

# ST Engineering Ltd

## Strong performance

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

Phillip Securities Research Pte Ltd

8 November 2012

### 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.

- Net income of S\$146.4mn (+9.5%y-y)
- Healthy order book of S\$12.5bn (2.0X sales)
- Guidance remains positive
- Maintain Accumulate with revised TP of S\$3.96

#### What is the news?

STE reported a strong set of results in the quarter with net income of S\$146.4mn (+9.5%y-y). With the exception of the Marine (-7.4%) division, higher sales was reported across all other business segments (Aero: +9.2%, Electronics: +10.4%, Land Systems: +26.6%). Consequently, EBITDA improved by 8.2% y-y with a slight decline in margin to 13.1% (3QFY11: 13.3%). Order book remains strong at S\$12.5bn. Guidance remains positive for higher revenue and PBT for FY2012 over FY2011.

Fig 1. Results Summary

Income Statement				
(Extract)	3QFY11	3QFY12	y-y (%)	Comments
<b>(US\$'mn)</b>				
Revenue	1,394.5	1,541.7	10.6%	
EBITDA	186.0	201.3	8.2%	EBITDA margin: 13.1%
EBIT	153.1	167.6	9.4%	
<b>Net Income</b>	<b>133.8</b>	<b>146.4</b>	<b>9.5%</b>	<b>Above expectations</b>

Source: Company, PSR

#### How do we view this?

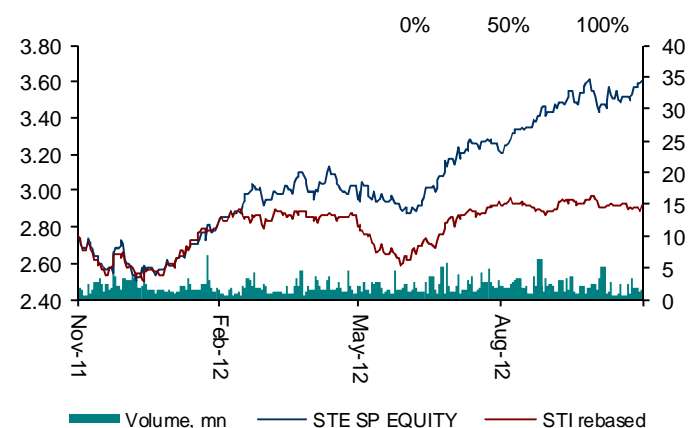
The results beat our expectations due largely to higher than expected profitability at its Aerospace and Electronics division. The relatively low shipbuilding revenue recognized in the quarter for shipbuilding division was the only disappointment in the results, in our view.

#### Investment Actions?

We believe that expectations of a major US defence contract win by the Land Systems division could drive higher valuations on the stock. Earnings outlook remains positive with good revenue visibility with the strong order book of S\$12.5bn. We lift our TP to S\$3.96 after increasing our P/E valuation peg to 22.8X FY12/13E (based on 1 S.D. above historical mean). Maintain Accumulate.

#### ST Engineering Ltd

<b>Rating</b>	<b>2</b>	<b>Accumulate</b>
- Previous Rating	2	Accumulate
<b>Target Price (SGD)</b>	<b>3.96</b>	
- Previous Target Price (SGD)	3.40	
Closing Price (SGD)	3.60	
Expected Capital Gains (%)	10.0%	
Expected Dividend Yield (%)	4.5%	
<b>Expected Total Return (%)</b>	<b>14.5%</b>	
Raw Beta (Past 2yrs weekly data)	0.62	
Market Cap. (USD mn / SGD mn)	9065 / 11076	
Enterprise Value (USD mn / SGD mn)	8658 / 10561	
3M Average Daily T/O (mn)	2.0	
52 w week range (SGD)	2.54 - 3.62	
Closing Price in 52 w week range		



#### Major Shareholders

	(%)
1. Temasek Holdings Pte Ltd	50.7
2. Aberdeen Asset Management PLC	10.0
3. Capital Group Companies Inc	6.0

