May 30, 2022

Maybank

Industrials

Singapore

ST Engineering (STE SP)

Flightpath to recovery

BUY

Share Price	SGD 4.06
12m Price Target	SGD 4.75 (+17%)

Leading engineering conglomerate; initiate with BUY

We initiate coverage with a BUY rating and DCF-based target price of SGD4.75, offering 17% upside potential at 7.5% WACC and 2% TGR. With borders re-opening, the aerospace landscape is improving. STE's recent acquisition of TransCore holds growth promise in smart city solutions and rising defence spending could increase international sales at a robust pace. Significant contract wins with a record-breaking FY21 order book of SGD19.3b (+25% YoY) have provided good revenue visibility and promises sustainable dividend yields of 2.5%. The strategy to better integrate STE's various divisions could surprise with revenue and cost synergies.

A confluence of drivers for FY22E-FY24E

Aerospace MRO (Maintenance, Repair & Overhaul) is witnessing green shoots of recovery as international borders reopen. Rising demand (4.7% YoY) for freighter aircraft should see an uptick in passenger-to-freight (PTF) conversion contracts supported by 7% pa growth in the global aircraft fleet. We see demand for urban and satellite communications solutions, delivering 9.9% revenue CAGR from FY21-FY24E, with new drivers from smart-city and ICT solutions. Recent inorganic growth has established a strong global footprint, casting a wider net. Prospects for the defence segment remain captivating with an addressable market of USD5b.

Greater integration to leverage on core strengths

STE's core value proposition is offering tailored customer solutions using a deep pool of engineering and technological expertise in multiple sectors. The recent restructuring, which focuses on pushing greater integration across what have historically been silo-like divisions, could be a material positive. We project pretax profit margin to increase from 9% in FY21 to 10.2% by FY24, mainly on efficiencies in smart cities initiatives coupled with strong order book growth (+15% YoY) to provide greater visibility for the revenue pipeline. We also see a potential surprise to the upside from revenue (cross-selling) and cost (central procurement, systems standardisation) synergies in the coming 2-3 years.

Catalysts and key risks

Potential catalysts for STE include a faster-than-expected pace of global reopening and travel relaxation. We are prudently below consensus on FY22E-FY24E net profit due to our concerns about: a) relatively slower opening of Asian skies; and b) global chip shortage disrupting smart device output, dampening sales for smart-city solutions.

FYE Dec (SGD m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	7,159	7,693	8,222	8,942	9,725
EBITDA	939	1,045	1,103	1,279	1,472
Core net profit	576	590	582	628	722
Core EPS (cts)	18.4	18.9	18.6	20.1	23.1
Core EPS growth (%)	(5.3)	2.4	(1.3)	7.8	15.1
Net DPS (cts)	15.0	15.0	15.9	17.1	19.7
Core P/E (x)	20.7	19.9	21.8	20.2	17.6
P/BV (x)	4.6	4.4	4.6	4.4	4.3
Net dividend yield (%)	3.9	4.0	3.9	4.2	4.9
ROAE (%)	23.1	23.9	23.7	24.7	27.3
ROAA (%)	6.0	5.9	5.1	5.1	5.7
EV/EBITDA (x)	14.4	12.7	12.8	11.2	9.8
Net gearing (%) (incl perps)	51.1	48.7	43.8	47.6	48.0
Consensus net profit	-	-	589	674	738
MKE vs. Consensus (%)	-	-	(1.1)	(6.9)	(2.1)

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Company Description

STE is an engineering conglomerate with business segments of Aerospace, Electronics, Land Systems, and Marine. It is also a major defence contractor.

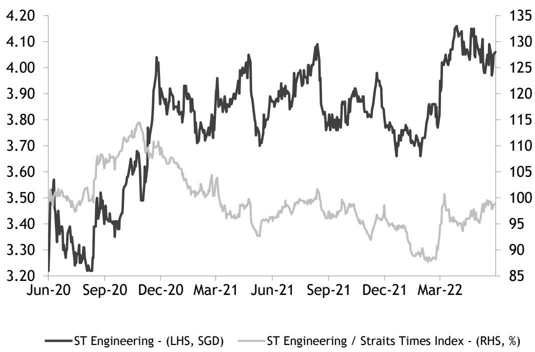
Statistics

52w high/low (SGD)	4.16/3.66
3m avg turnover (USDm)	16.0
Free float (%)	48.1
Issued shares (m)	3,122
Market capitalisation	SGD12.7B
	USD9.3B

Major shareholders:

Temasek Holdings Pte Ltd. (Investment Co	49.8%
Capital Research & Management Co. (Globa	3.3%
BlackRock Fund Advisors	1.4%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(1)	6	4
Relative to index (%)	3	7	3

Source: FactSet

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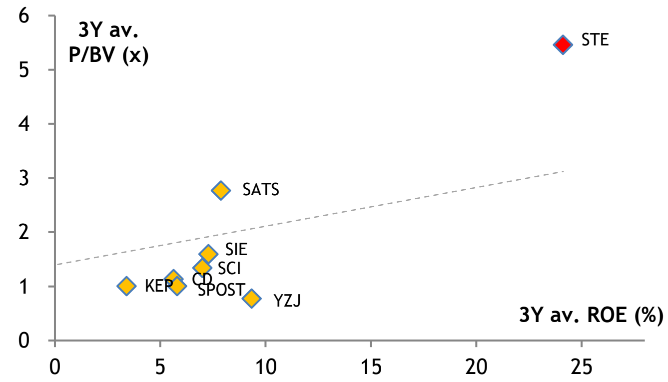
Tear Sheet Insert

Value Proposition

- STE has a 50-year history as Singapore's primary defence contractor. In the past couple of decades it has successfully evolved its operations to tap the commercial marketplace and presently the split between commercial and defence derived revenues is roughly 65:35.
- STE's operating segments are aligned by the commercial aerospace, urban solution & satellite communication and defence & public security sectors.
- The value proposition it offers customers is the ability to leverage a deep pool of engineering expertise across multiple sectors to deliver tailored solutions.
- STE is also one of the largest and non-airline affiliated aviation MRO providers in the world.

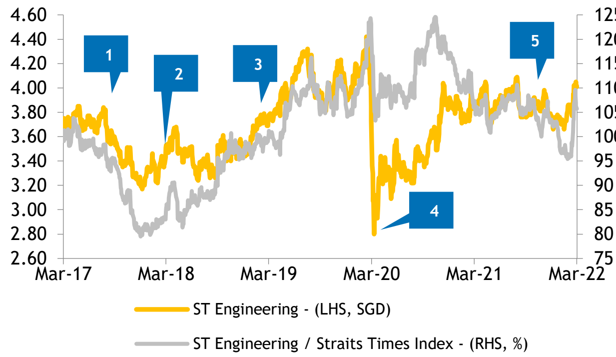
SG large-cap industrials historical P/BV vs. ROE



Source: FactSet

Price Drivers

Historical share price trend



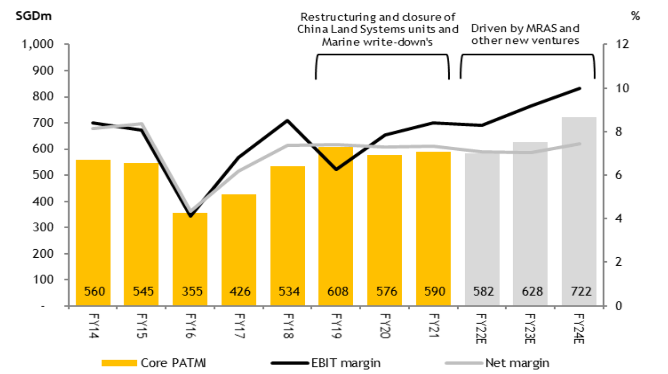
Source: Company, Maybank IBG Research

1. Guidance and growth outlook downgraded from demand slowdown and higher competition.
2. Multiple stock rating upgrades from the street.
3. Large contract win of SGD1bin with options up to SGD2.6b for US marine subsidiary VT Halter Marine after a prolonged dry spell of material contract awards.
4. Global pandemic strikes causing huge disruption to aviation industry.
5. Singapore Technologies Engineering is marking its largest acquisition to date with the US$2.68 billion (S$3.64 billion) all-cash offer for a group of entities under Roper Technologies focused on transport management systems.

Financial Metrics

- Two key factors drive our expectation of a blended margin recovery in FY22E-FY24E: higher EBITDA margin (17-18%) from aerospace PTF contributions and monetisation from inorganic growth.
- Aside from improving margins, robust aerospace and defence order books with relatively stable smart city initiatives underpinning our 8.3% core PATMI CAGR forecast.
- We expect ROE to rebound from 23% in FY21 to over 30% by FY25E.

PATMI, margin improvements expected



Source: Company, Maybank IBG Research

Swing Factors

Upside

- Higher-than-expected passenger to freighter (PTF) work from airlines upgrading their passenger fleets with cargo growth supportive.
- Better-than-expected margins if aircraft OEMs slow down their aftermarket expansion (as order books are full).
- The recent Polar Vessel contract win aside, a broader recovery in marine orders from a demand rebound for oilfield services vessels and specialised ship repair.
- Order book growth from US defence and infrastructure project wins, an area that STE has been pursuing but where large contracts have been few and far in-between.

Downside

- Intensifying price competition in aerospace driven by smaller players struggling with excess capacity.
- Ongoing rise in inflation could have supply crunch on aircraft materials and equipment.
- Structural threat from aircraft OEMs like Boeing and Airbus becoming more aggressive in expanding in the aftermarket-MRO space.
- Major disruption in airborne cargo growth due to the aftermath of a US-China trade war could adversely affect aircraft PTF conversion demand.

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Risk Rating & Score[1]	30.9
Score Momentum[2]	+2.9
Last Updated	19 Nov 2021
Controversy Score[3] (Updated: 07 Jun 2020)	2 - Customer incident

Business Model & Industry Issues

- Given the nature of the aviation engineering industry, which accounts for about 2% of direct CO2 global emissions, this number is expected to increase given the projected expansion of air travel. Mitigated that STE's greenhouse gas emissions reduction programme is strong. Furthermore, its carbon intensity trend is observed to have moderately declined over the past three years.
- The aerospace & defence industry is exposed to bribery and corruption risks through its close business relationship with government officials and bodies, and the competition for a limited number of high-value contracts. STE has a policy of zero tolerance in fraud and corruption practices. There were no reported cases of bribery and corruption in 2021.
- Being the largest government contractors, the group is entrusted with managing, storing and processing highly confidential information. Cyberattacks could result in data breaches and leaks of confidential documents, which can have serious consequences on national security matters, and impact companies' costs and operations. The company has average preparedness measures to address data privacy and security issues and has been implicated in minor controversies related to the issue.

Material E issues

- In FY21, STE achieved a 30% absolute GHG emissions reduction as compared to FY10. This translated to a 46% reduction in GHG emissions intensity, which is on track to achieve the Group's target of a 50% reduction by FY30E.
- The Group designed eco-engine wash services – EcoPower which has significant environmental benefits. It washes more than 9,000 aircraft engines annually using innovative and environmentally-friendly processes. These result in fuel savings, which translate to an estimated emissions avoidance of 500,000 tonnes CO2e annually as well as the recovery and reuse of around 2m litres of water.
- FY21 STE Singapore operations recycled 78% of 5,900 tonnes of waste generated. The recyclables included wood, metal, batteries and paper products.

Material S issues

- Total Group economic contribution of SGD7.2b, which includes: (i) bought in material and services; (ii) employee wages, salaries and benefits; and (iii) dividends and others.
- As at end Dec 2021, 79% of the workforce is male while 21% is female with 14% turnover rate. Among them, about 14% of female and 15% of male employees are managers.
- In FY21, accident frequency (+37.5% YoY) and severity rate (+30% YoY) per million manhours has been on the uptrend. One of the key factors that contributed to the increase is human error in complying with safety procedures. Key mitigating measures have been imposed through cross sharing of best practices within the global operations.
- Positioning employees for the future of work through workforce transformation programmes including upskilling and reskilling initiatives. Average training of 21 hours per employee.

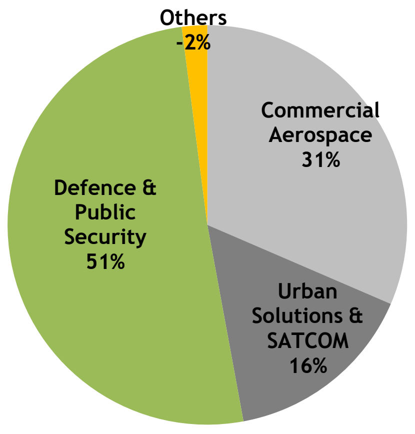
Key G metrics and issues

- STE's board comprises 13 directors and an alternate director. The current board composition has: 9 independent & non-executive directors, 3 non-independent & non-executive director and 1 executive director/ group president & CEO. There are 2 women directors and 11 men directors on the board.
- The nomination, audit, investment and remuneration committees are chaired by independent and non-executive directors.
- The board consists of members with established track record in various industries. The company has a majority standard for election of directors and the company has a resignation policy for directors failing to receive a majority of votes.
- PricewaterCoopers has been STE's auditor since 2020. In compliance with the SGX-ST Listing Manual, PwC can only be in charge till 2025.
- As of March 2022, STE principal shareholders, with stake sizes in percentage of ordinary shares were as follows: Temasek Holdings (49.8%), Capital Research & Management (3.3%) and BlackRock Fund Advisors (1.4%).
- To date, STE has never received or been the subject of any legal action in relation to anti-competitive behaviour and violations of anti-trust and monopoly legislation. There were no reported cases of bribery and corruption in 2021.

