

ST Engineering Ltd

Above Expectations

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STE.SP | STEG.SI | STN.SG
Industry: Defence & Aerospace

Phillip Securities Research Pte Ltd

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Report type: Results

Company Overview

ST Engineering (STE) is an integrated engineering group with exposures to four key business segments: Aerospace, Marine, Electronics and Land Systems. The company is also an anchor customer of Singapore's defence industry.

- 7.4% increase in PATMI to S\$528mn in FY11
- ROPAX contract termination reduced sales by S\$176mn
- Final dividend of 12.5cents proposed
- Maintain Accumulate with revised TP of S\$3.37

What is the news?

STE reported a credible set of results with PATMI growth of 7.4% to S\$528mn in FY11. Revenue was little changed as compared to FY10, mainly due to the S\$176mn reversal of sales booked for the terminated ROPAX contract. 12.5cents of dividend had been proposed, translating to payout ratio of 90%. Order book improved sequentially to an all time high of S\$12.3bn, implying a net increase of S\$1.3bn from 3months ago. Outlook statement: Expect higher revenue and PBT in FY12E.

Fig.1. Results Summary

Income Statement				
(Extract)	FY10	FY11	y-y (%)	Comments
(US\$m)				
Revenue	5,984	5,991	0.1%	Ropax reversal, Weaker USD
EBITDA	719	743	3.3%	
EBIT	587	608	3.6%	
Net Income	491	528	7.4%	Above expectations

Source: Company, PSR

How do we view this?

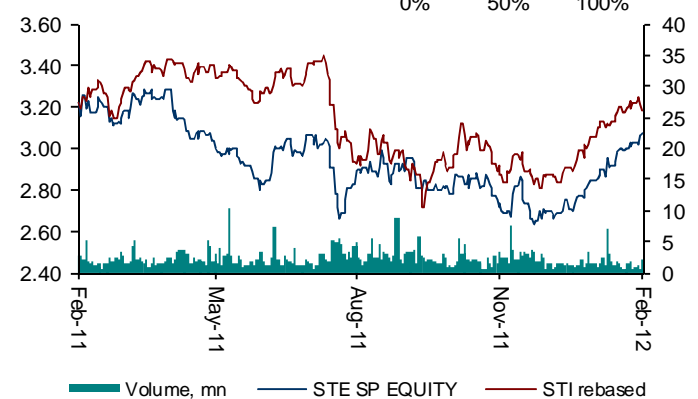
STE's performance was above our expectations mainly due to better than expected margins in 4QFY11. We expect earnings growth of 2-3% over the next 2 years driven by its robust order book. The Aerospace division, STE's largest profit contributor, is expected to undergo significant capacity expansion over the next few years and would allow the company to tap into the fastest growing markets in the industry.

Investment Actions?

We revised our earnings estimates up and lift our target price to S\$3.37, based on a blended valuation of DCF & P/E. Maintain Accumulate.

ST Engineering Ltd

Rating	2	Accumulate
- Previous Rating	2	Accumulate
Target Price (SGD)	3.37	
- Previous Target Price (SGD)	3.13	
Closing Price (SGD)	3.08	
Expected Capital Gains (%)	9.4%	
Expected Dividend Yield (%)	5.1%	
Expected Total Return (%)	14.5%	
Raw Beta (Past 2yrs weekly data)	0.65	
Market Cap. (USD mn / SGD mn)	7466 / 9389	
Enterprise Value (USD mn / SGD mn)	7383 / 9281	
3M Average Daily T/O (mn)	2.0	
52 w week range (SGD)	2.61 - 3.23	
Closing Price in 52 w week range		



Major Shareholders

	(%)
1. Temasek Holdings Pte Ltd	51.1
2. Aberdeen Asset Management	11.0
3. Capital Research Global Investor	5.5

Key Financial Summary

FYE	12/10	12/11	12/12F	12/13F
Revenue (SGD mn)	5,984	5,991	6,431	6,693
Net Profit, adj. (SGD mn)	491	528	542	553
EPS, adj. (SGD)	0.16	0.17	0.18	0.18
P/E (X),adj.	19.1	17.9	17.5	17.2
BVPS (SGD)	0.53	0.58	0.61	0.63
P/B (X)	5.8	5.3	5.1	4.9
DPS (SGD)	0.15	0.16	0.16	0.16
Div. Yield (%)	4.7%	5.0%	5.1%	5.2%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Valuation Method