#### Key Financial Summary

FYE	12/11	12/12F	12/13F	12/14F
Revenue (SGD mn)	5,991	6,202	6,710	7,135
Net Profit, adj. (SGD mn)	528	556	576	619
EPS, adj. (SGD)	0.17	0.18	0.19	0.20
P/E (X),adj.	20.9	19.9	19.3	18.1
BVPS (SGD)	0.58	0.61	0.64	0.68
P/B (X)	6.2	5.9	5.6	5.3
DPS (SGD)	0.16	0.16	0.17	0.18
Div. Yield (%)	4.3%	4.5%	4.7%	5.0%

Source: Bloomberg, PSR est.

\*All multiples & yields based on current market price

#### Valuation Method

Blended Valuation:

DCF (WACC: 7.3%; terminal g: 3.5%), 22.8X P/E (FY12/13E)

#### Analyst

**Derrick Heng**

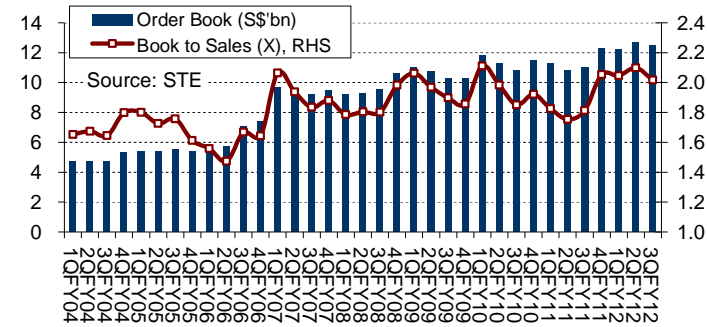
derrickhengch@phillip.com.sg

+65 6531 1221

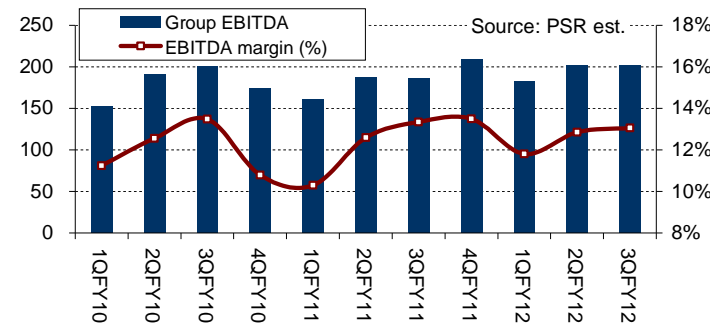
**Group**

STE reported a strong set of results in the quarter with net income of S\$146.4mn (+9.5%y-y). EBITDA margins continued to improve q-q to 13.1% in the quarter. The group's order book remains healthy at S\$12.5bn (2.0X sales).

**Fig 2. Order book (S\$'mn)**



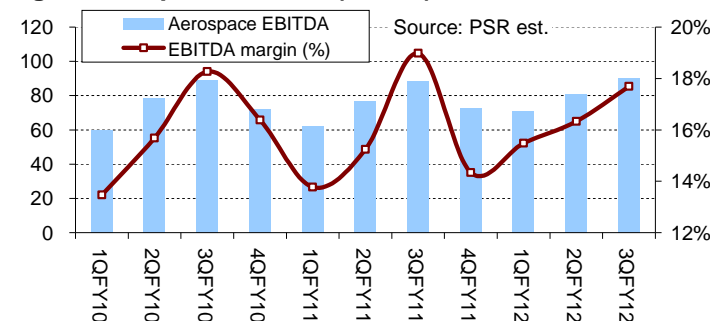
**Fig 3. EBITDA margins improved 0.3% (S\$'mn)**



**Aerospace**

Despite a fairly strong performance in 3QFY11, the Aerospace division managed to match EBITDA contributions on a marginal increase in sales this year. The CERO sub-segment turned in surprisingly strong PBT of S\$31.7mn (+64%y-y), largely due to write-back on allowance for inventories made with the ongoing restructuring of its operations in Scandinavia. FY2012 PBT is expected to be higher than FY2011.