[1]***Risk Rating & Score*** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. [2]***Score Momentum*** - indicates changes to the company's score since the last update – a negative integer indicates a company's improving risk score; a positive integer indicates a deterioration. [3]***Controversy Score*** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

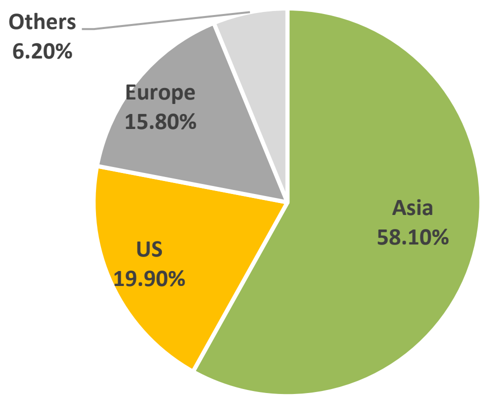
Focus charts

Fig 1: Group revenue breakdown by business sector



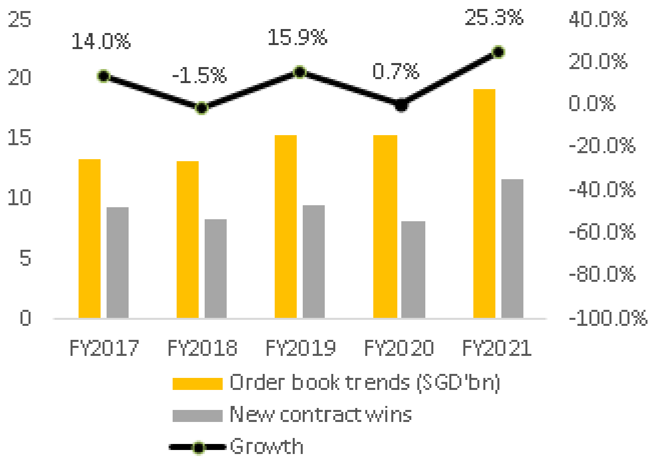
Source: Company, Maybank IBG Research

Fig 2: Revenue breakdown by geography



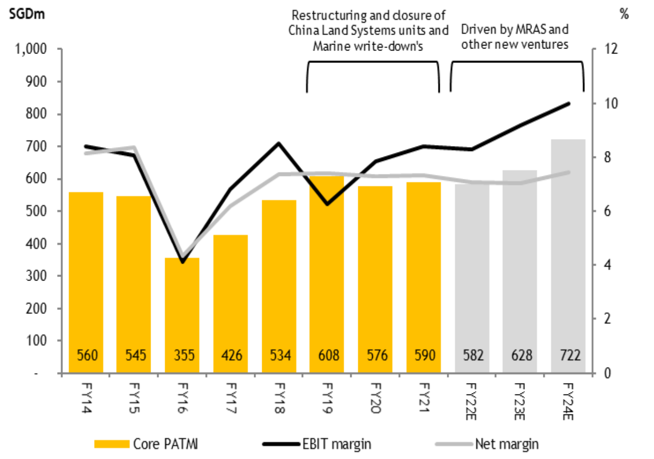
Source: Company, Maybank IBG Research

Fig 3: Record contract wins & order book



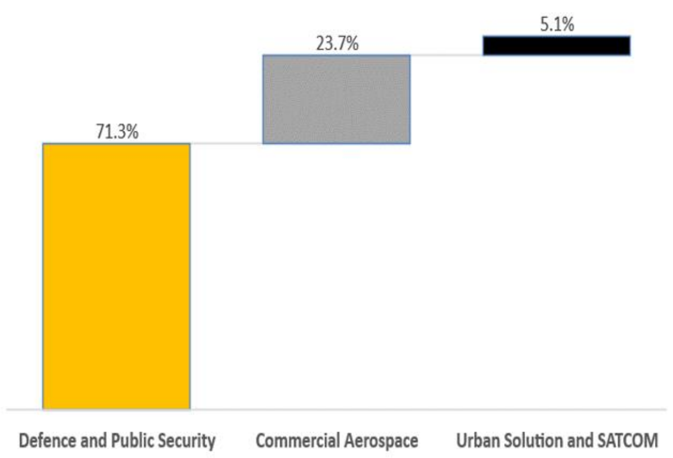
Source: Company, Maybank IBG Research

Fig 4: PATMI, margin improvements expected



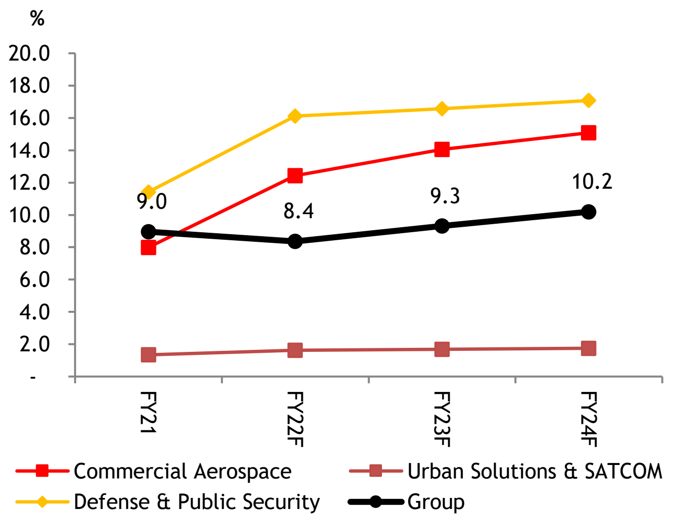
Source: Company, Maybank IBG Research

Fig 5: Operating income proportion



Source: Company

Fig 6: Divisional pretax margins



Source: Company

1. Investment thesis

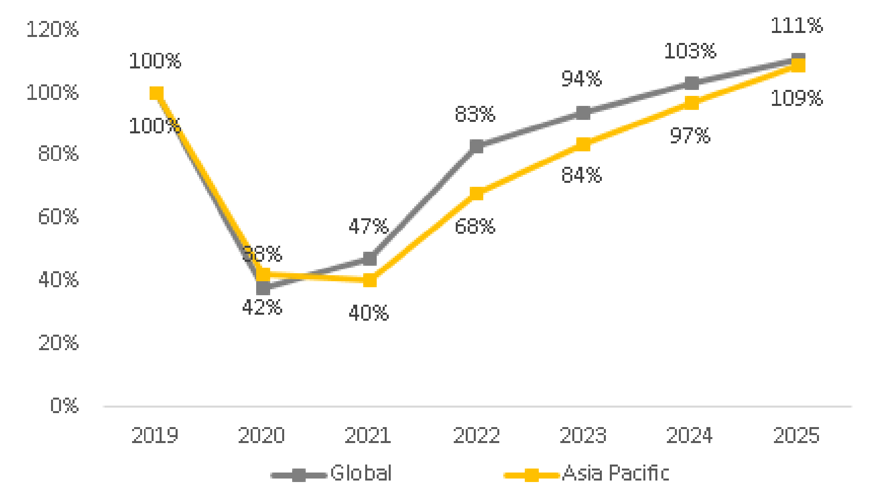
1.1 Aerospace industry looks to turn the corner

The past two years have been difficult for the global aerospace industry. Travel bans and tightened borders worldwide arising from the pandemic reduced demand for commercial air travel and has had knock-on impacts on the global aerospace industry. According to Singapore's Ministry of Trade and Industry, global aircraft production and maintenance, repair and overhaul (MRO) spending both shrank by 40% YoY in FY20. Likewise, Singapore's aerospace industry was not spared, as output contracted by 26% YoY in FY20.

Growing industry cluster support in home base - Singapore accounts for around 10% of global MRO output

Despite these challenges, the aerospace industry grew by 8.8% YoY in FY21. Singapore continues to be Asia's leading aerospace hub, contributing to 10% of the global MRO output, and home to a vibrant cluster of over 130 aerospace industry players. STE is also planning to hire over 200 positions in the next few years to capture new growth areas as the industry emerges from the pandemic. The International Air Transport Association (IATA) predicts global passenger numbers to top 2019 levels by 2024. However, Asia may not exceed 2019 levels until 2025 due to Asian governments' risk aversion towards easing of travel restrictions.

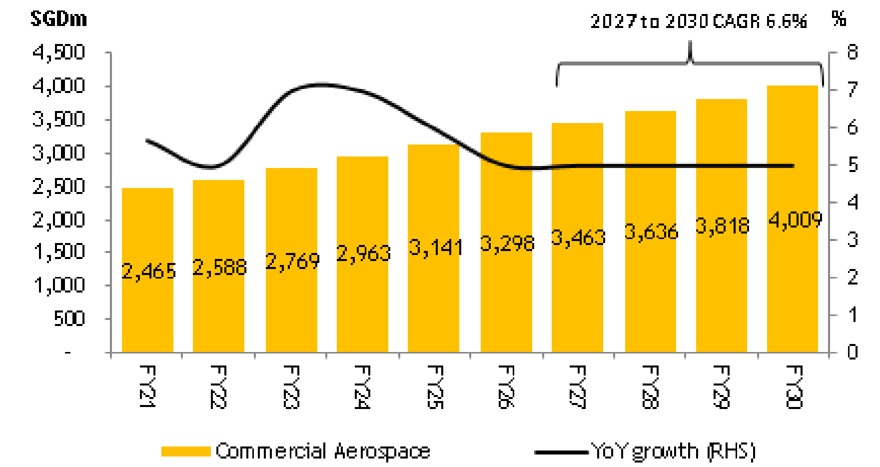
Fig 7: Passenger numbers as % of pre-Covid (2019) level



Source: IATA

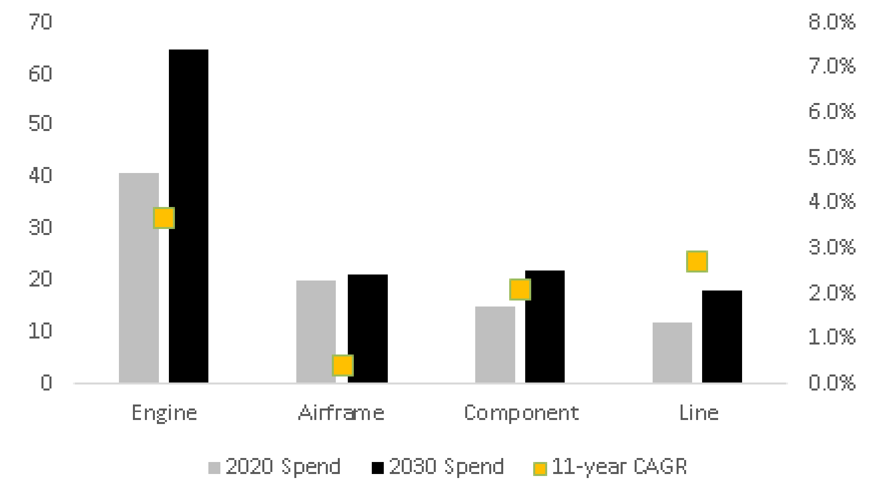
As such, STE's MRO revenue could revitalize ahead of passenger traffic as airlines restore more capacity starting in 2023. We predict maintenance revenue at STE could get a boost in FY23E of about 7% even if a full traffic recovery stays elusive until FY25. Airlines may reactivate their fleets amid a domestic passenger comeback and gradual resumption of cross-border travel, which may fuel demand for return-to-service checks, restore scheduled maintenance, and dusted-off deferred projects.

