8.4%	1.2%
Simple Average (all co)						**25.8**	**17.9**	**2.59**	**13.2%**	**15.0%**	**2.9%**

SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS, BLOOMBERG
Note: All forecasts for Not rated companies are based on Bloomberg consensus estimates
Data as of 12 Feb 2024

ESG in a nutshell

Refinitiv ESG Scores

B	A+	B	A	B	C-
ESG Score	ESG Controversies Score	ESG Combined Score	ESG Environment Pillar Score	ESG Social Pillar Score	ESG Government Pillar Score

SIA Engineering (SIE) has made steady progress in improving its ESG standing via increased environmental and social initiatives. According to Refinitiv, the group's overall ESG score improved from C- in FY16 to B in FY23. Its current score of B is split into Environment: A (weightage: 29.1%), Social: B (weightage: 42.7%) and Governance: C- (weightage 28.2%). We believe the group will continue to improve its ESG standing as it strives towards its long-term 2030 carbon emissions target.

Keep your eye on

SIE was fined S$230k in FY18 over a workplace safety lapse which resulted in the death of a foreign worker at the Changi Hangar Complex. SIE was charged for failing to ensure an adequately safe workplace environment, as well as failing to implement adequate risk assessment. In FY20, an SIE employee fell from an aircraft while performing maintenance work, the result of which was fatal.

Implications

As a company with labour-intensive operations, it is imperative for SIE to maintain high workplace safety standards. Since FY18, the group has steadily improved its safety measures, resulting in a decline in the reportable accident rate (accidents per million hours) from 2.06 in FY18 to 1.62 in FY20. However, we believe there is room for improvement, given the two workplace fatalities over the course of FY18-20. Positively, there were zero work-related fatalities in FY21-23. We will continue to monitor the group's adherence to high international safety standards.

ESG highlights

According to Refinitiv, SIE scored an overall ESG score of A in FY23, which is above its Singapore aviation services peer SATS Ltd (scored B by Refinitiv).

SIE improved its Environmental score to A- from C- in 2018. We believe this was attributable to the installation of solar photovoltaic systems on the roofs of its buildings and hangars, which reduced its electricity consumption from non-renewable sources by 20%. SIE has also set a long-term target of achieving more than 24.48% reduction in carbon emissions intensity level by 2030 (base year: FY14).

Implications

We like that SIE has made efforts to improve its environmental performance, showing its commitment to environmental sustainability. The group also fares satisfactorily with regards to corporate governance, with little controversy in recent years. We have not factored this into our fundamental valuations of SIE yet.

Trends

SIE steadily improved its Social score from D+ in FY17 to B in FY23.

In FY18, SIE introduced various initiatives to promote safe workplace behaviour. These initiatives include the introduction of an aircraft towing simulator offering risk-free virtual training to staff, automated guided vehicles (AGVs) with enhanced safety features, and development of a computer-based workplace safety training module.

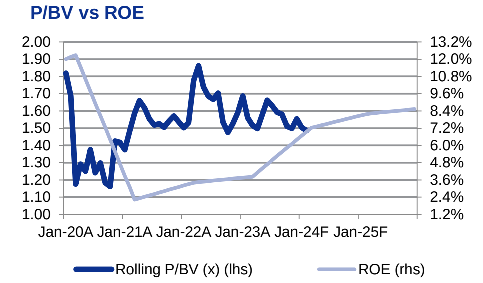
In FY22, SIE launched its new Lean Academy, a training institute targeted at re-skilling and upskilling its workforce. In FY23, SIE launched a diversity task force to implement initiatives that promote inclusiveness and attract varied talents from various backgrounds.

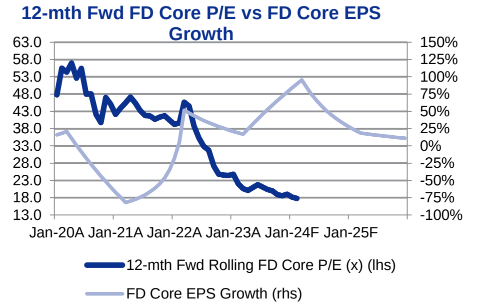
Implications

SIE is showing a clear commitment towards better safety and staff welfare, as demonstrated by its efforts in recent years. We have not factored these into our fundamental valuations of SIE yet.

