

Singapore Company Focus

ST Engineering

Bloomberg: STE SP | Reuters: STEG.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

9 Nov 2015

BUY

Last Traded Price: S\$3.22 (STI : 3,010.47)

Price Target : S\$3.60 (12% upside)

Reason for Report : 3Q15 results

Potential Catalyst: Better earnings execution, strong order wins, M&A

Where we differ: More conservative on FY16/17 earnings

Analyst

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Result Summary

| FY Dec (\$m) | 3Q 2015 | 3Q 2014 | 2Q 2015 | yoy % chg | qoq % chg |
|----------------------|------------|------------|------------|--------------|--------------|
| P&L Items | | | | | |
| Turnover | 1,500 | 1,553 | 1,545 | (3.4) | (2.9) |
| Gross Profit | 319 | 333 | 333 | (4.3) | (4.2) |
| Opg Profit | 144 | 144 | 148 | 0.2 | (2.8) |
| EBITDA | 207 | 196 | 208 | 5.3 | (0.6) |
| Net Profit | 133 | 121 | 125 | 9.9 | 6.6 |
| Other Data | | | | | |
| Gross Margin (%) | 21.3 | 21.5 | 21.5 | | |
| Opg Margin (%) | 9.6 | 9.2 | 9.6 | | |
| Net Margin (%) | 8.9 | 7.8 | 8.1 | | |

Financial Summary

| FY Dec (\$m) | 2014A | 2015F | 2016F | 2017F |
|----------------------|-------|-------|-------|-------|
| Revenue | 6,539 | 6,345 | 6,194 | 6,155 |
| Operating Profit | 156 | 143 | 148 | 144 |
| EBITDA | 835 | 852 | 861 | 883 |
| Net Pft (Pre Ex.) | 532 | 531 | 536 | 545 |
| EPS (S cts) | 17.1 | 17.0 | 17.2 | 17.5 |
| EPS Pre Ex. (S cts) | 17.1 | 17.0 | 17.2 | 17.5 |
| EPS Gth (%) | (9) | 0 | 1 | 2 |
| EPS Gth Pre Ex (%) | (9) | 0 | 1 | 2 |
| Net DPS (S cts) | 15.0 | 15.0 | 15.0 | 15.0 |
| BV Per Share (S cts) | 68.4 | 70.4 | 72.6 | 75.1 |
| PE (X) | 18.9 | 18.9 | 18.7 | 18.4 |
| PE Pre Ex. (X) | 18.9 | 18.9 | 18.7 | 18.4 |
| EV/EBITDA (X) | 11.5 | 11.3 | 11.1 | 10.8 |
| Net Div Yield (%) | 4.7 | 4.7 | 4.7 | 4.7 |
| P/Book Value (X) | 4.7 | 4.6 | 4.4 | 4.3 |
| Net Debt/Equity (X) | CASH | CASH | CASH | CASH |
| ROAE (%) | 25.0 | 24.6 | 24.0 | 23.7 |

At A Glance

| | |
|---------------------------|---------------|
| Issued Capital (m shrs) | 3,103 |
| Mkt. Cap (\$m/US\$m) | 9,993 / 7,037 |
| 3m Avg. Daily Val (US\$m) | 7.3 |

ICB Industry : Industrials

ICB Sector: Aerospace & Defense

Principal Business: ST Engineering (STE) is an integrated engineering group in the aerospace, electronics, land systems and marine sectors. The company has over the years diversified its businesses and geographies.

Source: Company, DBS Bank, Bloomberg Finance L.P.

Stay invested for the long-haul

- 3Q15 net profit was up 10% y-o-y, in line with expectations of a stronger 2H
- Electronics and Aerospace divisions remain the key growth drivers in near to medium term
- Smart Nation initiatives in Singapore should provide a boost for ST Electronics in future
- Maintain BUY with TP of S\$3.60

Highlights

3Q15 results in line

- 3Q15 net profit was up 10% y-o-y to S\$132.5m, largely in line with expectations, and boosted by a stronger USD. Group revenues for 3Q15 came in at S\$1.5bn, down 3% y-o-y. Growth in profits before tax (PBT) was positive on a y-o-y basis for all segments except for Marine, which saw a 51% plunge in PBT this quarter.

