

ST Engineering (STE SP)

Deepening DC footprint

Building new 7.5MW data centre; maintain BUY

STE is constructing its fourth data centre (DC) in Singapore with installed IT capacity of 7.5MW. The green, secure, AI-ready DC will boost STE's DC footprint to > 30MW with a cumulative investment of SGD400m. The new DC will strengthen STE's digital business offerings. With capex spread over three years, we view the development as augmenting group revenue while keeping enough cover for the dividend. We raise our FY25-26 estimates by 2-3% and our SOTP-based TP to SGD4.60 from SGD4.30 and reiterate BUY.

Breaking ground for new DC

STE held a groundbreaking ceremony for its fourth data centre yesterday. The installed IT capacity is 7.5MW with a Power Usage Effectiveness (PUE) of 1.25. It is designed to accommodate high power density AI and GPU-based workloads in excess of 20KW per rack. It will also have advanced security features. The DC will be cooled by various cooling systems including proprietary Airbitat DC Cooling System and will have 2700 sq. m of solar panels to offset energy requirements. The new DC can also go beyond a Tier 3 rating and meet BCA-IMDA Green Mark Platinum standards.

Strategic and financial merits

The new DC will boost STE's DC footprint to more than 30MW with a total investment in excess of SGD400m. The DC will be built with a capex of SGD120m. Interestingly; capex of SGD16m per MW is much higher than the existing DCs and is likely due to higher specs and green features. Management says STE has received strong interest from customers for the facility. Conservatively assuming monthly rent of SGD300 per KW, the facility may entail potential back-ended revenue of SGD20-25m on a c.30% EBITDA margin. With an est. SGD1b of annual free cash flow and DC capex spread over three years, we see reasonable cover for the c.SGD500m annual payout. That said, we would have preferred a partly or fully committed undertaking given current DC supply and high interest rates.

Tweak up estimates and TP, maintain BUY

We raise estimates by 2-3% for FY25-26 taking into account prior order wins and the new DC and raise our TP to SGD4.60. We maintain our BUY rating on an unchanged thesis of mid-teens EPS growth and c.5% yield.

FYE Dec (SGD m)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue	9,035	10,101	10,994	11,764	12,692
EBITDA	1,252	1,456	1,658	1,907	2,231
Core net profit	535	586	707	797	932
Core EPS (cts)	17.1	18.8	22.6	25.5	29.9
Core EPS growth (%)	(5.0)	9.6	20.5	12.8	17.0
Net DPS (cts)	16.0	16.0	21.1	23.8	27.9
Core P/E (x)	19.6	20.7	18.3	16.2	13.9
P/BV (x)	3.9	4.4	4.3	3.9	3.5
Net dividend yield (%)	4.8	4.1	5.1	5.8	6.7
ROAE (%)	22.2	24.1	27.6	28.3	29.5
ROAA (%)	4.2	3.9	4.4	4.7	5.3
EV/EBITDA (x)	13.3	12.5	10.9	9.2	7.8
Net gearing (%) (incl perps)	223.6	209.1	160.3	130.7	111.1
Consensus net profit	-	-	690	787	883
MIBG vs. Consensus (%)	-	-	2.4	1.2	5.6

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BUY

Share Price	SGD 4.14
12m Price Target	SGD 4.60 (+11%)
Previous Price Target	SGD 4.30

Company Description

STE is an engineering conglomerate with business in commercial aerospace, urban solutions & SATCOM and defence & public security.

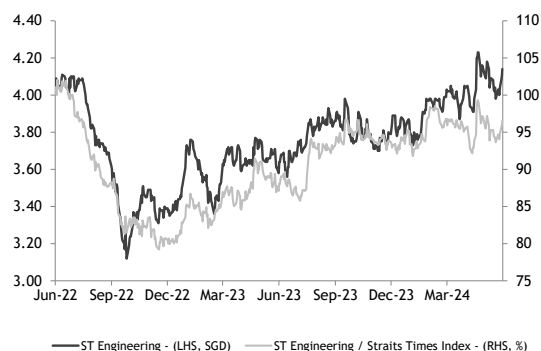
Statistics

52w high/low (SGD)	4.23/3.56
3m avg turnover (USDm)	13.1
Free float (%)	48.1
Issued shares (m)	3,122
Market capitalisation	SGD12.9B USD9.5B