Fig 8: STE commercial aerospace gross revenue projections



Source: Maybank IBG Research, Company

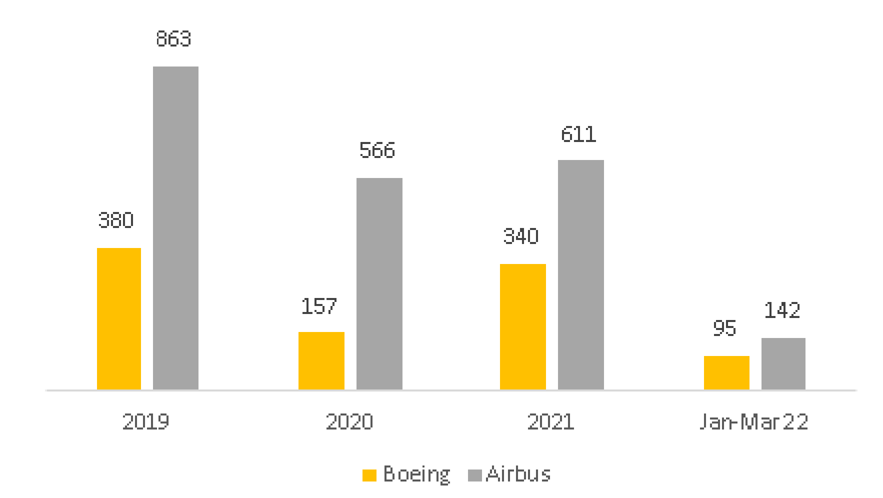
Fig 9: Aerospace MRO CAGR growth FY20-FY30E



Source: Oliver Wyman

However, we would expect softer MRO demand growth over the forecast period, partly reflecting the significant reduction in deliveries in FY20 and FY21. Following a more-than challenging FY20 due to the pandemic, FY21 was a year of recovery for the two largest commercial plane makers, Airbus and Boeing. FY22 is well underway and is expected to be another year of recovery for the commercial aircraft manufacturing industry, despite events currently unfolding in the Ukraine. We believe Boeing and Airbus still have a long way to go before deliveries are back to pre-pandemic levels. With a total of only 1,674 deliveries projected for FY22, this is half of what has historically been delivered over a two-year period. In addition, aircraft production lines have been slow to ramp up to pre-Covid levels, given the inventory of already built aircraft the OEMs are sitting on. Together, this implies less maintenance involving newer aircraft during the middle of the forecast period. Most aircraft delivered in the next couple of years will not reach their first significant maintenance visits until after FY30, resulting in a plateau in MRO spending during the latter years of the forecast period.

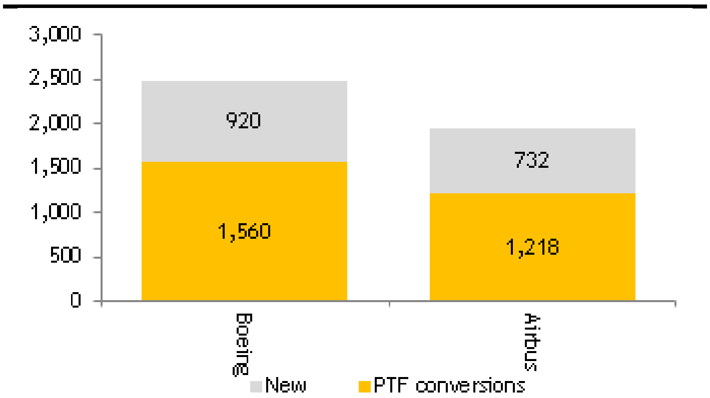
Fig 10: Aircraft deliveries and orders



Source: Boeing, Airbus

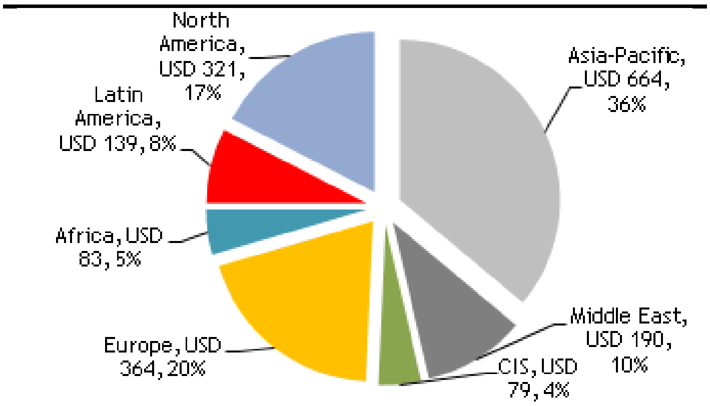
The World Trade Organisation expects overall growth in goods trade to remain above trend for 2022 at c4.7% YoY (vs. the 4.0% estimated for 2021). Boeing (BA US; CMP USD176.92; NR) and Airbus (AIR FP; CMP EUR103.88; NR) also forecast long-term freighter demand over the next two decades to range from 1,950 to 2,480 aircraft, of which they expect c58-60% to be met by conversions. E-commerce, which is expected to be a big part of this overall economic growth, will continue boosting demand for freighter aircraft as well.

Fig 11: 20-year freighter demand forecast



Source: Boeing CMO, Airbus GMF

Fig 12: Cumulative MRO market for FY21-36E



Source: Airbus GMF

Anticipating higher demand for services in freighter leasing and MRO - PTF contracts for STE should accelerate

This should drive acceleration in PTF work in the near term as current market conditions are favourable with ready availability of mid-life and older generation aircraft that are due to be replaced over the next 3 years. Operating in 6 global sites, STE plans to build momentum to strengthen its leadership position in freighter conversion solutions by targeting more than 60 conversions per year (3x current level) from which it aims to generate steady state annual revenue of more than SGD700m by FY26.

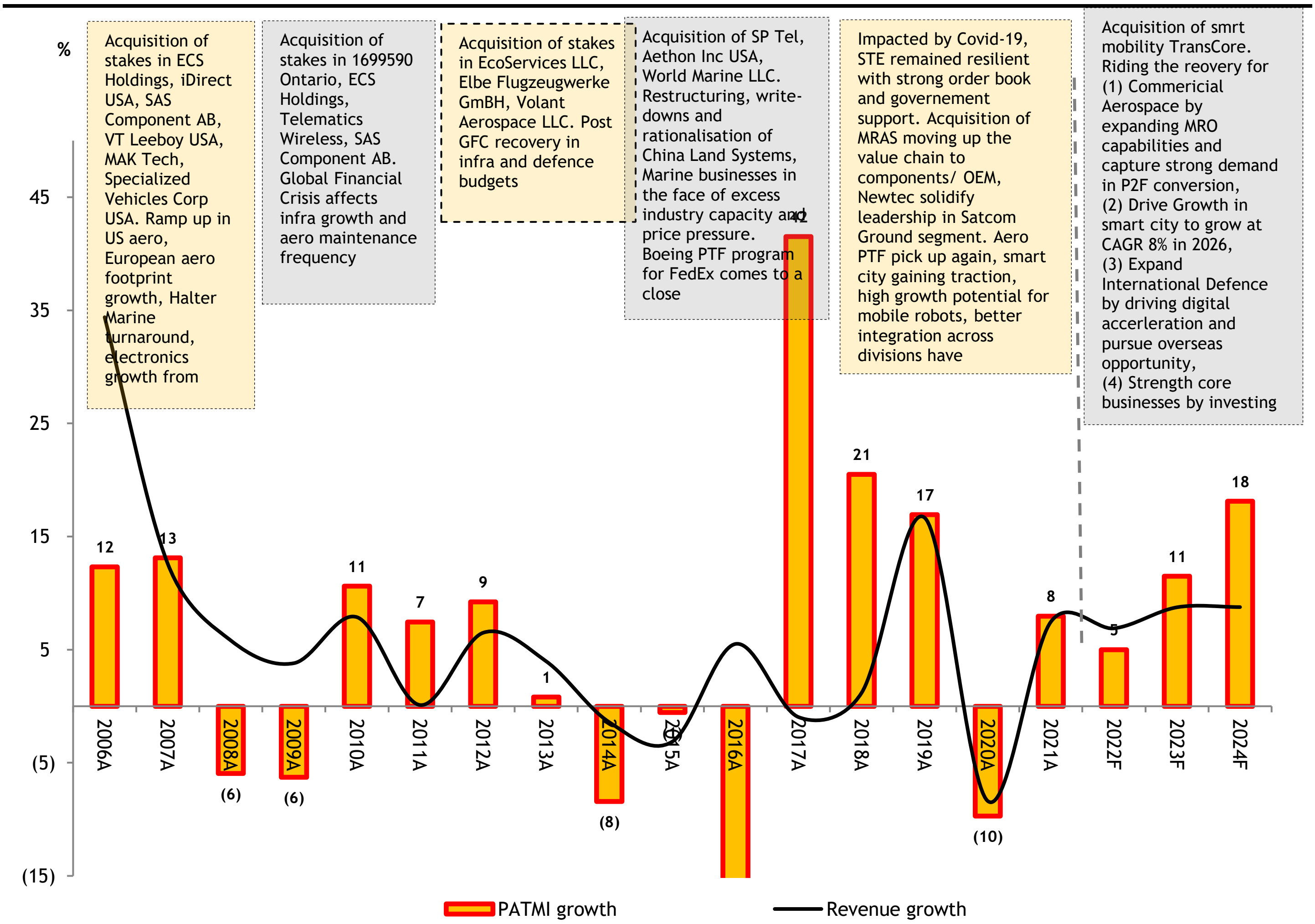
1.2 Reigniting growth

STE has characteristically been involved in a lot of M&A global activity over the years. It has typically invested in or acquired entities for reasons of securing technology that can be applied in or commercialised in its engineering solutions or for various reasons of market structure, regulation etc. that justify an on-ground presence in various geographies. Apart from the industry cycles in its operating sectors, inorganic drivers from the likes of M&A corporate action has also played an important role in its revenue and profit growth cycles.

Resumption of the growth cycle propelled by 5 factors

We expect a resumption of growth in FY22-24F driven by five factors: 1) commercial aerospace revenue looks set to recover by FY24, ie, expanding MRO capabilities while capturing strong demand in P2F conversion. Partnerships should help STE to deepen working relationships with global leading OEMs and help STE expand its engineering capabilities to optimise the cost structure of its components MRO business. 2) The outlook for its smart city solutions remains robust and could hold upside with governments increasing investment in smart cities and sustainable infrastructure i.e. smart street lighting, water management and metering, cyber-security etc. 3) Building on strong momentum to accelerate growth in global smart cities through recent acquisition of Newtec and Glowlink, which could strengthen its satellite-based internet-of-things solutions, while TransCore could enhance its smart transportation offerings. Growth in demand at the intersection of urbanisation, digitalisation and sustainability. 4) Driving success in international defence business through digitalisation and pursuing more overseas opportunities. 5) Consistently investing 4-5% of revenue in Digital Technologies R&D to enhance product offerings and solutions, scale operations and processes and fund technology gaps to enhance existing capabilities and materially speed up time-to-market for new solutions.

Fig 13: STE revenue and reported PATMI growth cycles & major investments



Source: Company, Maybank IBG Research

Fig 14: Notable acquisitions and disposals

Announce Date	Close Date	Deal Title	Transaction Value (LCY'm)
03 Oct '21	18 Mar '22	Acquisition of TransCore by ST Engineering	2,680
21 Feb '20	21 Feb '20	ST Engineering's JV announces securitisation of 30 aircraft engines	358
11 Oct '19	11 Oct '19	ST Engineering's Marine Arm Completes Sale of ROPAX	Undisclosed
17 Sep '19	17 Sep '19	ST Engineering Acquires Satcom Anti-Jamming Capabilities	20
29 Mar '19	18 Apr '19	ST Engineering Updates on the Proposed Acquisition of MRAS	696
27 Mar '19	1 Oct '19	ST Engineering Positions for Growth in Satcom Market, with Offer to Acquire Newtec	250
2 Sep '19	2 Sep '19	ST Engineering's Aerospace Arm Injects Capital into Aircraft Leasing JV Co	1.6
17 Sep '19	17 Sep '19	Singapore Technologies Engineering Ltd. acquires Glowlink Communications Technology, Inc.	33.4
27 Mar '19	01 Oct '19	Singapore Technologies Engineering Ltd. acquires Newtec Cy NV	381.1

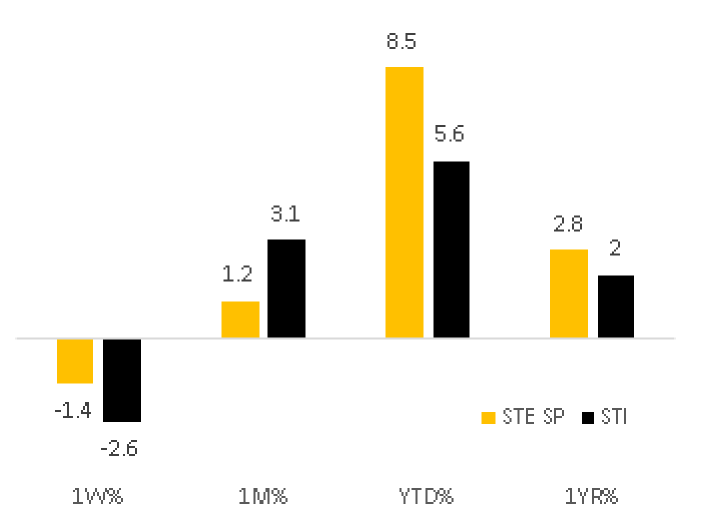
Source: SGX

1.3 Relative share price underperformance should reverse

STE's relative stock price has outperformed the benchmark FT Straits Times Index over the past 12 and 24 months by around 6.5% and 32.3%, respectively. However, the absolute price returns over this 12- and 24-month period has lagged a number of the Singapore-listed industrial sector counters.