Blended Valuation:

DCF (WACC: 7.3%; terminal g: 3.5%), 18X P/E (FY11/12E)

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Group

The Aerospace division continued to be the largest revenue and profit contributor to the Group. A sequential improvement in the Group's revenue & PBT of 11% in 4QFY11 is the key source of variance from our expectations. Despite similar sales level as compared to FY10, EBITDA margin for the Group expanded by 0.4ppt, leading to a 3.3% growth at the EBITDA level.

Fig.2. EBITDA improved on better margins (S\$'mn)

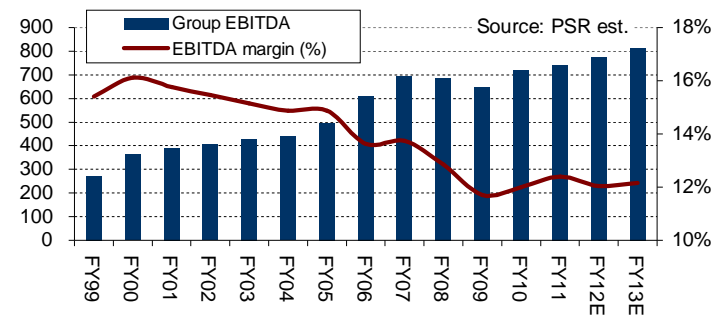


Fig.3. FY11 Revenue Spread (S\$'mn)

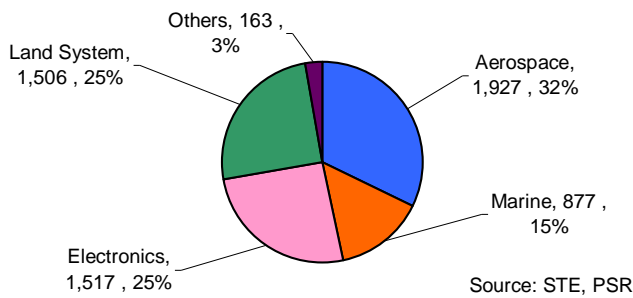
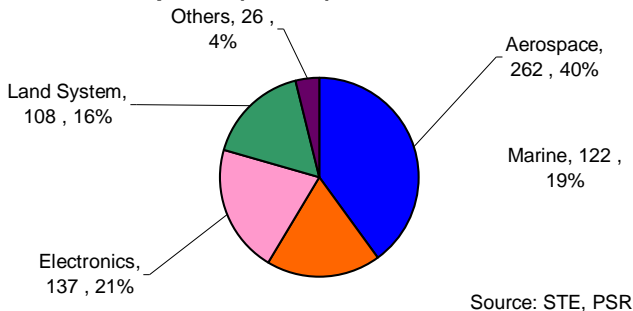


Fig.4. FY11 PBT Spread (S\$'mn)



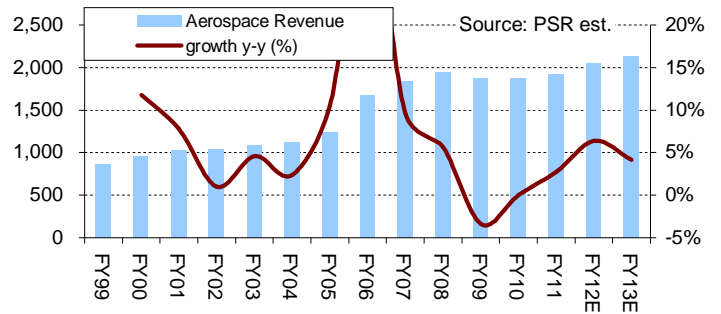
Aerospace

Performance: Aerospace's performance was driven by higher engine inputs that led to improved result from the CERO segment. Airframe Maintenance & Modification sales at the largest division of STE, declined by 1.9% due to weakened USD.