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 (%)	(0)	4	15
Relative to index (%)	(0)	0	10

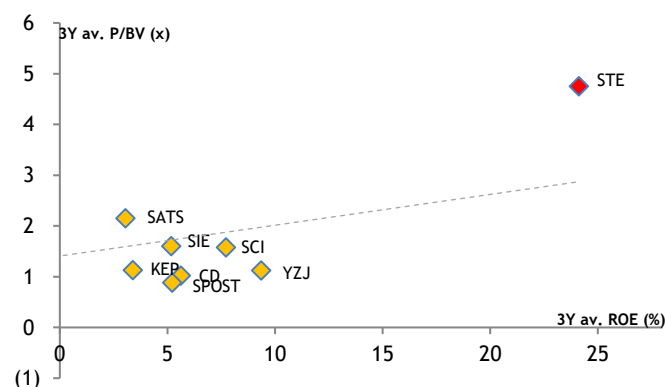
Source: FactSet

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Tear Sheet Insert

Value Proposition

- STE has a 50-year history as Singapore’s primary defence contractor. In recent decades it has successfully evolved its operations to tap the commercial marketplace and presently the split between commercial and defence derived revenues is roughly 55:45.
- 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.

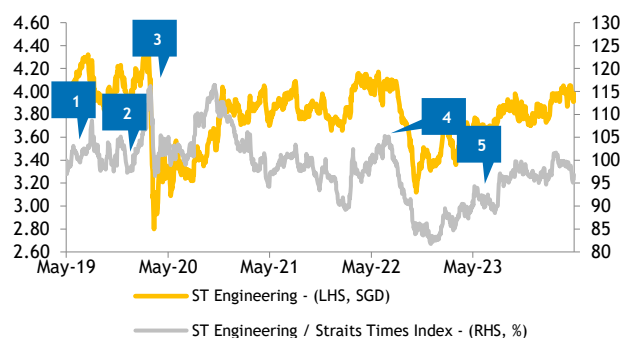
Singapore large-cap industrials - historical P/BV vs ROE



Source: Company

Price Drivers

Historical share price trend



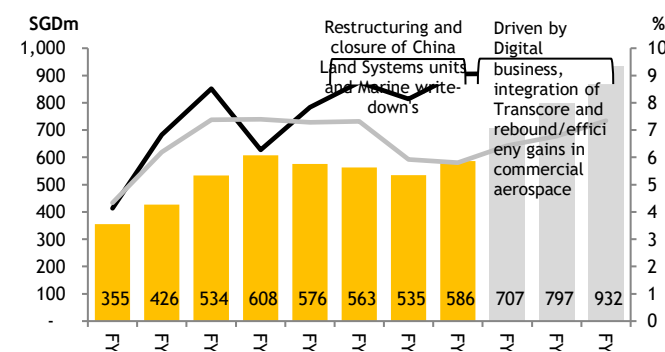
Source: Company, Maybank IBG Research

1. Multiple stock rating upgrades from the street.
2. Large contract win of SGD1b with options up to SGD2.6b for US marine subsidiary VT Halter Marine after a prolonged dry spell of material contract awards.
3. Global pandemic strikes causing huge disruption to aviation industry.
4. Singapore Technologies Engineering is marking its largest acquisition to date with the USD2.68b (SGD3.64b) all-cash offer for a group of entities under Roper Technologies focused on transport management systems.
5. Gradual rebound in MRO business, demand for PTF business and growth in Digital business within Defence and Public Security business

Financial Metrics

- Key factors driving our expectation of a blended margin recovery in FY23-FY25E: higher EBITDA margin from aerospace, growth of digital business and monetisation from inorganic growth.
- Aside from improving margins, robust aerospace and defence order books with relatively stable smart city initiatives underpin our 15% core PATMI CAGR forecast.
- We expect ROE to rebound from 24% in FY23 to 27% by FY26E.

Expecting PATMI and margin improvements



Source: Company

Swing Factors

Upside

- Higher-than-expected passenger to freighter 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

- Ongoing rise in inflation could see a supply crunch in 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 hurt aircraft PTF conversion demand.