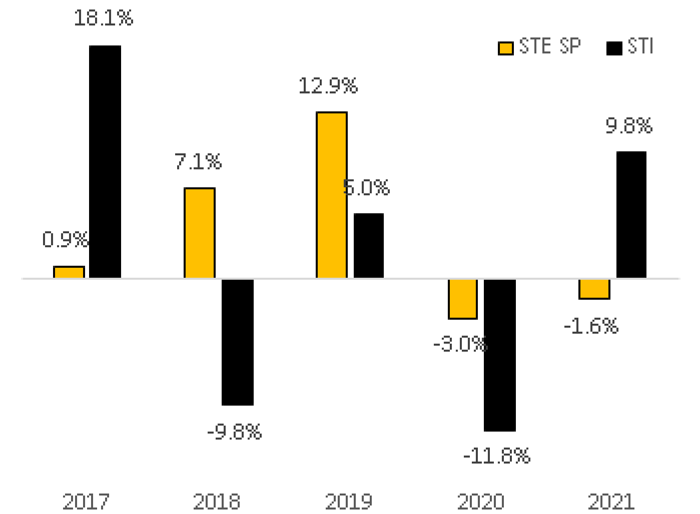
With STE's core PATMI growth expected to see an inflection this year and deliver 18.9% CAGR in FY21-FY24F due to Covid-19 recovery, we would correspondingly expect a reversal of fortune in this relative underperformance of recent years.

Fig 15: Total Shareholder Return (TSR) on varying time frames



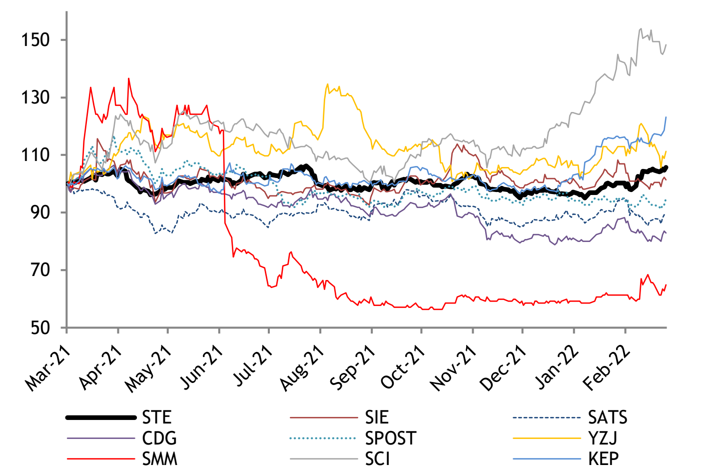
Source: Maybank IBG Research

Fig 16: Annualised TSR (5%) in the past 5 years



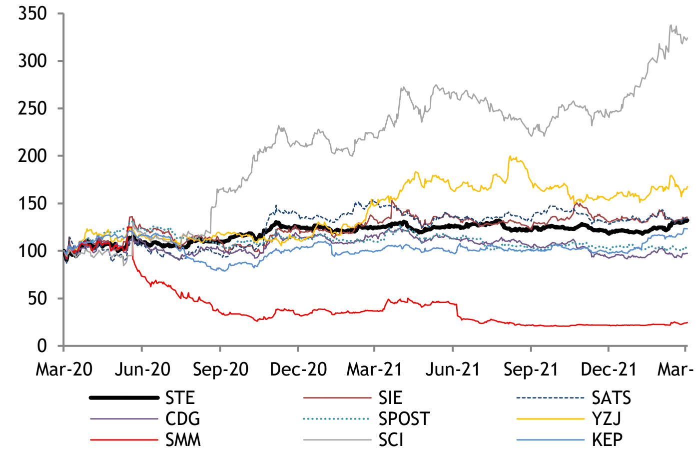
Source: Maybank IBG Research

Fig 17: Relative 1-year performance of SG industrials



Source: FactSet

Fig 18: Relative 2-year performance of SG industrials



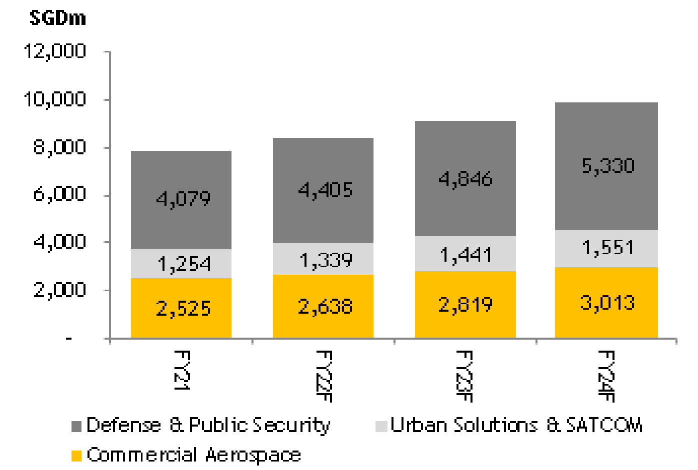
Source: FactSet

Fig 19: Growth and margin outlook by division

Business	Revenue FY21-FY25F CAGR %	PATMI FY21-FY25F CAGR %	Core PATMI FY21-FY25F CAGR %	EBITDA margin outlook FY21-FY25F	Growth drivers/comments
Commercial Aerospace	6.0	28.9	24.7	Maintaining at 18-20% (18.2% in FY21) with higher PTF order books and overall sector recovery	Airbus PTF programme expected to increase with higher order books. Components and engines repair looking promising too with border reopening and aviation industry
Urban Solution & SATCOM	7.3	11.1	11.1	Growing by c100bps (8.5% in FY21) from mix factors (higher growth forecast for smart city solutions) and new product initiatives/launches in pipeline	Strong market demand for rail electronics and smart-city management solutions. ICT solution capability augmented by the TransCore acquisition, enhancing smart mobility products and gained entry to North American Electronic Toll Collection and congestion pricing.
Defence and Public Security	9.2	24.7	24.3	Hovering around 20% with GPM outlook largely flat	Growing trends in military transformation through technology innovation. New growth drivers from accelerated adoption of technology, record high defence budget in Singapore, the US and in the region.
Group	7.8	14.0	13.0	Growing by c200bps (25.2% in FY21)	Profit growth to recover with improving business outlook for all three divisions.

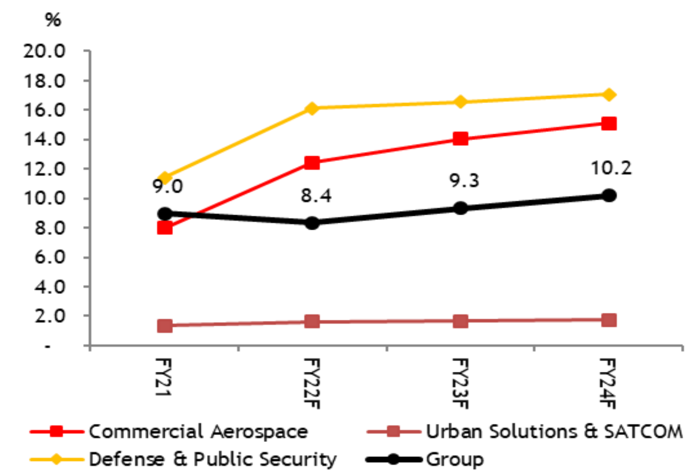
Source: Maybank IBG Research, Company

Fig 20: Divisional revenue breakdown



Source: Maybank IBG Research, Company

Fig 21: Divisional pre-tax margin breakdown

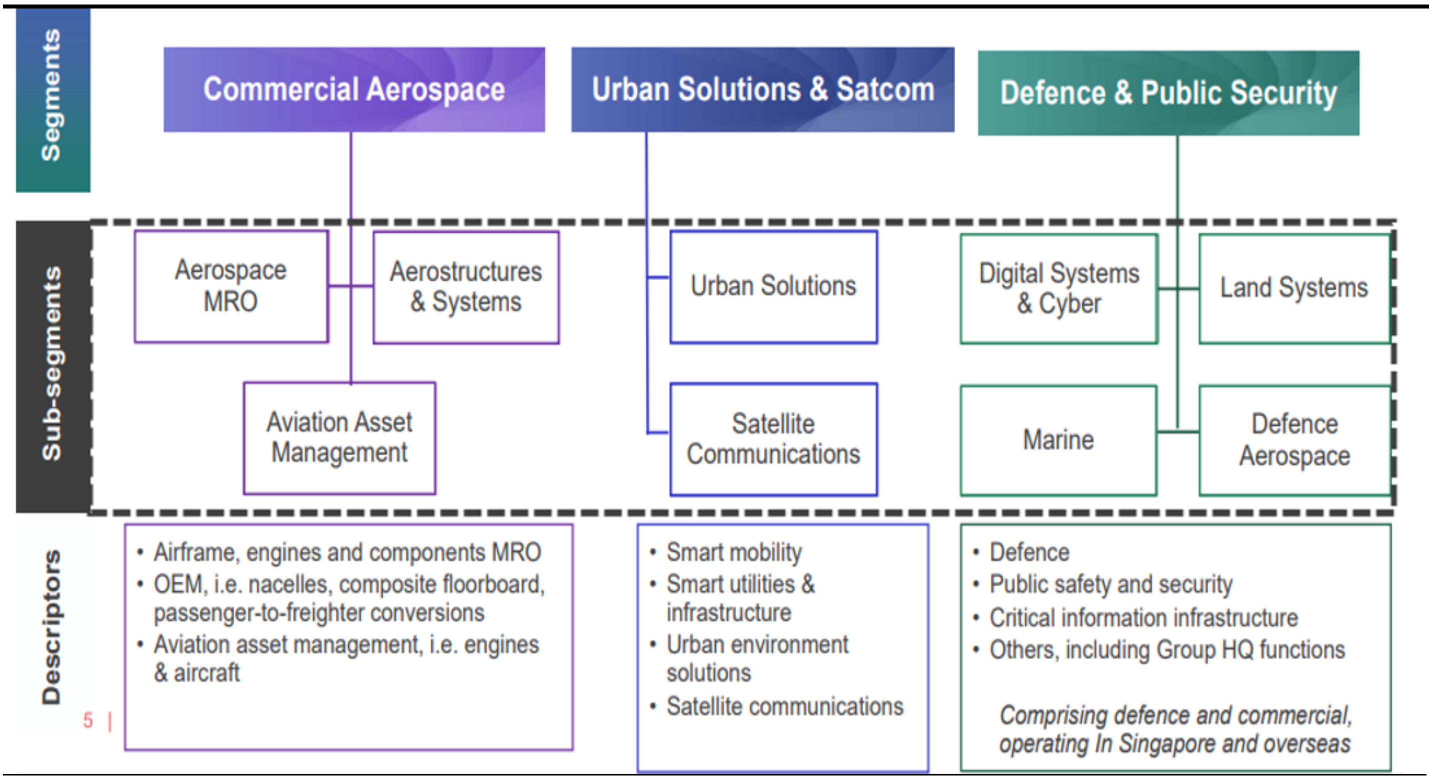


Source: Maybank IBG Research, Company

2. Corporate Information

Incorporated in 1997, Singapore Technologies Engineering Ltd. (STE) is one of Asia's largest global technology, defence and engineering groups. The group was recently restructured and it operates through the following segments: commercial aerospace, urban solution & satellite communication and defence & public security. A leader in each of these core businesses, ST Engineering leverages its multi-sector capabilities to be a one-stop solution provider for its customers in over 100 countries. As of end of Dec21, roughly 65-70% of its revenues are derived from commercial contracts and the balance from defence orders.

Fig 22: Three business segments of STE



Source: Maybank IBG Research

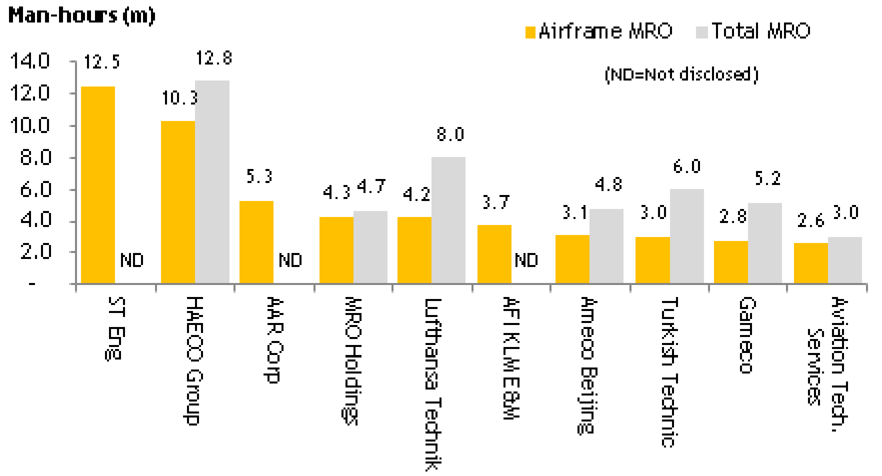
2.1 Commercial aerospace (CA)

STE is the world's largest independent aerospace MRO group by man-hours

The commercial aerospace segment provides total aviation support to commercial airlines, airfreight operators and military operators. It is the world's largest aerospace Maintenance Repair Overhaul (MRO) service provider in terms of man-hours (and one of the three independent amongst the top ten companies) with a large footprint of facilities across Asia-Pacific, Europe and North America.