SOURCES: CGS-CIMB RESEARCH, REFINITIV

BY THE NUMBERS





Profit & Loss

(S$m)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Net Revenues	**566.1**	**796.0**	**1,044.5**	**1,175.7**	**1,242.2**
Gross Profit	**485.3**	**677.2**	**878.4**	**991.1**	**1,049.7**
Operating EBITDA	**41.5**	**37.7**	**69.5**	**93.1**	**103.4**
Depreciation And Amortisation	(63.3)	(64.0)	(64.0)	(65.8)	(67.6)
Operating EBIT	**(21.9)**	**(26.3)**	**5.5**	**27.3**	**35.7**
Financial Income/(Expense)	(0.8)	10.3	20.5	18.0	17.0
Pretax Income/(Loss) from Assoc.	79.1	77.8	103.4	116.7	124.7
Non-Operating Income/(Expense)	(7.2)	3.7	0.0	0.0	0.0
Profit Before Tax (pre-EI)	**49.2**	**65.5**	**129.3**	**162.1**	**177.4**
Exceptional Items					
Pre-tax Profit	**49.2**	**65.5**	**129.3**	**162.1**	**177.4**
Taxation	18.6	1.0	(6.5)	(16.2)	(17.7)
Exceptional Income - post-tax					
Profit After Tax	**67.8**	**66.5**	**122.9**	**145.9**	**159.7**
Minority Interests	(0.2)	(0.1)	(0.3)	(0.7)	(0.9)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	**67.6**	**66.4**	**122.6**	**145.2**	**158.8**
Recurring Net Profit	53.5	62.7	122.6	145.2	158.8
Fully Diluted Recurring Net Profit	**53.5**	**62.7**	**122.6**	**145.2**	**158.8**

Cash Flow

(S$m)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
EBITDA	41.46	37.70	69.46	93.12	103.35
Cash Flow from Invt. & Assoc.	(79.09)	(77.81)	(103.36)	(116.73)	(124.67)
Change In Working Capital	(9.05)	21.51	(7.77)	(10.50)	(5.32)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	81.45	74.69	57.86	73.73	82.67
Net Interest (Paid)/Received	(0.86)	5.54	20.50	18.00	17.00
Tax Paid	(4.71)	2.99	(6.47)	(16.21)	(17.74)
Cashflow From Operations	**29.20**	**64.61**	**30.22**	**41.41**	**55.29**
Capex	(18.43)	(48.60)	(30.00)	(30.00)	(30.00)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	34.18	29.14	65.00	68.00	67.00
Cash Flow From Investing	**15.75**	**(19.46)**	**35.00**	**38.00**	**37.00**
Debt Raised/(repaid)	(7.14)	(0.44)	0.00	0.00	0.00
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	0.00	0.00	(61.79)	(67.33)	(84.17)
Preferred Dividends					
Other Financing Cashflow	(28.61)	(36.67)	(4.50)	(5.00)	(5.00)
Cash Flow From Financing	**(35.74)**	**(37.11)**	**(66.29)**	**(72.33)**	**(89.17)**
Total Cash Generated	9.21	8.04	(1.07)	7.08	3.13
Free Cashflow To Equity	**37.81**	**44.71**	**65.22**	**79.41**	**92.29**
Free Cashflow To Firm	**47.58**	**47.15**	**69.72**	**84.41**	**97.29**

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

BY THE NUMBERS… cont'd

Balance Sheet

(S$m)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Cash And Equivalents	625	633	632	639	642
Total Debtors	35	34	47	53	56
Inventories	33	43	57	65	68
Total Other Current Assets	219	242	249	270	280
Total Current Assets	**913**	**952**	**985**	**1,026**	**1,047**
Fixed Assets	157	175	171	164	156
Total Investments	448	453	516	588	668
Intangible Assets	33	41	36	32	27
Total Other Non-Current Assets	287	362	362	362	362
Total Non-current Assets	**925**	**1,031**	**1,086**	**1,146**	**1,213**
Short-term Debt	3	2	2	2	2
Current Portion of Long-Term Debt					
Total Creditors	128	162	188	212	224
Other Current Liabilities	47	51	51	51	51
Total Current Liabilities	**178**	**216**	**241**	**265**	**277**
Total Long-term Debt	0	0	0	0	0
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	39	91	91	91	91
Total Non-current Liabilities	**39**	**91**	**91**	**91**	**91**
Total Provisions	0	0	0	0	0
Total Liabilities	**217**	**307**	**333**	**356**	**368**
Shareholders' Equity	1,611	1,666	1,727	1,805	1,879
Minority Interests	11	11	11	12	12
Total Equity	**1,621**	**1,677**	**1,738**	**1,816**	**1,892**