Risk Rating & Score ¹	30.9
Score Momentum ²	-0.1
Last Updated	19 Nov 2021
Controversy Score ³ (Updated: 07 Jun 2022)	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. 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 2022.
- 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 FY22, STE achieved a 30% absolute GHG emissions reduction as compared to FY21. This translated to a 37% 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.
- In FY22, STE's Singapore operations recycled 75% of 5,900 tonnes of waste generated. The recyclables included wood, metal, batteries and paper products.

Material S issues

- Total Group economic contribution of SGD8.7b, which includes: (i) bought in material and services; (ii) employee wages, salaries and benefits; and (iii) dividends and others.
- As at end Dec 2021, 78% of the workforce is male while 22% is female with 14% turnover rate. Among them, about 14% of female and 15% of male employees are managers.
- In FY22, accident frequency (+37.5% YoY) and severity rate (-5% 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 22.5 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.
- 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).

1. Valuation

We value STE using a DCF model and applying a WACC of 8.6%. The below table summarises the key inputs to the DCF model. We raise core profit estimate by 2-3% for FY25 and FY26 on back of the recent SGD100m defense order win and the new DC facility. We assume EBIT margin same as the EBIT margin of Defence and Public Security business of c.13% for the defense order win and 20% EBIT margin for the new DC. This raises our SOTP-based TP to SGD4.60. STE's strong long-term growth will be supported by organic and inorganic factors. Further re-rating catalysts include better margin recovery in commercial aerospace and higher group margin from TransCore projects.

Fig 1: DCF forecasts

FYE Dec (SGDm)	2022A	2023A	2024F	2025F	2026F	2027F	2028F	2029F	2030F
-Commercial Aerospace	3053	3966	4239	4532	4800	5085	5386	5706	6044
-Urban Solutions & SATCOM	1821	1981	2203	2353	2513	2684	2868	3064	3274
-Defence & Public Security	4320	4289	4718	5048	5553	5830	6122	6428	6749
-Others & Elimination	(158)	(134)	(166)	(169)	(173)	(176)	(178)	(181)	(184)
Revenue	9035	10101	10994	11764	12692	13423	14197	15016	15884
Growth YoY, %	17	12	9	7	8	6	6	6	6
EBIT	735	915	997	1097	1190	1284	1358	1437	1520
Operating margin, %	8	9	9	9	9	10	10	10	10
- Adj for taxes	(54)	(100)	(127)	(144)	(127)	(134)	(142)	(150)	(159)
+ Depreciation	338	341	394	428	463	498	534	570	608
+ Amortisation	179	201	179	179	179	179	179	179	179
+ Working cap chgs	(731)	(101)	649	(108)	(179)	(35)	(989)	2	(2)
- Capex	(1056)	(603)	(613)	(623)	(634)	(645)	(656)	(667)	(679)
+ Investment income	40	56	63	64	66	67	69	71	73
FCFF	(549)	709	1542	893	958	1215	354	1442	1539
Year	0	0	1	2	3	4	5	6	7
WACC (%)	8.6%	8.6%	8.6%	8.6%	8.6%	8.6%	8.6%	8.6%	8.6%
Disc. factor (x)	1.00	1.00	0.92	0.85	0.78	0.72	0.66	0.61	0.56
Discounted FCF	(549)	709	1419	757	748	873	234	878	863

Source: Maybank IBG Research

2. Risks

Risks include: moderation of growth and margins in commercial aerospace, slower-than-expected turnaround of urban solutions and SATCOM business, wage inflation, dilutive M&As and integration challenges.