In our view, STE provides some comparative advantages in its home base versus most alternative MRO locations in the region. The Economic Development Board of Singapore estimates that the country now accounts for around 10% of global aerospace MRO output.

Fig 23: Largest aircraft MRO groups by man-hours



Source: Aviation Week Network biennial MRO survey

Fig 24: Brief guide to types of maintenance checks for commercial aircraft

Check	Content	Typical frequency
Line maintenance: checks and minor repairs done when an aircraft is in its operating environment		
The 'A' Check **STE involvement small**	Maintenance check with inspection of wheels, brakes, fluids, filters plus minor repairs / replacement of on-board equipment & sensors etc	Done every 100-500 flight hours depending on type and age of aircraft. The check takes around 10-12 hours
Heavy maintenance: Aircraft taken out of operations during the period; far more intensive and longer in duration than Line checks		
The 'B' Check **STE involvement small**	More comprehensive, sophisticated, time consuming than 'Line checks. Airlines are increasingly doing away with 'B' Checks and incorporating them into a longer roster of 'A' Checks while the aircraft is still operating. This is particularly so for newer generation aircraft.	Performed every 6-8 months and requires the aircraft to be out of service for 2-3 days, typically in a hangar
The 'C' Check **STE involved**	Involves inspection of a large majority of the aircraft's components	Typically done every 18-24 months depending on aircraft type and age and takes 2-3 weeks during which the aircraft must remain out of operation
The 'D' Check **STE involved**	Comprehensive check of all aircraft systems and internal/external metal airframe that involves dismantling almost everything including landing gear and cabin for inspection, replacement, repair.	Typically done every 6+ years depending on type and age of aircraft. 'D' Check intervals for newer generation aircraft are longer. Takes 2-3 months to complete

Source: Maybank IBG Research

Recent contact wins/pipelines

The expansion of integrated solutions for nacelle was made through the merger with Middle River Aerostructure System – the world's leading OEM manufacturer of thrust reverser, engine nacelle components and specialized aerostructures. FY21 saw ramping up of production volume of nacelle for A320neo engines to be in line with the requirement of Airbus OEM. Overall, there is a steady growth in production volume and we expect total order book for nacelles to remain strong in the medium to long term.

Passenger to Freighter (P2F) conversion has been one of the brightest spots of the airline industry, driven by the robust e-commerce market. In FY21, the company inducted a total of 30 Boeing and Airbus aircraft for conversion, compared to 12 in FY20. The P2F customer base continued to receive additional orders of 20 A330P2F to be redelivered from FY23. With such strong interest, all slots for A330P2F and A321P2F have been fully booked through FY25. Planned expansion to new conversion lines in the US, China and Germany has been made to cater for higher demand.

In anticipation of a stronger recovery and longer-term growth, STE continues to invest in capabilities from construction of new aerospace facilities to smart technologies at hangers to enhance productivity. These investments will ensure that the company maintains a competitive edge, emerges stronger and is better positioned to take up new opportunities.

2.2 Urban solutions and SATCOM (USS)

A smart city uses a framework of information and communication technologies to create, deploy and promote development practices to address urban challenges and create a joined-up technologically-enabled and sustainable infrastructure. STE's USS business helps to strengthen the reliability and efficiency of land transportation, build integrated mobility networks infrastructures that optimise operational efficiency and enhance commuter experience. This segment has a long track record in executing subway and metro rail transport projects across various countries in the Asia-Pacific and the Middle East region (STE customises almost all types of electronics modules for such projects except those required in signalling equipment and rolling stock).

SATCOM is one of the world's largest VSAT (very small aperture terminals) systems manufacturers for enterprise use, in part due to a US acquisition in the last decade. SATCOM provides satellite imaging and geospatial analytics that enable more effective decision making in agriculture, environmental protection, land planning and disaster management.

STE is one of the largest VSAT technology systems manufacturers in the world.

Fig 25: Urban solutions segment

Source: Company

Recent contact wins/pipelines

Rail contracts were acquired for communication and control systems, automatic fare collection, platform screen doors, supervisory control, data acquisition and passenger information systems for various projects in Singapore, Taiwan, Australia, Egypt and Romania. Land Transport continues to develop enhanced urban traffic management through AI, data analytics and IoT. In March 22, STE acquired TransCore – a US market leader in Electronic Toll Collection solutions and Intelligent Transport System. We believe this integration will provide a full range of solutions and position STE as a leader in smart mobility, which will accelerate the growth of its smart city division.

We are bullish about SATCOM; STE expanded its network connectivity in emerging markets and helped customers capture growth opportunities in the cellular backhaul segments. The acquisition of Newtec Group and Growlink Communication Technology in 2019 provides consumers with

SATCOM solutions across key segments in maritime, aero, enterprise, military and broadcast. The segment was selected to support 3G, 4G and corporate Internet services across Brazil and the Democratic Republic of Congo. The company has expanded its portfolio by partnering with various agencies (NUS-CRISP, DSO and DSTA) to collaborate on R&D and to commercialise advanced remote sensing technologies and geospatial imagery analytics solutions. It now has applications in areas such as urban planning, infrastructure development, maritime safety and security, environmental monitoring and agricultural growth tracking.

2.3 Defence and public security (DPS)

The DPS cluster is one of Asia's leading defence solutions with a comprehensive portfolio of products and services. This cluster helps to equip public-safety agencies to deal with threats and unexpected incidents in more than 100 cities.

Fig 26: Defence and public security segment

Source: Company

Notable recent contract wins/pipelines

The digital and cyber unit has secured more turnkey projects compared to the year before, leading to higher sales of cybersecurity solutions and services. STE won defence and commercial contracts for 40mm munitions, next generation armoured fighting vehicles, road construction and other speciality vehicles. It completed the supply of cybersecurity products and solutions, AI-based mission critical systems, on-premise cloud solutions and cloud managed services. It also completed various ship repair and shipbuilding contracts in Singapore and at US yards, including the fifth US Navy APL(S) berthing barge, the supply of design, platform equipment and technical assistance for four Falaj 3-class Offshore Patrol Vessels and the second Polar Security Cutter. To strengthen its portfolio, STE signed agreements with Oshkosh Defence to develop prototypes for the US Army's Cold Weather All-Terrain Vehicle (and also signed a MOUs with NIMR to work on integrating hybrid drive systems for armoured vehicles). The segment also received strong orders for its specialty vehicle, Leeboy and Hackney in 2021 despite challenging business conditions amid the global chip shortage.

Fig 27: Specialty vehicle LeeBoy unveiled a limited edition paver

Source: STE annual report 2021

3. Financial analysis

3.1 Revenue growth backed by strong order intake and backlog at record levels

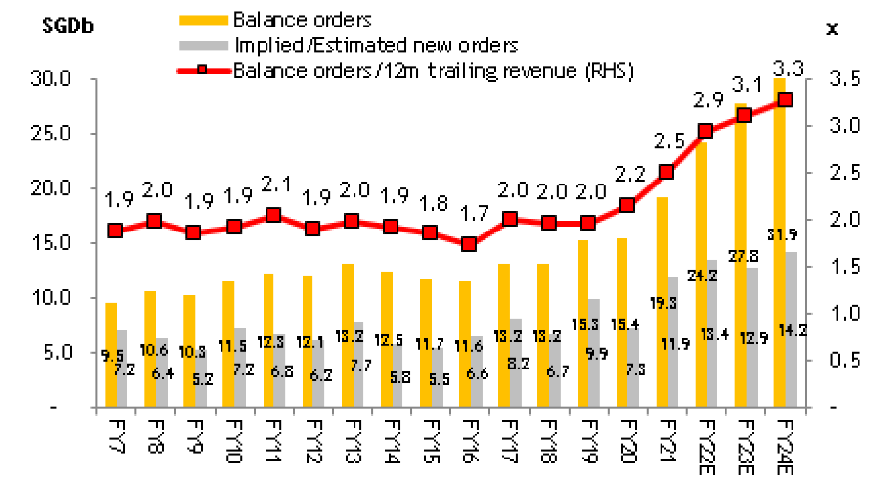
FY21 has been one of the best new contract win years in STE's history. Notably, demand for P2F continues to be strong with order slots booked through FY25E.

Our estimates for new orders per year differ from what might be inferred from company disclosures due to two key reasons: 1) a material number of new contracts might not be disclosed due to various reasons of limitations in information disclosure for some defence and government contracts as well as commercial sensitivity in others; and 2) the company does not announce firmed contracts that are less than three months old or orders that might be deemed short term and somewhat recurring in nature like ship repair, satellite and communications product sales etc.

Order backlog at an all-time high

Our own estimates for STE's new orders per year is based on the assumption that the balance order book at the beginning of the year less revenues recognised plus new order intake in the year will translate to the balance order book at end of the year. On this basis, we saw new orders in FY21 stood at cSGD11.6b, the highest level in well over a decade and management has highlighted SGD5.8b is expected to be delivered in the remaining months of FY22. Also, the balance order book of SGD21.3b as at end of Mar-22 (incl.SGD1.6b from TransCore) is at an all-time high and at c2.5x trailing 12-month revenues. From FY22E-FY25E, we are expecting order book remains robust growing at a 3-year CAGR of 10% with growth in overall business post-pandemic.

Fig 28: Order book balance and estimated annual new orders*

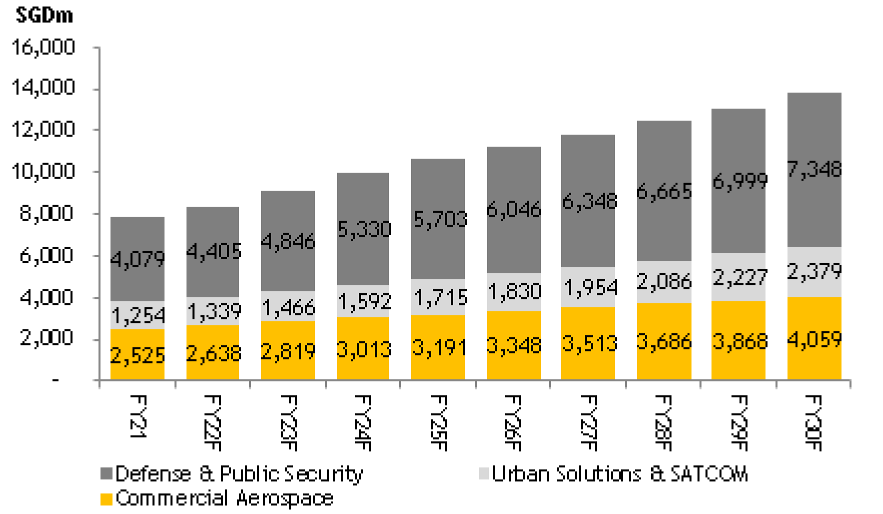


*Source: Maybank IBG Research (*New orders: BOY order book - Revenue + New orders= EOY order book)*

On that basis, we are forecasting STE's revenue to increase 7-9% pa for the next 5 years, which we see as relatively in line with street guidance in the medium to long term. We also forecast net revenue to see CAGR of 10.2%, as growth from Defence & Public Security (CAGR: 11.7%) and Urban Solution & SATCOM (CAGR: 10.9%) outpace growth from Commercial Aerospace (CAGR: 8%) within the same timeframe. Downside risk for the business would be if economies that STE operates in witness a slowdown in growth and increase in inflation, resulting rising capex and operational costs. We also see chip shortages as an ongoing issue for smart cities and SATCOM.

Chips are needed for new initiatives in smart city solutions. The ongoing supply crunch has continued to hurt production. In contrast, the key upside risk to our commercial aerospace assumptions in FY22-FY24E is if countries exit Covid-19 related restrictions faster than expected and if cross-border tourism recovers faster than expected.