Key Ratios

	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Revenue Growth	27.8%	40.6%	31.2%	12.6%	5.7%
Operating EBITDA Growth	(10.3%)	(9.1%)	84.2%	34.1%	11.0%
Operating EBITDA Margin	7.32%	4.74%	6.65%	7.92%	8.32%
Net Cash Per Share (S$)	0.55	0.56	0.56	0.57	0.57
BVPS (S$)	1.44	1.48	1.54	1.61	1.67
Gross Interest Cover	(8.31)	(13.15)	1.21	5.47	7.15
Effective Tax Rate	0.0%	0.0%	5.0%	10.0%	10.0%
Net Dividend Payout Ratio	NA	93.1%	54.9%	58.0%	63.6%
Accounts Receivables Days	22.62	15.93	14.22	15.51	15.99
Inventory Days	153.8	117.3	111.1	120.7	126.1
Accounts Payables Days	642.6	445.4	385.7	395.1	412.5
ROIC (%)	(5.38%)	(4.53%)	0.76%	3.60%	4.71%
ROCE (%)	(1.26%)	(0.85%)	1.78%	2.83%	3.11%
Return On Average Assets	3.78%	2.93%	5.10%	6.11%	6.51%

Key Drivers

	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Airframe overhaul and line maintenance yoy (%)	23.6%	38.5%	28.0%	11.9%	5.8%
Engine and component yoy (%)	51.1%	50.6%	45.0%	15.0%	5.0%

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Company Note

Conglomerate | Singapore | February 12, 2024

Singapore

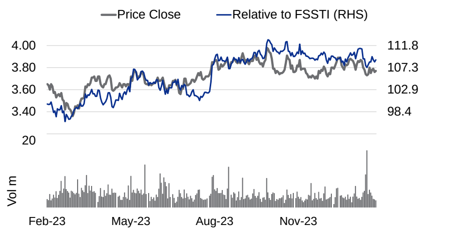
ADD *(no change)*

Consensus ratings*:	Buy 12 Hold 2 Sell 0
Current price:	S$3.77
Target price:	S$4.36
Previous target:	S$4.27
Up/downside:	15.6%
CGS-CIMB / Consensus:	0.4%
Reuters:	STEG.SI
Bloomberg:	STE SP
Market cap:	US$8,716m
	S$11,737m
Average daily turnover:	US$9.62m
	S$12.87m
Current shares o/s:	3,122m
Free float:	49.0%

Source: Bloomberg

Key changes in this note

- FY24-25F core EPS lowered by 2-4% as slower USS margin recovery is partially offset by lower interest expenses (from debt reduction).



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	-1.3	-1.3	2.2
Relative (%)	0.6	-1.4	8.8

Major shareholders	% held
Temasek Holdings	50.0
Capital Group	5.0
BlackRock	1.8

ST Engineering

Longer-term growth drivers intact

- We think elevated global MRO demand (US and China) and improving PTF profitability should drive healthy CA EBIT growth over FY24-25F.
- We push back our USS margin recovery expectations on concerns over slower project spend and time lag for Satcom transformation to bear fruit.
- Reiterate Add. Our TP is raised to S$4.36, based on a blended valuation.

Bright outlook ahead for Commercial Aerospace

We expect airlines to face capacity disruptions in 2024F as safety issues surrounding newer generation aircraft/engines could drive increased fleet groundings. We believe this should translate into airlines extending the service life of older aircraft or reinstating their inactive fleet, driving heightened demand for STE's MRO services given the heavier work content associated with older aircraft models. While STE does not service GTF engines and has no direct exposure to recalls, we note that a sizeable portion of aircraft facing issues (A320neo, B787, B737 MAX) are based in China and the US, which should accord increased MRO volumes for STE's overseas hangars, in our view. We see healthy growth for the OEM business, premised on stable nacelle production and improving PTF profitability. We raise FY24-25F CA EBIT by 1-5% as we see an improved MRO outlook.

Pushing back our recovery expectations for USS

Against the backdrop of slow and uneven economic growth in 2024F, we think enterprise spending could take a hit as companies slow their non-essential spending. Margin recovery will likely be weighed by increased R&D costs, slower project executions and time lag for Satcom transformation initiatives to bear fruit. Ramp-up of major projects in 2024-25F (e.g. US congestion pricing and tolling projects, Taiwan rail mobility) should be a key topline driver, in our view. Following a review of our margin assumptions, we temper our growth expectations and now expect USS OPM to only exceed FY20 levels in FY25F (vs. FY24F previously) upon full integration of subsidiary TransCore and realisation of streamlined Satcom costs.