Aerospace and Electronics performance was steady

- Revenue at the Aerospace division increased 7% y-o-y to S\$506m, driven by healthy engines output, which was partially offset by lower airframe MRO work, while PBT of US\$63.3m was unchanged from 3Q14, due to lower margins from the slowdown in MRO work as well as provisions related to development of the B757 15-pallet P2F programme. The Electronics segment did as well as expected, with revenues rising by 22% y-o-y and PBT rising 5% y-o-y; all three Electronics sub-divisions recorded 15-30% jump in revenues y-o-y due to higher-value milestone completions on projects.

Land Systems continues to face headwinds; Marine affected by secular downturn

- The Land Systems segment saw a 10% decline in revenues y-o-y but a 9% increase in PBT due mainly to a more favourable sales mix. However PBT margins remain subdued at ~6%, affected by recurring inventory obsolescence costs arising from a prolonged slowdown in specialty vehicle sales. The Marine Sector remains a drag, with revenues for the quarter down 39% y-o-y and PBT down 51% y-o-y, mainly due to lower revenue recognition at the Shipbuilding and Shiprepair businesses from both local and US operations, in line with the downturn in the offshore oil & gas industry and the traditional shipping market continuing to be plagued by overcapacity.

Outlook

Orderbook at decent levels

The group's orderbook of S\$12.2bn remains relatively stable, and covers close to two years of revenue, securing decent visibility going forward. However, order wins announced YTD in 2015 have been slower than previous years, given that the Marine and Land Systems have seen a relative dearth of order wins so far this year.

Long-term growth initiatives pave the way forward in MRO.

The Aerospace division has been investing in the cabin interiors and VIP completion businesses, which it sees as growth segments, as compared to a more mature airframe MRO space. It is also continuously enhancing its passenger-to-freighter conversion capabilities to serve a broader market.

The Electronics division is positioned to capitalise on the Smart Nation revolution in Singapore,

with projects worth more than S\$1bn in the near future, according to our estimates. Further, the launch of its TeLEOS-1 satellite this December will herald in a new space-centered growth channel for the division, which management expects to be an important part of the company's growth story going forward. We are also seeing increased importance placed on robotics, such as in the development of unmanned land, aerial and maritime vehicles/carriers, and the group's foray into autonomous vehicles via a partnership with the Singapore Ministry of Transport and Sentosa Development Corporation to conduct tests on self-driving shuttles for the leisure island.

In the near term, 'comparable' is the key word

Management expects the group to see comparable revenue in FY15 compared to FY14, while PBT is expected to be lower than in FY14, largely due to low earnings at the Marine division. The Aerospace and Land Systems divisions are

expected to see comparable revenues and PBT for FY15 compared to the previous year; the Electronics division is expected to see higher revenues but comparable PBT in FY15; the Marine division is expected to see both its revenues and PBT at lower levels in FY15.

Valuation:

We believe the strength in the Electronics division will help to offset weakness in Marine division over the next 2 years and allow STE to report steady earnings and dividends in the near term. Given the healthy orderbook of S\$12.2bn, strong balance sheet and dividend yield of 4.5%, we maintain our BUY call on the counter. Share price should be supported by upcoming final dividend. Our TP of S\$3.60 is based on a blended valuation framework (blend of price-earnings, dividend yield and discounted cash flows) to factor both earnings growth and cash-generative nature of the business.

Key Risks:

Declining defense budgets in the West. Austerity programmes in Europe and planned US spending cuts create the risk of delays to some defense programmes that STE may be bidding for.

Commercial vehicle businesses face headwinds. The growth of STE's commercial vehicle operations in China have been affected by weak demand and high inventory levels. Its Brazil operations have also been affected by withdrawal of subsidies for purchases of construction equipment.

Slowdown in shipbuilding. Traditional shipping sector has been plagued by overcapacity for some time now, and the recent fall in oil prices also affects demand for offshore vessels. Visibility on demand recovery is low at this point.

Target Price & Ratings History



| S.No. | Date | Closing Price | Target Price | Rating |
|-------|-----------|---------------|--------------|--------|
| 1: | 10 Nov 14 | 3.46 | 3.80 | HOLD |
| 2: | 20 Jan 15 | 3.31 | 3.80 | BUY |
| 3: | 02 Mar 15 | 3.40 | 3.80 | BUY |
| 4: | 14 May 15 | 3.59 | 3.80 | BUY |
| 5: | 10 Aug 15 | 3.26 | 3.80 | BUY |
| 6: | 17 Aug 15 | 3.17 | 3.80 | BUY |
| 7: | 31 Aug 15 | 3.07 | 3.40 | BUY |
| 8: | 04 Nov 15 | 3.30 | 3.60 | BUY |

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

Source: DBS Bank

DBS Bank recommendations are based on Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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