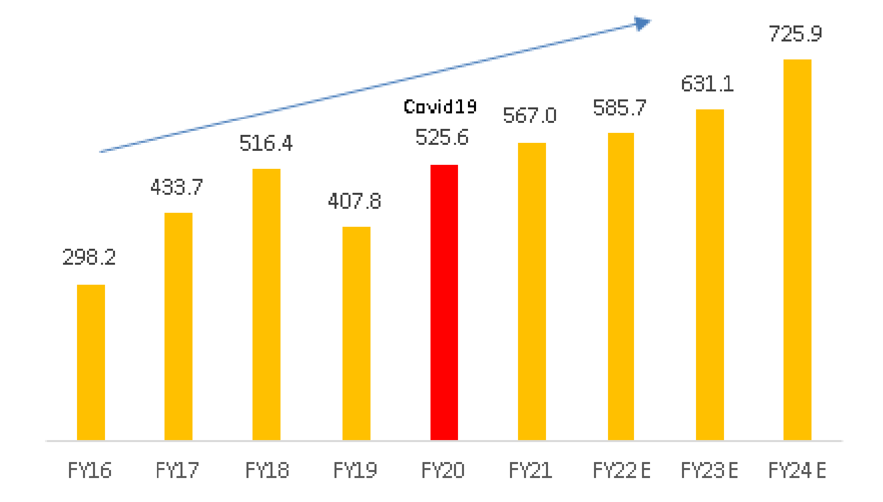
Fig 29: Revenue by segments



Source: Maybank IBG Research, Company

The Group's various business initiatives and further business recovery should position it well for FY22-FY25 business performance. As such, we forecast net profit to recover to SGD644m/SGD712m/SGD777m in FY22/23/24 respectively.

Fig 30: Net profit recovery trajectory



Source: Company

Fig 31: P&L statement

Profit & Loss	Re-organisation 2021A	2022F	2023F	2024F	2025F
Commercial aerospace	2,525.0	2,638.2	2,819.4	3,013.2	3,191.0
Urban Solutions & SATCOM	1,253.8	1,338.9	1,440.8	1,550.8	1,669.7
Defence & public security	4,078.9	4,405.2	4,845.7	5,330.3	5,810.0
Others & elimination	(164.8)	(159.8)	(164.3)	(169.2)	(174.1)
Net revenue	**7,692.9**	**8,222.4**	**8,941.6**	**9,725.1**	**10,496.6**
Cost of goods (ex-depr & SGA)	(5,757.4)	(6,109.2)	(6,616.8)	(7,177.1)	(7,715.0)
Gross profit	1,935.4	2,113.2	2,324.8	2,548.0	2,781.6
Margin	25.2	25.7	26.0	26.2	26.5
SGA & other expenses	(890.2)	(1,010.2)	(1,045.8)	(1,076.4)	(1,106.1)
Total cash opex (Incl COGS)	(6,647.6)	(7,119.5)	(7,662.6)	(8,253.5)	(8,821.1)
EBITDA	**1,045.3**	**1,103.0**	**1,278.9**	**1,471.6**	**1,675.5**
Margin	13.6	13.9	14.3	15.1	16.0
Depreciation	(314.2)	(331.9)	(366.5)	(401.6)	(437.4)
Amortisation	(83.9)	(88.6)	(93.3)	(98.0)	(103.0)
Total operating expenses	(7,045.7)	(7,540.0)	(8,105.5)	(8,718.8)	(9,309.5)
Operating income	**647.2**	**682.5**	**819.1**	**972.0**	**1,135.2**
Interest income	11.7	23.7	21.9	20.1	20.2
Interest expense	(47.7)	(51.2)	(72.1)	(68.3)	(55.6)
Other income (expense) - wage credit, investment inc, rental etc	10.5	12.5	12.8	13.0	13.3
Equity in earnings (Share of result of associates and JV)	16.0	21.7	22.2	22.7	23.2
Other income (expense)	**(9.5)**	**6.8**	**(15.3)**	**(12.4)**	**(6.2)**
Pre-tax profit	637.6	689.2	803.9	959.5	1,129.0
Income tax	(70.6)	(103.5)	(172.8)	(233.6)	(279.6)
Consolidated net profit	**567.0**	**585.7**	**631.1**	**725.9**	**849.4**
Minority interest	(3.6)	(3.8)	(3.6)	(3.8)	(3.6)
Cash dividends on Preferred stock	0.0	0.0	0.0	0.0	0.0
Reported profit to common stock	**563.4**	**582.0**	**627.5**	**722.1**	**845.8**
Exceptional gains/(losses)	(26.3)	(0)	(0)	(0)	(0)
Adjusted core PATMI	**589.7**	**582.0**	**627.5**	**722.1**	**845.8**

Source: Company

Fig 32: MIBG vs. consensus

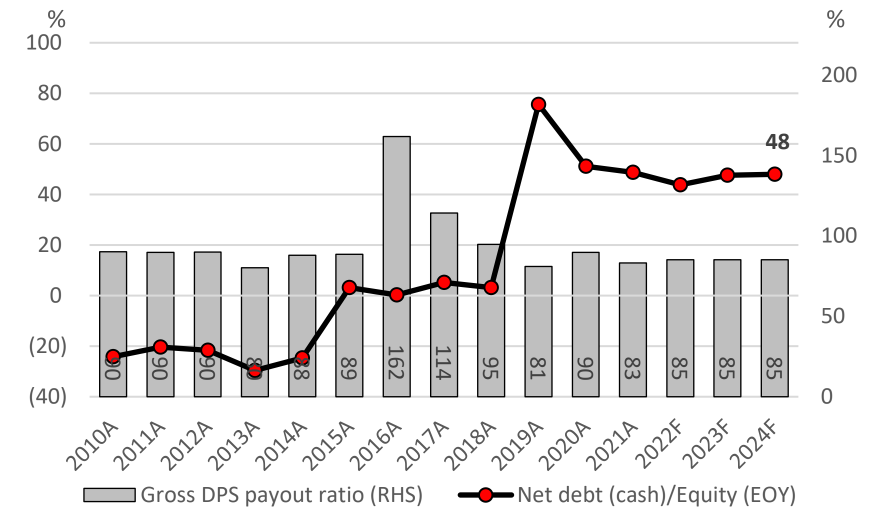
	2022E			2023E			2024E		
	MIBG	Csus	%	MIBG	Csus	%	MIBG	Csus	%
Revenue (SGD m)	8,222	8,764	-6.2%	8,942	9,430	-5.2%	9,725	9,970	-2.5%
EBITDA (SGD m)	1,103	1,156	-4.6%	1,279	1,309	-2.3%	1,472	1,447	1.7%
Net Profit (SGD m)	586	587	-0.3%	631	664	-4.9%	726	728	-0.3%

Source: Bloomberg, Maybank IBG Research

3.2 Debt burden to multiply with M&A drive

ST Engineering's debt burden is poised to rise amid an M&A spree. We predict it may to above SGD3.5b, or hovering around 50% of equity (FY22-FY24), with the acquisition of transport solutions provider Transcore for USD2.68b in March 2022. STE has also made a few other large purchases in the past few years, including aircraft engine parts maker MRA Systems for USD506m and satellite communications business Newtec for USD281m, reflecting an aggressive growth proposition. Its strong cash flow and a stable AA+ credit rating from S&P could allow it to maintain operations, fund growth investment and conduct more M&A. Transcore booked USD135m EBITDA for FY21 and we expect it to be earnings accretive from FY23E, but the interest burden incurred may dilute gains. Still, additional product and service capabilities could strengthen STE's market position and fuel profit growth.

Fig 33: STE net D/E and Gross DPS payout ratio



Source: Maybank IBG Research, Company

3.3 Dividend capacity may stay intact on earnings and cash

ST Engineering's dividend capacity could hold steady even as its debt burden balloons, given its resilient earnings and cash flow. Its diversified business carries high exposure to defence, public security and critical infrastructure projects, which may buttress the company against uncertain commercial aerospace demand. Order flow has been robust since 2017, and a SGD19.3b backlog as of December 2021 delivers earnings visibility. ST Engineering generates at least SGD500m a year in cash from operations, yet annual capital spending was only about SGD300m, mostly for capacity expansion.

STE likely to increase DPS and maintain dividend payout of ~85%

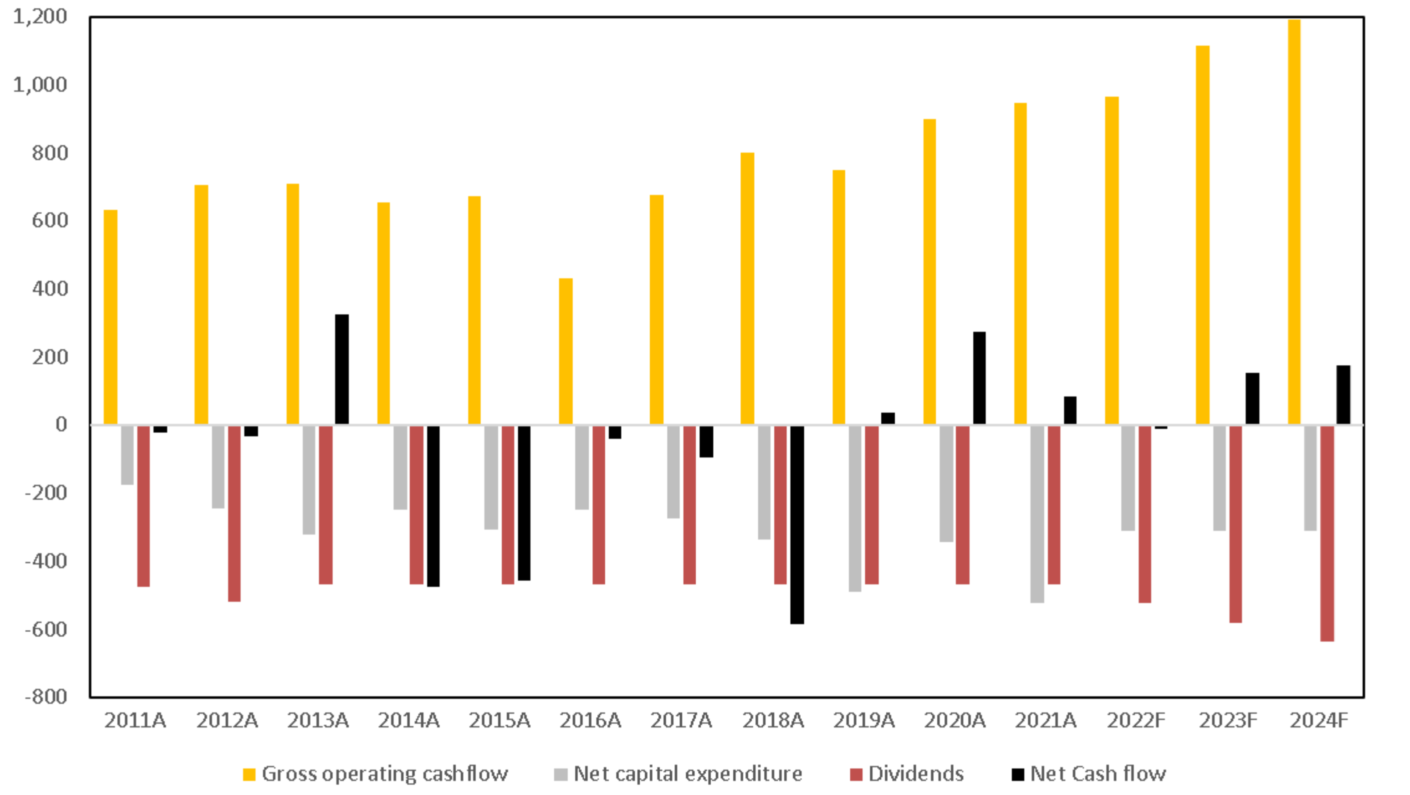
We believe STE is well positioned to resume dividend payout of 85%, backed by our expected recovery of core profitability and strengthened net cash position. We are projecting DPS of 16.7/18.55/20.33 S cents for FY22/23/24 respectively, translating to a dividend yield of 2.7% on current trading price of SGD4.07. Therefore, we think our dividend forecasts are sustainable based on our expectation of positive free cash flows in the next three years.

Fig 34: Dividend payouts

	2020A	2021A	2022F	2023F	2024F
Total DPS	15.00	15.00	16.70	18.55	20.33
Payout Ratio	89.8%	83.1%	85.2%	85.2%	85.2%
DPS yield (%)	2.9%	2.7%	2.7%	2.7%	2.7%

Source: Maybank IBG Research

Fig 35: Cashflow vs dividends



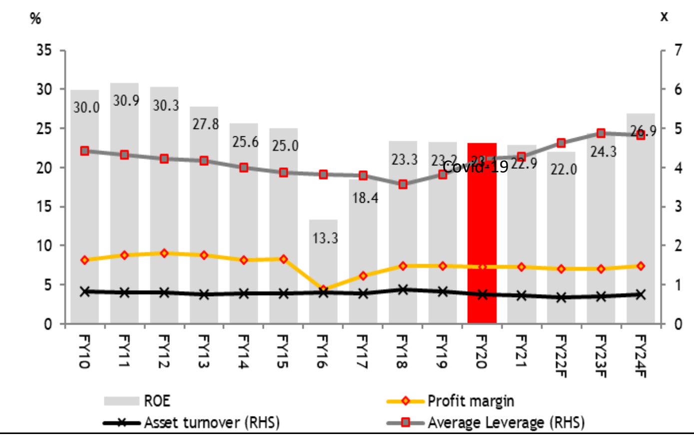
Source: Maybank IBG Research, Company

3.4 ROE recovery to high-20s expected

Post the past three years of relatively lower returns on equity in the c23-25% range due to restructuring and one-off charges in various operating units, we expect returns to recover back to the high-20s levels by FY22. These forecast ROE levels are not out of the ordinary; the company has delivered 25%+ ROE for 15 of the past 20 years.