2H23F: expecting net profit of c.S$276m (+10% yoy, -2% hoh)

STE will report 2H23F results on 29 Feb. We believe the key driver was CA on stronger hoh OPM of 8.9% (1H23: 8.3%) on stronger operating leverage from higher revenue (+24% yoy, 6% hoh) and improving PTF margins. DPS could surprise on the upside if OPM remains as strong as 1H23 of 14% due to project mix delivery. We conservatively expect DPS OPM at 8.3% for 2H23F with FY23F OPM at 11.2% (FY22: 8.5%). USS should be profitable at EBIT level as we estimate OPM of 3.6% (1H23: op. loss of 3.4%)

Reiterate Add: TP raised to S$4.36 on rollover to CY25F

Our TP is raised to S$4.36 based on a blended valuation (Fig 5). Re-rating catalysts: quicker USS margin recovery, strong MRO demand from higher usage of older jets. Key downside risks: project cost overruns, global economic slowdown impacting order wins.

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Financial Summary	Dec-21A	Dec-22A	Dec-23F	Dec-24F	Dec-25F
Revenue (S$m)	7,693	9,035	9,904	10,514	11,152
Operating EBITDA (S$m)	1,044	1,181	1,250	1,388	1,486
Net Profit (S$m)	570.5	535.0	556.9	683.9	785.2
Core EPS (S$)	0.18	0.15	0.19	0.22	0.25
Core EPS Growth	9.3%	(18.8%)	25.5%	17.7%	14.8%
FD Core P/E (x)	20.60	25.39	20.23	17.19	14.97
DPS (S$)	0.15	0.16	0.16	0.16	0.16
Dividend Yield	3.98%	4.24%	4.24%	4.24%	4.24%
EV/EBITDA (x)	12.29	14.79	14.01	12.49	11.49
P/FCFE (x)	15.58	17.37	37.86	16.81	12.08
Net Gearing	49%	224%	219%	198%	171%
P/BV (x)	4.87	4.90	4.79	4.45	4.02
ROE	24.3%	19.2%	23.9%	26.8%	28.2%
% Change In Core EPS Estimates			0.69%	(2.11%)	(3.80%)
EPS/Consensus EPS (x)			0.95	1.01	1.02

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Longer-term growth drivers intact

Abbreviation list

CA: Commercial Aerospace
CAPA: Centre for Aviation
DPS: Defence and Public Security
MRO: Maintenance, repair and overhaul
OEM: Original equipment manufacturer
PTF: Passenger-to-freighter
STE: ST Engineering
USS: Urban Solutions and Satcom

CA could benefit from equipment issues

Recall that STE operates airframe facilities across Singapore (Changi, Paya Lebar, and Seletar), China (Guangzhou, Shanghai) and the US (Mobile, Pensacola, San Antonio). In light of recent quality issues with newer generation aircraft (B737 MAX-9, B787) and engines (GTF), we think that there could be positive impact for STE's MRO services as widespread aircraft grounding should prompt airlines to extend the service life of older aircraft or reinstate inactive aircraft. Given the heavier work content required for older aircraft, we think this should translate into heightened demand for STE's airframe and MRO services in 2024-25F. Based on data from CAPA, a sizeable portion of affected aircraft is based in the US and China; c.89% of the global B737 Max-9 fleet operate in the US, while c.47%/20% of the global A320neo fleet operate in Asia/US. We believe this presents a decent addressable market for STE's overseas MRO business to capture in the coming quarters, in our view.

On the OEM front, we expect a healthy ramp-up in nacelle production (via subsidiary MRAS) as Airbus deliveries improve in tandem with easing supply chain disruptions. We do acknowledge that aircraft OEMs (Airbus and Boeing) are still facing delivery delays due to supply chain issues and labour instability, which should still point to elevated lead times in 2024F, in our view. PTF profitability should continue to improve in 2024F given quicker progression on the learning curve. Longer-term revenue upside should come from the commencement of new capacity, as STE is adding new hangars in China (Guangzhou, Hubei), the US (Pensacola), and Singapore; we believe these are set to progressively come online through 2024-25F.

Debt paydown could lower interest expenses

We think strong operating cash flow generation and potential aircraft sales (1H23: S$98m, likely some in 4Q23F) should allow STE to lower its debt levels in FY23-24F. As shared in its 3Q23 analyst briefing, STE believes its near-term debt levels could range between mid-S$5bn to low-S$6bn. Hence, we think STE could reduce its total debt to S$6.1bn by end-FY23F (end-FY22: S$6.5bn), and potentially paring down to S$5.9bn by end-FY24F. STE had also successfully lowered its floating debt borrowings to 35% of total debt as at end-June 23 (vs. 47% as at end-Dec 22) on the back of some refinancing via fixed rate bonds.

With higher debt repayment assumptions, we lower our FY24-25F interest expenses assumptions by 3-7%. Upside could come from faster-than-expected repayments (supported via aircraft sales) and/or rate cuts by the US Federal Reserve (lowering interest paid on short-term commercial paper).