**Fig 4. Aerospace EBITDA (S\$'mn)**

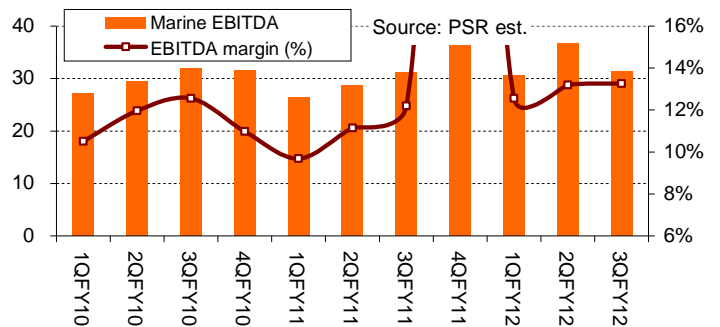


**Marine**

The Marine division reported a 7% decline in sales with weaker contributions from the shipbuilding division. This came as a surprise as we had been expecting strong shipbuilding revenue with the ongoing Fast Missile Craft project for the Egyptian Navy. However, given the lumpy

nature of shipbuilding projects, we are not overly concerned over the blip this quarter. FY2012 PBT is expected to be comparable to FY2011.

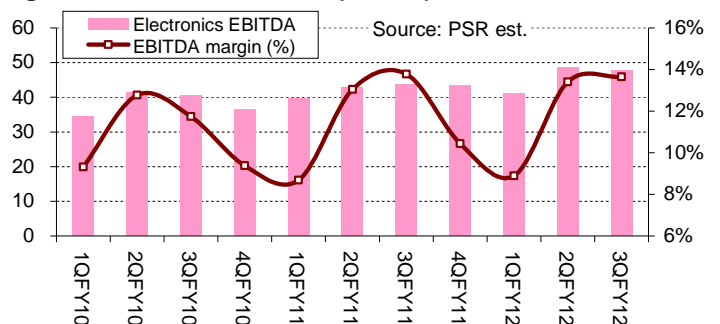
**Fig 5. Marine EBITDA (S\$'mn)**



**Electronics**

Revenue and PBT increased by 10% for the Electronics division. Despite a decline in sales at the Software System Group, PBT increased significantly for the sub-segment. Management attributed the strong relative performance to better product mix and an impairment charge that affected performance in the same period last year. Management reiterated their positive view for the Communications and Sensor sub-segment as sales of their satellite products increase with higher demand for mobile bandwidth. FY2012 PBT is expected to be higher than FY2011.

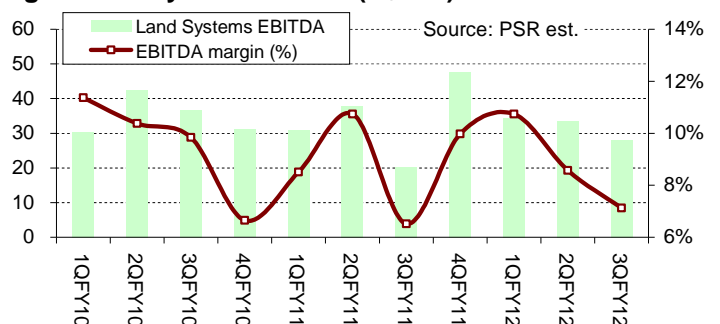
**Fig 6. Electronics EBITDA (S\$'mn)**



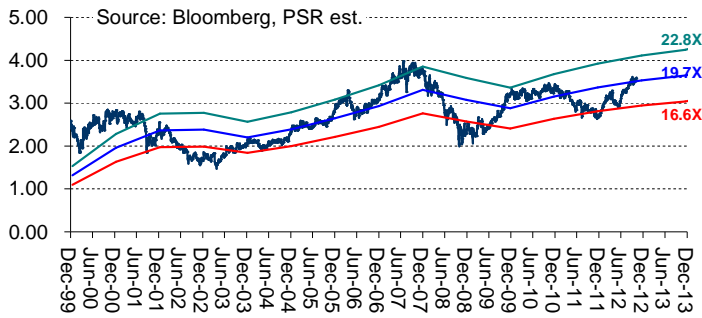
**Land Systems**

Land Systems reported strong sales with higher contributions across all sub-segments. Management guided that the order book for its US specialty vehicle business is higher than the same period last year. FY2012 PBT is expected to be comparable to FY2011.