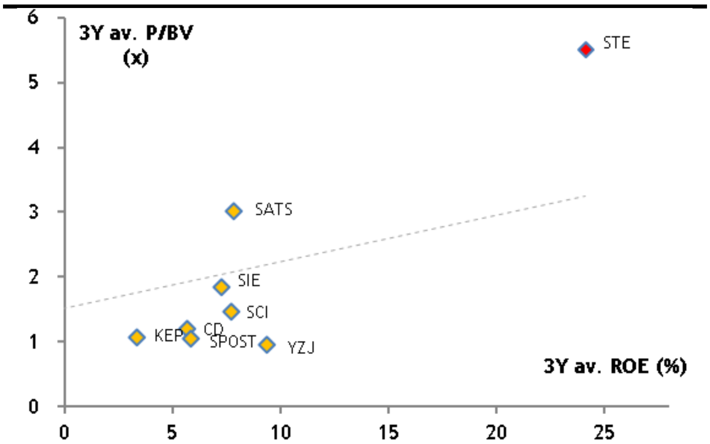
ROE growth could be even higher with balance sheet leverage and / or 'sweating' assets further

Fig 36: Du Pont ROE breakdown



Source: Maybank IBG Research, Company

Fig 37: SG large-cap industrials P/BV vs. ROE



Source: FactSet

Moreover we believe ROE's could trend even higher than our forecast levels from two factors:

1. 'Sweating' assets further – asset turnover has been quite range bound at c0.8x for almost a decade. We believe one of the key reasons for this is because the various business divisions have largely operated in a stand-alone manner in the past thereby curtailing the level of revenue synergies that could potentially be realised from cross-selling capabilities and products as well as the avenues for cost rationalisation from integrating systems, centralised procurement etc. This should change by breaking down the historical silo-like operating norm with greater cross-divisional integration of capabilities is a focus area for the management team.

2. Increasing leverage – We also note that STE, which has a relatively conservative balance sheet, has historically managed to meet its organic growth needs, acquisitions and a sizeable dividend payout (80-100% of profit in the past 20 years) largely from internally generated cashflow and any divestment proceeds. We are of the opinion that management is more open now to adding some debt to the balance sheet for funding acquisitions going forward.

Fig 38: DuPont analysis

DuPont		2016A	2017A	2018A	2019A	2020A	2021A	2022F	2023F	2024F
-Profit margin	%	4.3	6.2	7.4	7.4	7.3	7.3	7.1	7.0	7.4
-Asset turnover	x	0.8	0.8	0.9	0.8	0.7	0.7	0.7	0.7	0.8
-Average Leverage	x	3.8	3.8	3.6	3.8	4.2	4.3	4.6	4.9	4.8
ROE	%	13.3	18.4	23.3	23.2	23.1	22.9	22.0	24.3	26.9
EBIT ROCE	%	7.9	12.6	17.1	12.5	11.9	13.8	12.3	13.0	15.5
ROA	%	3.5	4.9	6.2	6.8	5.5	5.6	5.1	5.1	5.7
RONA	%	17.1	23.6	27.7	22.0	18.9	20.3	20.0	20.1	20.9
Gross dividend payout ratio	%	162	114	95	81	90	83	85	85	85
Net dividend payout ratio	%	162	114	95	81	90	83	85	85	85

Source: Company, Maybank IBG Research

4. Valuation

4.1 Target price and methodology

We value STE on a discounted cashflow of explicit forecasts to FY30 and terminal value based on a 3% long-term growth rate, which is our assumption for Singapore aviation sector's growth rate over the long term.

Our other key assumptions are a WACC of 7.2% and long-term capital structure with 25% net gearing. Our target is SGD4.75.

Fig 39: DCF forecasts

FYE Dec (SGDm)	2021A	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F
-Commercial Aerospace	2525	2638	2819	3013	3191	3348	3513	3686	3868	4059
-Urban Solutions & SATCOM	1254	1339	1441	1551	1670	1782	1902	2031	2168	2316
-Defence & Public Security	4079	4405	4846	5330	5810	6275	6777	7319	7904	8537
-Others & Elimination	(165)	(160)	(164)	(169)	(174)	(179)	(184)	(189)	(195)	(202)
Revenue	7693	8222	8942	9725	10497	11226	12008	12846	13745	14710
Growth YoY, %	7	7	9	9	8	7	7	7	7	7
EBIT	**647**	**682**	**819**	**972**	**1135**	**1275**	**1351**	**1428**	**1452**	**1498**
Operating margin, %	8	8	9	10	11	11	11	11	11	10
- Adj for taxes	(71)	(104)	(173)	(234)	(280)	(306)	(306)	(306)	(306)	(306)
+ Depreciation	314	332	366	402	437	474	511	548	586	625
+ Amortisation	84	89	93	98	103	84	84	84	84	84
+ Working cap chgs	7	(140)	(97)	(107)	(114)	(86)	(59)	(59)	(27)	(40)
- Capex	(524)	(597)	(607)	(617)	(627)	(638)	(649)	(660)	(671)	(683)
+ Investment income	11	15	16	16	16	17	17	17	18	18
FCFF	**470**	**278**	**417**	**530**	**671**	**820**	**950**	**1053**	**1137**	**1197**
Year	0	1	2	3	4	5	6	7	8	9
WACC (%)	7.2%	7.2%	7.2%	7.2%	7.2%	7.2%	7.2%	7.2%	7.2%	7.2%
Disc. factor (x)	1.00	0.93	0.87	0.81	0.76	0.71	0.66	0.61	0.57	0.53
Discounted FCF	**470**	**259**	**363**	**430**	**508**	**579**	**625**	**647**	**651**	**639**

Source: Maybank IBG Research

Fig 40: DCF summary and assumptions

DCF summary	SGD'm	Key assumptions	%
Terminal Value (TV)	22,951	Risk Free Rate (%)	2.5
TV: Implied EV/EBITDA (x)	6.6	Risk Premium (%)	6.5
		Cost of Equity	9.0
FCFF: 2021-2030 explicit forecast	4,701	Cost of debt (or YTM of bond)	2.3
FCFF: TV	11,433	After-tax cost of debt	1.9
Less: Net Debt (Cash)	1,299	Current Net Debt proportion	32.7
FCFE	14,835	LT Net Debt proportion	25.0
O/s shares	3,123	**WACC**	**7.2**
FCFE per Share (SGD/share)	4.75	**LT Growth Rate**	**3.0**

Source: Maybank IBG Research

Fig 41: DCF sensitivity

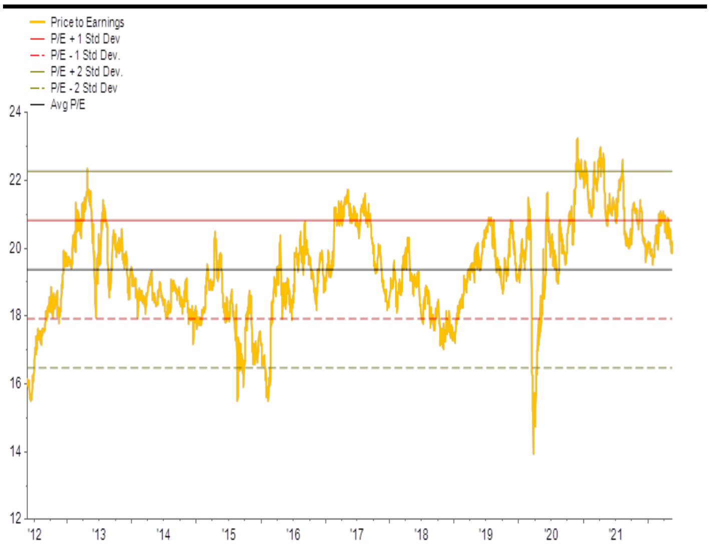
SGD/share	COE (%)				
TGR (%)	8.0	8.5	9.0	9.5	10.0
2.0	4.70	4.29	3.94	3.64	3.38
2.5	5.14	4.65	4.24	3.89	3.59
3.0	5.70	5.10	4.60	4.19	3.84
3.5	6.46	5.69	5.07	4.57	4.15
4.0	7.53	6.48	5.68	5.04	4.53

Source: Maybank IBG Research

4.2 Historical trading bands

STE is trading at a similar level to its respective five-year forward P/E and P/BV averages of 19.9x and 4.8x. Moving forward, we forecast that 15% YoY increment in order book. As such, we believe the stock will likely trade back to forward P/E levels of 22x, similar to the levels witnessed in the last periods of profit growth in FY17-FY18 and FY20-FY21.

Fig 42: 12m forward P/E band



Source: FactSet

Fig 43:12m forward P/BV band

Source: FactSet

4.3 Peer multiple comparisons

Singapore's aerospace and defence market is highly fragmented. There are more than 120 aerospace companies in the country and there are many companies entering the market that offer aerospace design and manufacturing services. Some of the prominent players in the market are SIA Engineering Company, Singapore Technologies Engineering Ltd, Rolls-Royce Holdings plc, Raytheon Technologies Corporation and Airbus SE. The players in the region are integrating advanced technologies for enhancing customer experience and increasing their customer base. Also, the growing partnerships of local and international players for transfer of technology and development of new product lines will help the companies increase their presence in the country. For instance, in 2021, STE secured several key naval contracts with US Navy and US coast guards. This includes the design and engineer of the Polar Security Cutter (PSC). The development and production will be completed in three phases and the first shipment is schedule to occur in 2024.