Outlook: Higher Sales, Higher PBT

We expect significant sales growth from STE's capacity expansion over the next few years. STE's Engine facility in Xiamen has capacity for c.300engines/yr with management aiming for 15-20 overhauls in the first year of its operations. STE also announced its intention to increase its presence at Seletar Aerospace Park with new hangar facilities that can concurrently accommodate 24 General Aviation & 11 narrow body aircrafts.

Fig.5. Aerospace Revenue (S\$'mn)



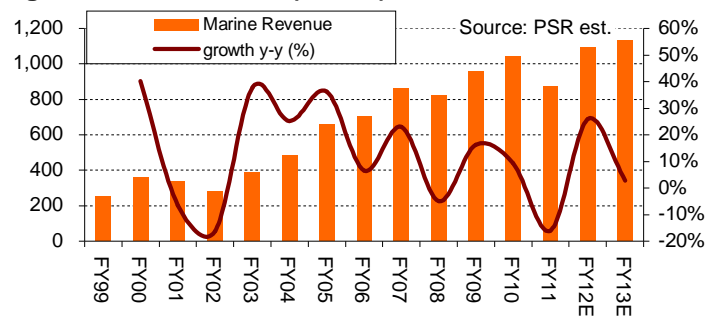
Marine

Performance: The Marine division recorded a decline in sales for the year due to the reversal of the S\$176mn ROPAX contract that was terminated with Louis Dreyfus Armateurs (LDA). PBT contributions from the Ship Repair business improved due to a healthy level of activities in Singapore.

Outlook: Higher Sales, Comparable PBT

STE's outlook statement highlighted a likely decline in profitability from the Marine division. We believe that this is due to an expected shift in product mix towards the lower Shipbuilding contracts that is expected to dominate FY12E's contracts.

Fig.6. Marine Revenue (S\$'mn)



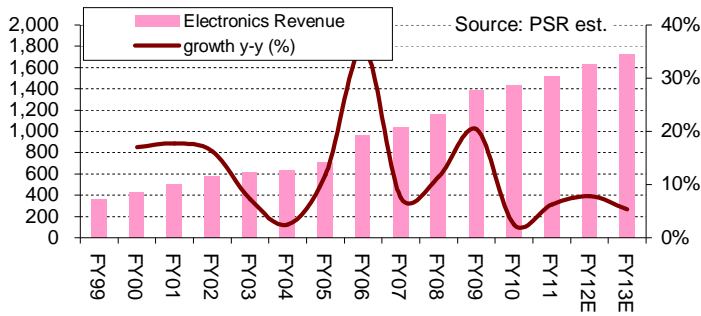
Electronics

Performance: Growth at the Electronics division was broad based with improved performance across all business segments. Significant projects for the year include the Circle Line project, half height screen door project and fare collection system in Bangkok.

Outlook: Higher Sales, Higher PBT

STE recently announced its intention to acquire Nera Telecommunications to improve its range of products. Management highlighted optimism over potential synergies in operations, sales and marketing of Nera's products with its existing satellite business.

Fig.7. Electronics Revenue (S\$'mn)



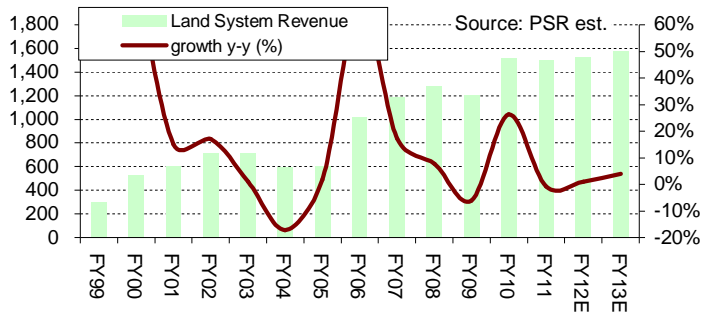
Land Systems

Performance: A 30.8% decline in sales from the Munitions and Weapons division was offset by higher sales from other divisions.

Outlook: Comparable sales, Higher PBT

Management highlighted significant potential in the defence market for the upgrading of ageing military vehicles and equipment.