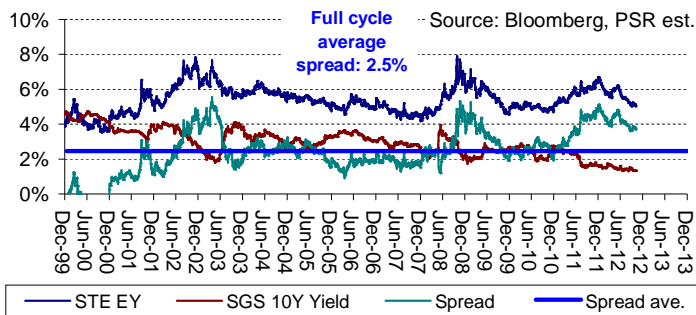
**Fig 7. Land System EBITDA (S\$'mn)**



**Fig 8. Valuation at historical average**



**Fig 9. Forward Earnings Yield spread at 3.7%**



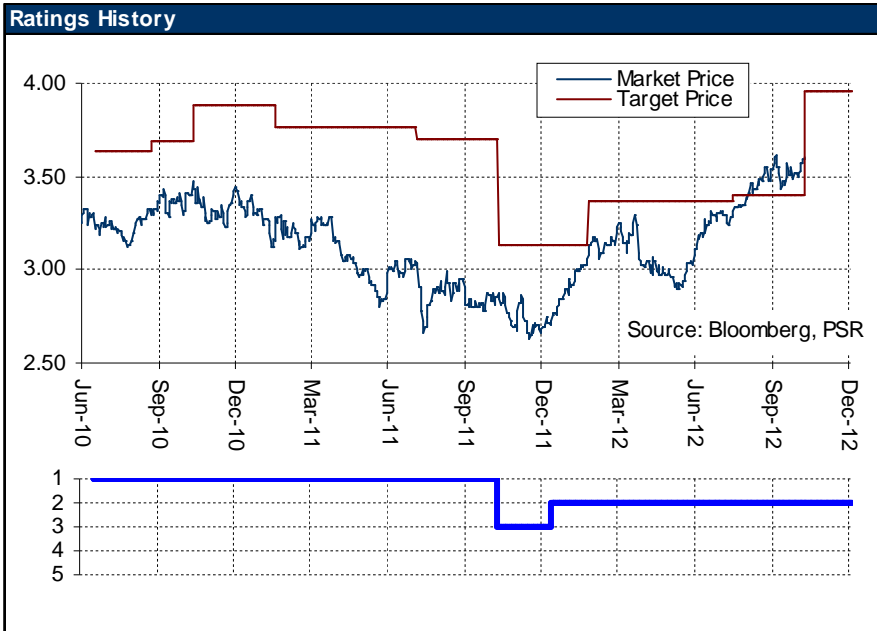
**US MPC project could be worth US\$3bn**

STE is one of four defence contractors (Lockheed Martin, BAE Systems & General Dynamics) selected for the US MPC contract for the production of up to 700 vehicles. According to a report by The Straits Times on 7<sup>th</sup> Nov 12, this contract could be worth approximately US\$3bn. While optimistic about their chances at winning this contract, management advised that the project is currently only in the demonstration phase and there are 3 other major players competing for the job. Even if the contract is awarded to STE, management guided that the requirement for local content could result in a lower share of the contract value for STE, as compared to their partner, SAIC.