Figure 1: We expect strong operating cash flow and aircraft sales to drive debt levels down to S$6.1bn by end-FY23F

Type	End-FY22 balance (S$m)(**)	End-FY23F estimated balance (S$m)	Assumed FY23F interest rate (%)	FY23F interest expense (S$m)	Comments
Floating debt:					
Commercial paper (*)	2,699	1,799	5.2%	94	We expect a c.S$900m reduction in CP balance as STE refinances using longer-term bonds in FY23F
Other floating loans and borrowings	401	301	5.0%	15	
Total	**3,100**	**2,100**		**109**	
Fixed debt:					
Fixed 1.5% bond due 2025	983	983	1.5%	18	
Fixed 3.375% MTN due 2027	952	952	2.7%	26	Yield lowered using treasury lock gains
Fixed 3.750% MTN due 2032	405	405	3.1%	13	Yield lowered using treasury lock gains
New bond issuance	-	700	3.3%	23	Yield lowered using treasury lock gains
Lease liabilities	589	589	4.0%	24	
Other fixed loans and borrowings	506	406	3.2%	13	
Total	**3,435**	**4,035**		**116**	
Total	**6,535**	**6,135**		**224**	

(*) S$900m reduction in CP arising from S$700m in new bond issuances and S$200m from repayment
(**) End FY22 fixed debt balance is estimated

SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS

2H23F preview

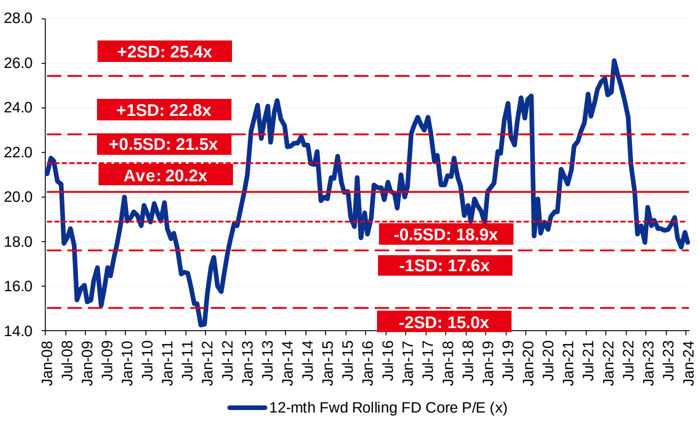
We expect CA to report seasonal hoh stronger revenue of S$1.9bn (+6% hoh), mainly on high hangar utilisation. This should flow through to its OP level and we forecast 10% OPM in 2H23. USS likely saw higher hoh revenue (guided in 3Q23 results) of S$961m (+8% hoh) but overall OPM was likely challenged by higher R&D costs, gradual catch up in activities previously affected by chip shortage and high overhead costs, in our view. Recall that DPS achieved 14% of OPM in 1H23 on delivery and recognition of high-margin projects. We conservatively factor in 8.3% of OPM for DPS in 2H23F on steady revenue run rate of S$2.1bn.

Figure 2: Revenue and EBIT forecast by segment

	1H22	2H22	1H23	2H23F	yoy%	hoh%	Comments
Segment revenue (S$m)							
Commercial Aerospace	1,404	1,587	1,856	1,970	24.2%	6.2%	Seasonal effect, stronger MRO and PTF
Urban Solutions & Satcom	757	1,015	891	961	-5.3%	7.9%	Slower yoy SATCOMS sale but expect better hoh fr execution of Transcore projects
Defence & Public Security	2,108	2,163	2,117	2,110	-2.5%	-0.4%	Steady
Total revenue	**4,270**	**4,765**	**4,863**	**5,041**	5.8%	3.7%	
EBIT (S$m)							
Commercial Aerospace	183	118	178	197	66.2%	10.7%	Improved operating leverage
Urban Solutions & Satcom	(12)	41	(34)	35	-16.1%	nm	yoy weaker profits on higher R&D costs, gradual catch up of chip-shortage issues and transformation costs
Defence & Public Security	214	191	301	175	-8.1%	-41.7%	Upside if project mix is as favourable as 1H23
Total EBIT	**385**	**351**	**444**	**407**	16.0%	-8.5%	
EBIT margin (%)							
Commercial Aerospace	13.0%	7.5%	9.6%	10.0%			Improved operating leverage
Urban Solutions & Satcom	-1.6%	4.1%	-3.8%	3.6%			Weaker yoy
Defence & Public Security	10.1%	8.8%	14.2%	8.3%			Overall OPM for FY23 assumed to be at c.11% vs. 9.5% in FY22
Reported net profit	**280**	**255**	**281**	**276**	8.3%	-1.5%	
EI	72	-	(24)	-			
Reported net profit	**208**	**255**	**305**	**276**	8.3%	-9.3%	