Fig.8. Land System Revenue (S\$'mn)



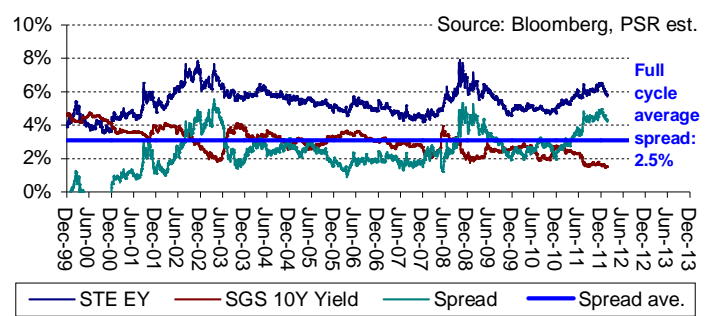
Valuation

Despite its recent outperformance, STE's share price continues to trade below its historical average of 19.7X. The company's forward earnings yield spread continued to indicate relative undervaluation at 4% over the paltry 10yr government bond yield of 1.5%. We expect healthy dividend yields of >5% over the next 2yrs at the current market price.

Fig.9. Still in lower end of historical earnings range



Fig.10. Forward Earnings Yield spread over Bonds at 4%

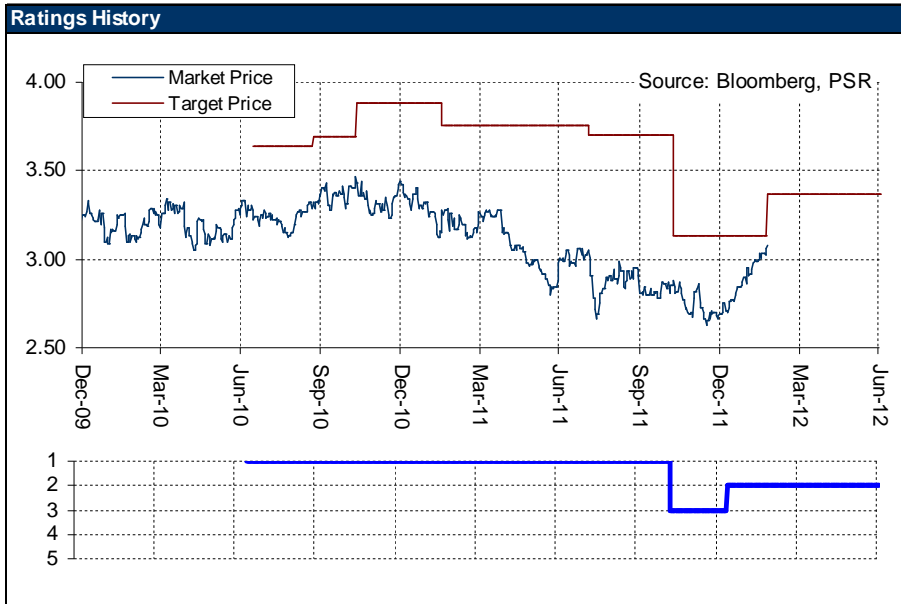


FYE Dec	FY09	FY10	FY11	FY12F	FY13F
Valuation Ratios					
P/E (X), adj.	20.9	19.1	17.9	17.5	17.2
P/B (X)	5.9	5.8	5.3	5.1	4.9
EV/EBITDA (X), adj.	13.8	12.9	12.5	12.0	11.4
Dividend Yield (%)	4.3%	4.7%	5.0%	5.1%	5.2%
Per share data (SGD)					
EPS, reported	0.15	0.16	0.17	0.18	0.18
EPS, adj.	0.15	0.16	0.17	0.18	0.18
DPS	0.13	0.15	0.16	0.16	0.16
BVPS	0.52	0.53	0.58	0.61	0.63
Growth & Margins (%)					
Growth					
Revenue	3.8%	7.9%	0.1%	7.4%	4.1%
EBITDA	-3.5%	7.2%	3.3%	4.3%	5.1%
EBIT	-5.3%	15.5%	3.6%	4.8%	3.6%
Net Income, adj.	-6.3%	10.6%	7.4%	2.7%	2.1%
Margins					
EBITDA margin	12.1%	12.0%	12.4%	12.0%	12.2%
EBIT margin	9.2%	9.8%	10.1%	9.9%	9.9%
Net Profit Margin	8.2%	8.4%	9.0%	8.6%	8.5%
Key Ratios					
ROE (%)	28.2%	30.8%	31.1%	29.9%	28.9%
ROA (%)	6.9%	6.9%	7.2%	7.2%	7.3%
Net Debt/(Cash)	(58)	(219)	21	196	310
Net Gearing (X)	Net Cash	Net Cash	0.0	0.1	0.1
Income Statement (SGD mn)					
Revenue	5,548	5,984	5,991	6,431	6,693
EBITDA	671	719	743	775	814
Depreciation & Amortisation	(163)	(132)	(135)	(138)	(154)
EBIT	508	587	608	637	660
Net Finance (Expense)/Income	(56)	(43)	(19)	(55)	(55)
Other items	56	40	32	40	40
Associates & JVs	39	44	35	48	46
Profit Before Tax	547	627	655	670	691
Taxation	(90)	(123)	(115)	(117)	(121)
Profit After Tax	456	505	541	553	570
Non-controlling Interest	12	14	13	11	17
Net Income, reported	444	491	528	542	553
Net Income, adj.	444	491	528	542	553

Source: PSR

FYE Dec	FY09	FY10	FY11	FY12F	FY13F
Balance Sheet (SGD mn)					
PPE	1,167	1,302	1,357	1,528	1,683