FYE Dec	FY10	FY11	FY12F	FY13F	FY14F
<b>Valuation Ratios</b>					
P/E (X), adj.	22.3	20.9	19.9	19.3	18.1
P/B (X)	6.7	6.2	5.9	5.6	5.3
EV/EBITDA (X), adj.	14.7	14.2	13.6	12.7	11.9
Dividend Yield (%)	4.0%	4.3%	4.5%	4.7%	5.0%
<b>Per share data (SGD)</b>					
EPS, reported	0.16	0.17	0.18	0.19	0.20
EPS, adj.	0.16	0.17	0.18	0.19	0.20
DPS	0.15	0.16	0.16	0.17	0.18
BVPS	0.53	0.58	0.61	0.64	0.68
<b>Growth &amp; Margins (%)</b>					
<b>Growth</b>					
Revenue	7.9%	0.1%	3.5%	8.2%	6.3%
EBITDA	7.2%	3.3%	4.9%	7.0%	6.6%
EBIT	15.5%	3.6%	5.5%	7.4%	7.1%
Net Income, adj.	10.6%	7.4%	5.4%	3.7%	7.4%
<b>Margins</b>					
EBITDA margin	12.0%	12.4%	12.6%	12.4%	12.4%
EBIT margin	9.8%	10.1%	10.3%	10.3%	10.3%
Net Profit Margin	8.4%	9.0%	9.1%	8.9%	8.9%
<b>Key Ratios</b>					
ROE (%)	30.8%	31.1%	30.5%	29.8%	30.3%
ROA (%)	6.9%	7.2%	7.5%	7.6%	7.9%
Net Debt/(Cash)	(219)	21	20	(19)	52
Net Gearing (X)	Net Cash	0.0	0.0	Net Cash	0.0
<b>Income Statement (SGD mn)</b>					
<b>Revenue</b>	<b>5,984</b>	<b>5,991</b>	<b>6,202</b>	<b>6,710</b>	<b>7,135</b>
<b>EBITDA</b>	<b>719</b>	<b>743</b>	<b>779</b>	<b>833</b>	<b>888</b>
Depreciation & Amortisation	(132)	(135)	(138)	(145)	(151)
<b>EBIT</b>	<b>587</b>	<b>608</b>	<b>641</b>	<b>689</b>	<b>737</b>
Net Finance (Expense)/Income	(43)	(19)	(55)	(55)	(55)
Other items	40	32	53	40	40
Associates & JVs	44	35	48	46	51
<b>Profit Before Tax</b>	<b>627</b>	<b>655</b>	<b>688</b>	<b>720</b>	<b>773</b>
Taxation	(123)	(115)	(120)	(126)	(135)
<b>Profit After Tax</b>	<b>505</b>	<b>541</b>	<b>567</b>	<b>594</b>	<b>638</b>
Non-controlling Interest	14	13	11	18	19
<b>Net Income, reported</b>	<b>491</b>	<b>528</b>	<b>556</b>	<b>576</b>	<b>619</b>
<b>Net Income, adj.</b>	<b>491</b>	<b>528</b>	<b>556</b>	<b>576</b>	<b>619</b>