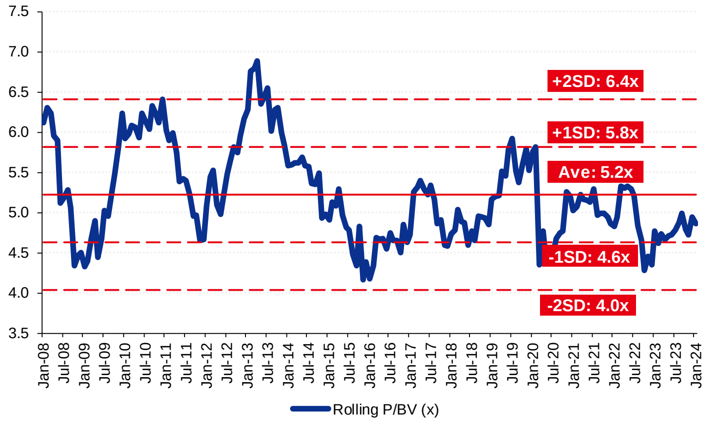
SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS

Figure 3: ST Engineering 12-month rolling forward core P/E (x)



SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS, BLOOMBERG

Figure 4: ST Engineering P/BV (x)



SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS, BLOOMBERG

Figure 5: Blended valuations (equal weightage)

Method	Value per share (S$)	Basis
P/E	4.93	20x CY25 EPS
DCF	4.14	WACC 7.1%, LTG 2%
Dividend yield (%)	4.00	4% net yield on FY24F DPS
Average	**4.36**	

SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS

Figure 6: Earnings revision

	New			Old			% change		
FYE Dec (S$ m)	FY23F	FY24F	FY25F	FY23F	FY24F	FY25F	FY23F	FY24F	FY25F
Revenue	9,904.4	10,514.0	11,152.3	9,821.7	10,487.1	11,157.1	0.8%	0.3%	0.0%
Gross profit	**1,972.2**	**2,161.9**	**2,335.2**	**2,085.8**	**2,316.0**	**2,513.7**	**-5.4%**	**-6.7%**	**-7.1%**
EBIT	803.8	940.7	1,038.1	848.9	992.6	1,103.2	-5.3%	-5.2%	-5.9%
Interest expense	(224.4)	(208.5)	(191.2)	(224.9)	(224.9)	(197.2)	-0.2%	-7.3%	-3.1%
Core net profit	**580.9**	**683.9**	**785.2**	**576.9**	**698.6**	**816.2**	**0.7%**	**-2.1%**	**-3.8%**

SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS

Figure 7: Peers Comparison

Company	Bbg Ticker	Recom.	Price (lcl curr)	Target Price (lcl curr)	Market Cap (US$ m)	Core P/E (x) CY24F	Core P/E (x) CY25F	P/BV (x) CY24F	Recurring ROE (%) CY24F	Recurring ROE (%) CY25F	Dividend Yield (%) CY24F
SIA Engineering	SIE SP	Add	2.28	2.70	1,901	18.3	16.5	1.43	8.0%	8.5%	3.1%
ST Engineering	STE SP	Add	3.77	4.36	8,716	17.2	15.0	4.45	27.0%	28.2%	4.2%
SATS Ltd	SATS SP	Add	2.72	3.44	3,011	41.9	22.2	1.90	4.5%	8.4%	1.2%
Simple Average (all co)						**25.8**	**17.9**	**2.59**	**13.2%**	**15.0%**	**2.9%**

SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS, BLOOMBERG
Note: All forecasts for Not rated companies are based on Bloomberg consensus estimates
Data as of 12 Feb 2024

ESG in a nutshell

Refinitiv ESG Scores

B	A+	B	A-	B	B
ESG Score	ESG Controversies Score	ESG Combined Score	ESG Environment Pillar Score	ESG Social Pillar Score	ESG Government Pillar Score

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 anti-personnel landmines/cluster munitions. Accordingly, its ESG combined score by Refinitiv has improved from a B- since 2015 to B in 2022 [says B on top]. The current score of B is split into E: A- (weightage 23.7%); S: B (weightage 43.9%); and G: B (weightage 32.4%). Being a Temasek-linked company, STE plays a role in helping Singapore achieve its 2030 Green Plan, in our view.

Keep your eye on	Implications
As STE is involved in the defence industry, the transparency of its information could be limited at times in relation to contract wins/tender pipeline. Order book amount disclosed includes defence contracts, but details are not disclosed.	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.