Intangibles	643	581	564	559	554
Associates & JVs	273	281	321	331	340
Investments	23	18	13	13	13
Others	188	170	185	185	185
Total non-current assets	2,294	2,351	2,440	2,616	2,775
Inventories	1,364	1,470	1,594	1,612	1,675
Accounts Receivables	1,477	1,657	1,604	1,715	1,782
Investments	236	198	403	403	403
Cash	1,514	1,592	1,366	1,192	1,077
Others	0	0	0	0	0
Total current assets	4,590	4,917	4,967	4,921	4,937
Total Assets	6,885	7,268	7,407	7,537	7,712
Short term loans	86	375	208	208	208
Accounts Payables	2,048	2,212	2,232	2,262	2,329
Others	948	965	1,039	1,039	1,039
Total current liabilities	3,082	3,551	3,479	3,509	3,576
Long term loans	1,371	998	1,180	1,180	1,180
Others	756	992	873	873	873
Total non-current liabilities	2,127	1,990	2,052	2,052	2,052
Non-controlling interest	108	105	110	115	124
Shareholder Equity	1,568	1,622	1,766	1,861	1,959
Cashflow Statements (SGD mn)					
CFO					
PBT	547	627	655	670	691
Adjustments	195	148	153	108	131
Cash from ops before WC changes	742	775	808	778	822
WC changes	276	121	(182)	(99)	(62)
Cash generated from ops	1,010	878	652	678	759
Taxes paid, net	(88)	(88)	(87)	(117)	(121)
Interest paid	(43)	(59)	(50)	(55)	(55)
Cashflow from ops	879	731	516	506	583
CFI					
CAPEX, net	(278)	(321)	(194)	(304)	(304)
Dividends from associates & JVs	45	24	26	39	37
Dividends/Interest from Investments	9	21	20	37	32
Purchase/sale of investments	(192)	31	(201)	0	0
Investments in subs & associates	(61)	(5)	(30)	0	0
Others	4	0	0	0	0
Cashflow from investments	(474)	(249)	(379)	(229)	(235)
CFF					
Share issuance	22	58	35	35	35
Purchase of treasury shares	0	0	0	0	0
Loans, net of repayments	557	3	48	0	0
Dividends to minority interests	(13)	(13)	(6)	(6)	(9)
Dividends to shareholders & capital reduction	(475)	(402)	(444)	(481)	(489)
Others	(30)	1	1	0	0
Cashflow from financing	62	(353)	(366)	(452)	(463)
Net change in cash	467	128	(230)	(175)	(115)
Effects of exchange rates	(3)	(50)	5	0	0
CCE, end	1,514	1,592	1,366	1,192	1,077

Source: PSR



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
<-20%	Sell	5

Remarks
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