Source: PSR

FYE Dec	FY10	FY11	FY12F	FY13F	FY14F
<b>Balance Sheet (SGD mn)</b>					
PPE	1,302	1,357	1,428	1,492	1,600
Intangibles	581	564	559	554	549
Associates & JVs	281	321	331	340	350
Investments	18	13	12	12	12
Others	170	185	185	185	185
<b>Total non-current assets</b>	<b>2,351</b>	<b>2,440</b>	<b>2,514</b>	<b>2,583</b>	<b>2,697</b>
Inventories	1,470	1,594	1,545	1,610	1,711
Accounts Receivables	1,657	1,604	1,657	1,731	1,836
Investments	198	403	403	403	403
Cash	1,592	1,366	1,367	1,406	1,336
Others	0	0	0	0	0
<b>Total current assets</b>	<b>4,917</b>	<b>4,967</b>	<b>4,972</b>	<b>5,150</b>	<b>5,286</b>
<b>Total Assets</b>	<b>7,268</b>	<b>7,407</b>	<b>7,486</b>	<b>7,733</b>	<b>7,982</b>
Short term loans	375	208	464	464	464
Accounts Payables	2,212	2,232	2,191	2,329	2,441
Others	965	1,039	1,039	1,039	1,039
<b>Total current liabilities</b>	<b>3,551</b>	<b>3,479</b>	<b>3,693</b>	<b>3,831</b>	<b>3,944</b>
Long term loans	998	1,180	924	924	924
Others	992	873	873	873	873
<b>Total non-current liabilities</b>	<b>1,990</b>	<b>2,052</b>	<b>1,796</b>	<b>1,796</b>	<b>1,796</b>
Non-controlling interest	105	110	116	124	134
<b>Shareholder Equity</b>	<b>1,622</b>	<b>1,766</b>	<b>1,881</b>	<b>1,981</b>	<b>2,108</b>
<b>Cashflow Statements (SGD mn)</b>					
CFO					
PBT	627	655	688	720	773
Adjustments	148	153	108	116	117
Cash from ops before WC changes	775	808	795	837	890
WC changes	121	(182)	(46)	(1)	(94)
Cash generated from ops	878	652	750	835	797
Taxes paid, net	(88)	(87)	(120)	(126)	(135)
Interest paid	(59)	(50)	(55)	(55)	(55)
<b>Cashflow from ops</b>	<b>731</b>	<b>516</b>	<b>575</b>	<b>654</b>	<b>606</b>
CFI					
CAPEX, net	(321)	(194)	(204)	(204)	(254)
Dividends from associates & JVs	24	26	39	37	41
Dividends/Interest from Investments	21	20	37	37	38
Purchase/sale of investments	31	(201)	2	0	0
Investments in subs & associates	(5)	(30)	0	0	0
Others	0	0	0	0	0
<b>Cashflow from investments</b>	<b>(249)</b>	<b>(379)</b>	<b>(127)</b>	<b>(130)</b>	<b>(175)</b>
CFF					
Share issuance	58	35	35	35	35
Purchase of treasury shares	0	0	0	0	0
Loans, net of repayments	3	48	0	0	0
Dividends to minority interests	(13)	(6)	(6)	(9)	(10)
Dividends to shareholders & capital reduction	(402)	(444)	(476)	(511)	(526)
Others	1	1	0	0	0
<b>Cashflow from financing</b>	<b>(353)</b>	<b>(366)</b>	<b>(447)</b>	<b>(485)</b>	<b>(501)</b>
<b>Net change in cash</b>	<b>128</b>	<b>(230)</b>	<b>0</b>	<b>39</b>	<b>(70)</b>
Effects of exchange rates	(50)	5	0	0	0
<b>CCE, end</b>	<b>1,592</b>	<b>1,366</b>	<b>1,367</b>	<b>1,406</b>	<b>1,336</b>
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**

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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Please contact Phillip Securities Research at [65 65311240] in respect of any matters arising from, or in connection with, this document.

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**Contact Information (Singapore Research Team)**

---

**Chan Wai Chee**

CEO, Research

Special Opportunities

+65 6531 1231

yebo@phillip.com.sg

**Magdalene Choong, CFA**

Investment Analyst

Regional Gaming

+65 6531 1791

magdalenechoongss@phillip.com.sg

**Ken Ang**

Investment Analyst

Financials, Telecoms

+65 6531 1793

kenangwy@phillip.com.sg

**Nicholas Ong**

Investment Analyst

Commodities, Offshore & Marine

+65 6531 5440

nicholasonghg@phillip.com.sg

**Joshua Tan**

Head of Research

Global Macro, Asset Strategy

+65 6531 1249

joshuatan@phillip.com.sg

**Go Choon Koay, Bryan**

Investment Analyst

Property

+65 6531 1792

gock@phillip.com.sg

**Ng Weiwen**

Macro Analyst

Global Macro, Asset Strategy

+65 6531 1735

ngww@phillip.com.sg

**Research Assistant**

General Enquiries

+65 6531 1240 (Phone)