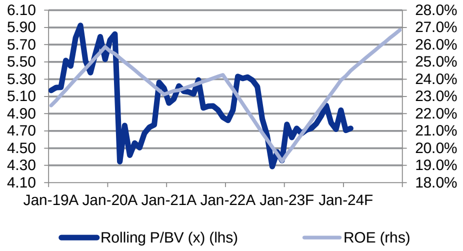
ESG highlights	Implications
Refinitiv ranked STE slightly below its Singapore industrial peer (KEP: B+) in 2022. STE scored particularly well in Environment (A-), which we believe was due to its emission reduction target achievement. In 2022, STE achieved a reduction of 37% (2021: 30% reduction) in greenhouse gas (GHG) emission intensity, which surpassed its target of a 36% reduction on a business-as-usual basis by 2030F, with 2010 as base year.	STE generally appears to fare well in environmental efforts among Singapore corporates, while governance is decent with little controversy in recent years. Hence, we believe STE 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 valuation of STE.

Trends	Implications
STE improved in the Environment pillar, based on Refinitiv rankings in 2022, 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 over time in its Social pillar in 2022, with a score of B (vs. C+ in 2018), mainly due to the disclosure of its human rights policy — with zero tolerance for unethical labour practices such as child labour, forced labour, slavery and human trafficking in its operations; the group maintained its score in 2020-22.	As STE ramps up its projects in smart cities, it could gain more interest from funds that focus on high E and S scores.

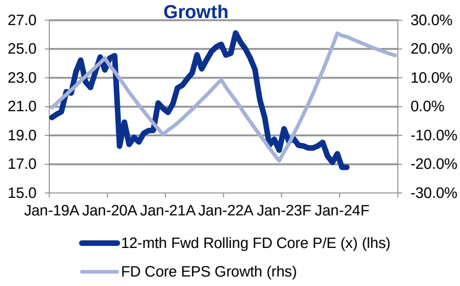
SOURCES: CGS-CIMB RESEARCH, REFINITIV

BY THE NUMBERS

P/BV vs ROE



12-mth Fwd FD Core P/E vs FD Core EPS Growth



Profit & Loss

(S$m)	Dec-21A	Dec-22A	Dec-23F	Dec-24F	Dec-25F
Total Net Revenues	**7,693**	**9,035**	**9,904**	**10,514**	**11,152**
Gross Profit	**1,535**	**1,699**	**1,972**	**2,162**	**2,335**
Operating EBITDA	**1,044**	**1,181**	**1,250**	**1,388**	**1,486**
Depreciation And Amortisation	(398)	(517)	(446)	(448)	(448)
Operating EBIT	**646**	**665**	**804**	**941**	**1,038**
Financial Income/(Expense)	(36)	(138)	(184)	(176)	(156)
Pretax Income/(Loss) from Assoc.	16	33	48	52	53
Non-Operating Income/(Expense)	12	37	(1)	0	0
Profit Before Tax (pre-EI)	**638**	**597**	**666**	**816**	**935**
Exceptional Items					
Pre-tax Profit	**638**	**597**	**666**	**816**	**935**
Taxation	(71)	(54)	(100)	(122)	(140)
Exceptional Income - post-tax					
Profit After Tax	**567**	**543**	**566**	**694**	**795**
Minority Interests	4	(8)	(10)	(10)	(10)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	**571**	**535**	**557**	**684**	**785**
Recurring Net Profit	571	463	581	684	785
Fully Diluted Recurring Net Profit	**571**	**463**	**581**	**684**	**785**

Cash Flow

(S$m)	Dec-21A	Dec-22A	Dec-23F	Dec-24F	Dec-25F
EBITDA	1,044	1,181	1,250	1,388	1,486
Cash Flow from Invt. & Assoc.	(16)	(33)	(48)	(52)	(53)
Change In Working Capital	137	(442)	(138)	(65)	(69)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	105	216	271	260	244
Net Interest (Paid)/Received	(44)	(142)	(184)	(176)	(156)
Tax Paid	(112)	(108)	(100)	(122)	(140)
Cashflow From Operations	**1,114**	**673**	**1,052**	**1,233**	**1,312**
Capex	(312)	(763)	(400)	(300)	(300)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(102)	(3,809)	59	(33)	(39)
Cash Flow From Investing	**(414)**	**(4,571)**	**(341)**	**(333)**	**(339)**
Debt Raised/(repaid)	54	4,575	(400)	(200)	0
Proceeds From Issue Of Shares	0	0	0	0	0
Shares Repurchased	(33)	(26)	0	0	0
Dividends Paid	(468)	(686)	(500)	(500)	(500)
Preferred Dividends					
Other Financing Cashflow	(168)	(165)	(224)	(208)	(191)
Cash Flow From Financing	**(615)**	**3,698**	**(1,124)**	**(908)**	**(691)**
Total Cash Generated	86	(201)	(414)	(9)	282
Free Cashflow To Equity	**754**	**677**	**310**	**699**	**973**
Free Cashflow To Firm	**748**	**(3,750)**	**935**	**1,108**	**1,164**