Fig 44: Peer valuation snapshot

Factset Code	Company	Price LC	Mcap USDm	3M ADV USDm	Rec	TP L Cur.	P/E (x) Act	FY1	FY2	FY3	DY (%) FY1	FY2	ND/E (x) FY1	ROE (%) FY1	FY2	FYE
	Singapore Industrials															
S63-SG	Singapore Technologies Engineering Ltd	3.99	8,932	16.9	Buy	3.7	22.0	21.7	19.5	16.5	3.8	3.9	0.5	22.9	23.3	31-Dec
S59-SG	SIA Engineering Co. Ltd.	2.44	1,966	2.0	-	-	-	-	-	-	-	-		4.5	4.9	31-Mar
S58-SG	SATS Ltd	4.32	3,481	9.9	-	-	-	-	-	-	-	-		2.7	6.9	31-Mar
1J4-SG	JEP Holdings Ltd.	0.37	108	0.1	-	-	-	-	-	-	-	-				31-Dec
C52-SG	Comfortdelgro Corporation Limited	1.42	2,206	13.7	Buy	1.8	23.7	16.5	14.8	13.5	4.3	4.8	(0.2)	7.3	7.9	31-Dec
S08-SG	Singapore Post Ltd.	0.71	1,158	2.1	-	-	26.9	22.9	19.5	16.5	2.2	2.2	(0.1)	4.4	5.1	31-Mar
BS6-SG	Yangzijiang Shipbuilding (Holdings) Ltd.	0.84	2,379	20.3	-	-	7.8	7.7	6.5	6.0	3.5	3.5	(0.3)	9.7	10.5	31-Dec
S51-SG	Sembcorp Marine Ltd	0.10	2,160	15.4	-	-	-	-	-	-	0.0	0.0	0.5	-4.1	-1.4	31-Dec
U96-SG	Sembcorp Industries Ltd.	2.77	3,550	11.9	-	-	10.4	11.1	9.8	9.3	2.3	2.3	1.5	10.1	10.3	31-Dec
BN4-SG	Keppel Corporation Limited	6.60	8,614	22.8	-	-	11.8	13.8	12.9	12.2	3.6	3.6	0.7	7.0	7.2	31-Dec
	Average						**10.8**	**10.8**	**9.8**	**8.8**	**2.4**	**2.4**	**0.4**	**8.9**	**10.0**	
	International Aviation Services															
AIR-US	AAR CORP.	45.51	1,602	18.7	-	-	34.7	19.3	14.0	-	-	-	0.1	7.7	9.9	31-May
DOC-AT	DO & CO Aktiengesellschaft	78.20	793	1.6	-	-	-	63.0	22.7	13.3	0.1	0.1	2.2	9.4	20.1	31-Mar
694-HK	Beijing Capital International Airport Co., Ltc	4.10	982	4.5	-	-	-	-	34.0	10.8	1.0	1.0	0.3	-4.8	2.4	31-Dec
CAE-CA	CAE Inc.	28.18	6,859	19.0	-	-	60.0	36.7	24.6	18.1	0.1	0.1	0.6	3.9	8.8	31-Mar
TXT-US	Textron Inc.	61.95	13,324	92.2	-	-	18.8	15.5	13.2	11.6	0.1	0.1	0.2	12.7	14.3	1-Jan
TDG-US	TransDigm Group Incorporated	549.93	30,500	214.2	-	-	45.3	34.1	25.4	21.6	0.0	0.0	(5.7)	-38.3	-113.7	30-Sep
600893-CN	AECC Aviation Power Co Ltd Class A	38.87	13,336	168.7	-	-	86.3	64.7	50.2	40.4	0.5	0.5		4.1	5.0	31-Dec
600760-CN	AVIC Shenyang Aircraft Co., Ltd. Class A	55.01	15,886	132.5	-	-	62.8	47.3	37.2	29.6	0.2	0.2	(1.6)	16.6	17.8	31-Dec
GD-US	General Dynamics Corporation	223.49	62,064	387.5	-	-	19.3	18.4	15.8	14.1	2.3	2.3	0.5	18.3	19.8	31-Dec
BA-US	Boeing Company	123.14	72,854	1,746.7	-	-	-	412.1	22.1	15.4	0.0	0.0	(3.1)	-26.7	-104.9	31-Dec
9706-JP	Japan Airport Terminal Co., Ltd.	5,280.00	3,839	15.0	-	-	-	374.1	39.9	28.4	0.1	0.1	1.0	-15.0	0.8	31-Mar
AENA-ES	Aena SME SA	129.20	20,179	34.1	-	-	-	35.0	18.2	14.5	2.1	2.1	1.0	8.5	14.9	31-Dec
FRA-DE	Fraport AG	48.27	4,648	18.0	-	-	53.8	28.7	12.7	10.2	0.3	0.3	1.9	4.6	8.3	31-Dec
MNZS-GB	John Menzies plc	5.95	669	13.2	-	-	22.9	-	-	-	-	-		3.2	3.3	31-Dec
ADP-FR	Aeroports de Paris SA	129.65	13,359	15.0	-	-	-	75.9	32.6	23.6	0.5	0.5	2.1	4.2	9.6	31-Dec
5014-MY	Malaysia Airports Holdings Bhd.	6.28	2,372	2.3	Buy	7.0	-	-	20.5	17.6	0.0	2.5	0.7	-12.7	8.8	31-Dec
	Average						**6.4**	**305.1**	**36.2**	**26.1**	**0.2**	**0.3**	**0.3**	**-13.9**	**-8.6**	
	International Defence & Engineering Services															
LMT-US	Lockheed Martin Corporation	434.59	115,647	1,016.2	-	-	19.1	16.1	15.3	15.0	2.6	2.6	0.9	69.7	62.3	31-Dec
NOC-US	Northrop Grumman Corporation	450.78	70,071	474.2	-	-	17.6	18.1	16.5	15.1	1.5	1.5	0.7	28.6	27.8	31-Dec
RTX-US	Raytheon Technologies Corporation	91.48	136,050	630.8	-	-	21.4	19.2	15.8	13.9	2.4	2.4	0.3	9.9	11.3	31-Dec
GD-US	General Dynamics Corporation	223.49	62,064	387.5	-	-	19.3	18.4	15.8	14.1	2.3	2.3	0.5	18.3	19.8	31-Dec
HO-FR	Thales SA	114.25	25,388	87.4	-	-	17.9	16.5	14.9	13.6	2.4	2.4	(0.0)	18.4	18.6	31-Dec
	Average						**18.7**	**17.4**	**15.8**	**14.7**	**2.1**	**2.1**	**0.6**	**38.2**	**35.9**	
	Overall average						**8.4**	**257.9**	**32.8**	**24.2**	**0.6**	**0.6**	**0.4**	**-5.4**	**-1.4**	

Source: Maybank IBG Research

STE is trading at an FY21 P/E of 22.6x, at a premium to the Singapore large-cap industrials average of 12.4x, but it also correspondingly (and consistently) generates a much higher return on equity than all peers in this category. STE's FY21 P/E is also at a premium to its peer basket average of international aviation services companies at 20.9x as well as international defence and engineering companies at 20.7x.

No direct comparable to STE in terms of business mix

We also note that given the mix of sectors and number of sub-sectors STE's operations are involved in, none of the companies in these peer baskets have a business mix that make it directly comparable to STE.

5. Key Risk Factors

The key downside risks to our positive outlook for the stock and our profit forecasts are the following:

5.1 Global Supply Chain woes

Global supply chain has been largely disrupted by the ongoing political instability. Due to its need for niche parts, STE may depend on a single supplier for a particular part or a particular process in the supply chain. Thus a disruption from those single suppliers pose a greater risk in terms of production disruptions and cost overruns. Engagement with customers to understand supplier stability and that supplier are making a "reasonable return" on work packages is critical.

5.2 Chip shortage for smart city

Semiconductor chip shortage has been aggravated by the pandemic and the short fall would not be resolved immediately. Deloitte Global predicts that many types of chips will still be in short supply throughout 2022 and with some components lead time pushing into 2023, meaning that the shortage will have lasted 24 months before it recedes. SATCOM segment, which has been reliant on chips to make devices, is facing supply issues. These might cause sales in this sector to plummet. We take comfort that STE has been able to mitigate this through product redesign, supply chain diversification and price adjustment.

5.3 Skilled labour shortage in Aerospace industry

The defence and aerospace industry faces impending retirements and a shortage of trained technical graduates while work and skills requirements become increasingly advanced. Talent shortages will have a moderate or extreme impact on production levels to meet growing customer demand. STE management have talked about improving attrition through wage improvement and attracting new talent by collaborating with various apprenticeship programmes.

5.4 Volatility in geopolitical and economic environment

As STE has a global footprint, it's vulnerable to external factors, such as political tension and economic conjunctures. In the case of the commercial aviation sector, political stability and sustained economic growth are major underlying factors driving long-term growth in air traffic. A potential economic slowdown could prove to be one of the major challenges for the aviation industry in the years to come. It could cause airlines to review their order intake strategies and postpone or even cancel existing aircraft orders. If orders are cancelled, it will create a domino-effect across the industry, presenting multiple issues for the aviation industry as a whole.

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Key Metrics					
P/E (reported) (x)	21.5	21.4	21.8	20.2	17.6
Core P/E (x)	20.7	19.9	21.8	20.2	17.6
P/BV (x)	4.6	4.4	4.6	4.4	4.3
P/NTA (x)	19.0	17.4	14.9	12.2	10.2
Net dividend yield (%)	3.9	4.0	3.9	4.2	4.9
FCF yield (%)	1.1	nm	nm	nm	nm
EV/EBITDA (x)	14.4	12.7	12.8	11.2	9.8
EV/EBIT (x)	24.1	20.5	20.7	17.4	14.8
INCOME STATEMENT (SGD m)					
Revenue	7,159.0	7,692.9	8,222.4	8,941.6	9,725.1
EBITDA	939.5	1,045.3	1,103.0	1,278.9	1,471.6
Depreciation	(297.6)	(314.2)	(331.9)	(366.5)	(401.6)
Amortisation	(81.0)	(83.9)	(88.6)	(93.3)	(98.0)
EBIT	560.9	647.2	682.5	819.1	972.0
Net interest income /(exp)	(61.9)	(36.0)	(27.5)	(50.2)	(48.2)
Associates & JV	30.4	16.0	21.7	22.2	22.7
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	5.1	10.5	12.5	12.8	13.0
Pretax profit	534.4	637.6	689.2	803.9	959.5
Income tax	(8.8)	(70.6)	(103.5)	(172.8)	(233.6)
Minorities	(3.8)	(3.6)	(3.8)	(3.6)	(3.8)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	521.8	563.4	582.0	627.5	722.1
Core net profit	575.6	589.7	582.0	627.5	722.1
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	730.6	815.9	2,324.9	2,078.9	1,845.0
Accounts receivable	1,435.5	1,552.9	1,651.2	1,795.7	1,953.0
Inventory	2,422.4	2,987.7	3,194.4	3,473.7	3,778.1
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	2,295.8	2,352.4	2,331.1	2,571.9	2,787.5
Intangible assets	1,946.1	1,992.7	1,904.1	1,810.8	1,712.8
Investment in Associates & JVs	468.9	482.9	509.4	516.0	522.8
Other assets	262.0	331.2	331.2	331.2	331.2
Total assets	**9,561.3**	**10,515.7**	**12,246.2**	**12,578.1**	**12,930.3**
ST interest bearing debt	496.3	559.9	1,059.8	1,030.8	979.2
Accounts payable	1,691.4	2,640.3	2,730.8	2,939.1	3,165.7
LT interest bearing debt	1,550.6	1,555.3	2,472.8	2,405.1	2,284.8
Other liabilities	3,248.0	3,092.0	3,227.0	3,354.0	3,543.0
Total Liabilities	**6,986.5**	**7,847.4**	**9,490.7**	**9,728.6**	**9,972.7**
Shareholders Equity	2,292.6	2,412.8	2,498.9	2,591.8	2,698.6
Minority Interest	282.2	255.5	256.7	257.8	259.0
Total shareholder equity	**2,574.8**	**2,668.2**	**2,755.6**	**2,849.6**	**2,957.7**
Total liabilities and equity	**9,561.3**	**10,515.7**	**12,246.2**	**12,578.1**	**12,930.3**
CASH FLOW (SGD m)					
Pretax profit	534.4	637.6	689.2	803.9	959.5
Depreciation & amortisation	378.6	398.1	420.5	459.8	499.7
Adj net interest (income)/exp	61.9	36.0	27.5	50.2	48.2
Change in working capital	145.0	7.5	(112.0)	(97.4)	(106.7)
Cash taxes paid	(0.6)	(78.8)	(70.6)	(164.6)	(172.8)
Other operating cash flow	(11.6)	(7.2)	(9.0)	(9.1)	(9.4)
Cash flow from operations	1,107.2	992.6	945.3	1,042.7	1,218.3
Capex	(343.9)	(523.6)	(597.0)	(607.0)	(617.0)
Free cash flow	1,097.9	521.4	614.9	435.7	601.3
Dividends paid	(468.4)	(468.4)	(495.8)	(534.7)	(615.3)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	(290.8)	68.3	1,417.4	(96.7)	(171.8)
Other invest/financing cash flow	272.7	16.3	239.1	(50.2)	(48.2)
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	276.8	85.3	1,508.9	(245.9)	(234.0)

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Key Ratios					
Growth ratios (%)					
Revenue growth	(8.4)	7.5	6.9	8.7	8.8
EBITDA growth	9.4	11.3	5.5	16.0	15.1
EBIT growth	14.4	15.4	5.5	20.0	18.7
Pretax growth	4.7	19.3	8.1	16.6	19.4
Reported net profit growth	(9.7)	8.0	3.3	7.8	15.1
Core net profit growth	(5.3)	2.4	(1.3)	7.8	15.1
Profitability ratios (%)					
EBITDA margin	13.1	13.6	13.4	14.3	15.1
EBIT margin	7.8	8.4	8.3	9.2	10.0
Pretax profit margin	7.5	8.3	8.4	9.0	9.9
Payout ratio	89.8	83.1	85.2	85.2	85.2
DuPont analysis					
Net profit margin (%)	7.3	7.3	7.1	7.0	7.4
Revenue/Assets (x)	0.7	0.7	0.7	0.7	0.8
Assets/Equity (x)	4.2	4.4	4.9	4.9	4.8
ROAE (%)	23.1	23.9	23.7	24.7	27.3
ROAA (%)	6.0	5.9	5.1	5.1	5.7
Liquidity & Efficiency					
Cash conversion cycle	114.2	101.5	92.5	94.8	96.3
Days receivable outstanding	77.0	69.9	70.1	69.4	69.4
Days inventory outstanding	153.7	158.2	170.4	169.6	170.0
Days payables outstanding	116.5	126.7	148.1	144.2	143.1
Dividend cover (x)	1.1	1.2	1.2	1.2	1.2
Current ratio (x)	1.2	1.2	1.3	1.3	1.3
Leverage & Expense Analysis					
Asset/Liability (x)	1.4	1.3	1.3	1.3	1.3
Net gearing (%) (incl perps)	51.1	48.7	43.8	47.6	48.0
Net gearing (%) (excl. perps)	51.1	48.7	43.8	47.6	48.0
Net interest cover (x)	9.1	18.0	24.8	16.3	20.2
Debt/EBITDA (x)	2.2	2.0	3.2	2.7	2.2
Capex/revenue (%)	4.8	6.8	7.3	6.8	6.3
Net debt/ (net cash)	1,316.3	1,299.3	1,207.7	1,356.9	1,419.1

Source: Company; Maybank IBG Research

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