research@phillip.com.sg

**Derrick Heng**

Deputy Head of Research

SG Equity Strategist &

Transport

+65 6531 1221

derrickhengch@phillip.com.sg

**Travis Seah**

Investment Analyst

REITs

+65 6531 1229

travisseahhk@phillip.com.sg

**Roy Chen**

Macro Analyst

Global Macro, Asset Strategy

+65 6531 1535

roychencz@phillip.com.sg

**Contact Information (Regional Member Companies)**

---

**SINGAPORE**

**Phillip Securities Pte Ltd**  
Raffles City Tower  
250, North Bridge Road #06-00  
Singapore 179101  
Tel +65 6533 6001  
Fax +65 6535 6631  
Website: [www.poems.com.sg](http://www.poems.com.sg)

**HONG KONG**

**Phillip Securities (HK) Ltd**  
Exchange Participant of the Stock Exchange of Hong Kong  
11/F United Centre 95 Queensway  
Hong Kong  
Tel +852 2277 6600  
Fax +852 2868 5307  
Websites: [www.phillip.com.hk](http://www.phillip.com.hk)

**INDONESIA**

**PT Phillip Securities Indonesia**  
ANZ Tower Level 23B,  
Jl Jend Sudirman Kav 33A  
Jakarta 10220 – Indonesia  
Tel +62-21 5790 0800  
Fax +62-21 5790 0809  
Website: [www.phillip.co.id](http://www.phillip.co.id)

**THAILAND**

**Phillip Securities (Thailand) Public Co. Ltd**  
15th Floor, Vorawat Building,  
849 Silom Road, Silom, Bangrak,  
Bangkok 10500 Thailand  
Tel +66-2 6351700 / 22680999  
Fax +66-2 22680921  
Website [www.phillip.co.th](http://www.phillip.co.th)

**UNITED KINGDOM**

**King & Shaxson Capital Limited**  
6th Floor, Candlewick House,  
120 Cannon Street,  
London, EC4N 6AS  
Tel +44-20 7426 5950  
Fax +44-20 7626 1757  
Website: [www.kingandshaxson.com](http://www.kingandshaxson.com)

**AUSTRALIA**

**Octa Phillip Securities Ltd**  
Level 12, 15 William Street,  
Melbourne, Victoria 3000, Australia  
Tel +61-03 9629 8288  
Fax +61-03 9629 8882  
Website: [www.octaphillip.com](http://www.octaphillip.com)

**MALAYSIA**

**Phillip Capital Management Sdn Bhd**  
B-3-6 Block B Level 3 Megan Avenue II,  
No. 12, Jalan Yap Kwan Seng, 50450  
Kuala Lumpur  
Tel +603 2162 8841  
Fax +603 2166 5099  
Website: [www.poems.com.my](http://www.poems.com.my)

**JAPAN**

**Phillip Securities Japan, Ltd.**  
4-2 Nihonbashi Kabuto-cho Chuo-ku,  
Tokyo 103-0026  
Tel +81-3 3666 2101  
Fax +81-3 3666 6090  
Website: [www.phillip.co.jp](http://www.phillip.co.jp)

**CHINA**

**Phillip Financial Advisory (Shanghai) Co. Ltd**  
No 550 Yan An East Road,  
Ocean Tower Unit 2318,  
Postal code 200001  
Tel +86-21 5169 9200  
Fax +86-21 6351 2940  
Website: [www.phillip.com.cn](http://www.phillip.com.cn)

**FRANCE**

**King & Shaxson Capital Limited**  
3rd Floor, 35 Rue de la Bienfaisance 75008  
Paris France  
Tel +33-1 45633100  
Fax +33-1 45636017  
Website: [www.kingandshaxson.com](http://www.kingandshaxson.com)

**UNITED STATES**

**Phillip Futures Inc**  
141 W Jackson Blvd Ste 3050  
The Chicago Board of Trade Building  
Chicago, IL 60604 USA  
Tel +1-312 356 9000  
Fax +1-312 356 9005