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

BY THE NUMBERS… cont'd

Balance Sheet

(S$m)	Dec-21A	Dec-22A	Dec-23F	Dec-24F	Dec-25F
Total Cash And Equivalents	816	602	188	179	462
Total Debtors	1,067	1,152	1,221	1,311	1,405
Inventories	1,261	1,684	1,739	1,785	1,860
Total Other Current Assets	2,213	2,689	2,603	2,606	2,609
Total Current Assets	**5,356**	**6,127**	**5,751**	**5,881**	**6,337**
Fixed Assets	1,794	2,076	2,149	2,204	2,253
Total Investments	519	545	535	523	512
Intangible Assets	1,993	5,291	5,172	5,066	4,971
Total Other Non-Current Assets	854	924	924	924	924
Total Non-current Assets	**5,159**	**8,837**	**8,780**	**8,717**	**8,661**
Short-term Debt	560	3,628	3,628	3,628	3,628
Current Portion of Long-Term Debt					
Total Creditors	2,613	2,826	2,760	2,815	2,899
Other Current Liabilities	1,507	1,551	1,517	1,536	1,556
Total Current Liabilities	**4,680**	**8,005**	**7,905**	**7,979**	**8,083**
Total Long-term Debt	1,555	2,907	2,507	2,307	2,307
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	1,612	1,399	1,399	1,399	1,399
Total Non-current Liabilities	**3,168**	**4,306**	**3,906**	**3,706**	**3,706**
Total Provisions	0	0	0	0	0
Total Liabilities	**7,847**	**12,311**	**11,811**	**11,685**	**11,789**
Shareholders' Equity	2,413	2,398	2,455	2,640	2,925
Minority Interests	255	255	264	274	284
Total Equity	**2,668**	**2,653**	**2,720**	**2,914**	**3,209**

Key Ratios

	Dec-21A	Dec-22A	Dec-23F	Dec-24F	Dec-25F
Revenue Growth	7.5%	17.4%	9.6%	6.2%	6.1%
Operating EBITDA Growth	10.1%	13.2%	5.8%	11.1%	7.1%
Operating EBITDA Margin	13.6%	13.1%	12.6%	13.2%	13.3%
Net Cash Per Share (S$)	(0.42)	(1.90)	(1.91)	(1.85)	(1.76)
BVPS (S$)	0.77	0.77	0.79	0.85	0.94
Gross Interest Cover	13.53	4.47	3.58	4.51	5.43
Effective Tax Rate	11.1%	9.1%	15.0%	15.0%	15.0%
Net Dividend Payout Ratio	82.1%	93.4%	89.7%	73.1%	63.6%
Accounts Receivables Days	50.17	44.82	43.73	44.07	44.45
Inventory Days	74.99	73.27	78.75	77.20	75.44
Accounts Payables Days	143.2	135.3	128.5	122.1	118.3
ROIC (%)	11.6%	11.9%	7.2%	8.4%	9.2%
ROCE (%)	14.0%	9.7%	9.4%	11.0%	11.9%
Return On Average Assets	5.85%	5.25%	4.90%	5.79%	6.27%

Key Drivers

	Dec-21A	Dec-22A	Dec-23F	Dec-24F	Dec-25F
Commercial Aerospace sales (S$m)	2,464.8	2,991.2	3,825.9	4,064.0	4,286.8
Urban Solutions & Satcom sales (S$m)	1,190.5	1,772.2	1,851.7	2,023.3	2,228.9
Defence & Public Security sales (S$m)	4,037.5	4,271.7	4,226.9	4,426.8	4,636.6

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Score Range:	90 - 100	80 – 89	70 - 79	Below 70	No Survey Result
Description:	Excellent	Very Good	Good	N/A	N/A

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Distribution of stock ratings and investment banking clients for quarter ended on 31 December 2023 636 companies under coverage for quarter ended on 31 December 2023		
	Rating Distribution (%)	Investment Banking clients (%)
Add	67.5%	1.3%
Hold	22.5%	0.0%
Reduce	10.1%	0.2%

Recommendation Framework

Stock Ratings	Definition:
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.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings	Definition:
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
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.

Country Ratings	Definition:
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.

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