FYE 31 Dec	FY22A	FY23A	FY24E	FY25E	FY26E
Key Metrics					
P/E (reported) (x)	22.2	19.7	18.3	16.2	13.9
Core P/E (x)	19.6	20.7	18.3	16.2	13.9
P/BV (x)	3.9	4.4	4.3	3.9	3.5
P/NTA (x)	(4.0)	(5.5)	(7.2)	(9.9)	(19.4)
Net dividend yield (%)	4.8	4.1	5.1	5.8	6.7
FCF yield (%)	nm	nm	1.5	nm	nm
EV/EBITDA (x)	13.3	12.5	10.9	9.2	7.8
EV/EBIT (x)	22.6	19.9	18.0	16.0	14.6
INCOME STATEMENT (SGD m)					
Revenue	9,035.1	10,101.0	10,994.0	11,763.5	12,692.4
EBITDA	1,252.0	1,456.1	1,658.5	1,907.3	2,231.5
Depreciation	(337.6)	(340.9)	(393.7)	(427.9)	(462.6)
Amortisation	(179.3)	(200.6)	(179.3)	(179.3)	(179.3)
EBIT	735.1	914.7	997.5	1,097.2	1,190.5
Net interest income / (exp)	(137.6)	(210.4)	(224.2)	(209.6)	(188.7)
Associates & JV	33.3	58.1	64.9	66.5	68.2
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	37.3	16.5	8.8	4.8	2.7
Pretax profit	597.5	704.2	847.1	958.9	1,072.6
Income tax	(54.1)	(99.8)	(127.1)	(143.8)	(126.9)
Minorities	(8.3)	(18.0)	(13.3)	(18.0)	(13.3)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	535.0	586.5	706.7	797.1	932.4
Core net profit	535.0	586.5	706.7	797.1	932.4
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	601.8	353.3	1,016.7	1,224.4	1,209.9
Accounts receivable	1,741.4	2,139.1	2,119.0	2,267.3	2,446.3
Inventory	3,783.9	4,137.4	4,604.3	4,926.6	5,315.6
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	2,658.1	2,727.3	2,946.7	3,142.1	3,313.2
Intangible assets	5,291.3	4,958.2	4,778.9	4,599.6	4,420.3
Investment in Associates & JVs	468.2	567.4	569.7	572.0	574.4
Other assets	419.3	496.2	496.2	496.2	496.2
Total assets	14,964.1	15,378.9	16,531.4	17,228.3	17,776.0
ST interest bearing debt	3,628.0	2,563.7	2,307.3	2,076.6	1,868.9
Accounts payable	2,868.4	3,205.2	3,724.6	3,955.9	4,203.9
LT interest bearing debt	2,906.6	3,544.4	3,473.5	3,444.1	3,455.2
Other liabilities	2,908.0	3,313.0	4,053.0	4,456.0	4,496.0
Total Liabilities	12,311.1	12,626.6	13,558.7	13,932.7	14,023.5
Shareholders Equity	2,398.0	2,459.3	2,666.5	2,964.0	3,365.6
Minority Interest	254.9	293.0	306.3	324.3	337.6
Total shareholder equity	2,652.9	2,752.3	2,972.8	3,288.2	3,703.1
Total liabilities and equity	14,964.1	15,378.9	16,531.4	17,228.3	17,776.0
CASH FLOW (SGD m)					
Pretax profit	597.5	704.2	847.1	958.9	1,072.6
Depreciation & amortisation	516.9	541.4	573.0	607.1	641.9
Adj net interest (income)/exp	137.6	210.4	224.2	209.6	188.7
Change in working capital	(731.4)	(100.8)	648.6	(108.3)	(179.5)
Cash taxes paid	(47.0)	(91.6)	(118.9)	(135.6)	(118.7)
Other operating cash flow	(2.0)	(2.0)	(2.3)	(2.3)	(1.4)
Cash flow from operations	471.2	1,261.4	2,171.4	1,529.1	1,603.4
Capex	(1,056.1)	(200.8)	(613.1)	(623.3)	(633.8)
Free cash flow	(3,996.2)	913.4	1,714.4	1,177.1	903.5
Dividends paid	(499.6)	(499.6)	(499.6)	(499.6)	(530.8)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	4,419.3	(426.4)	(327.3)	(260.2)	(196.5)
Other invest/financing cash flow	(3,549.0)	(357.7)	(68.1)	61.7	(254.8)
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	(214.2)	(223.1)	663.3	207.8	(12.5)

FYE 31 Dec	FY22A	FY23A	FY24E	FY25E	FY26E
Key Ratios					
Growth ratios (%)					
Revenue growth	17.4	11.8	8.8	7.0	7.9
EBITDA growth	16.9	16.3	13.9	15.0	17.0
EBIT growth	9.2	24.4	9.1	10.0	8.5
Pretax growth	(6.3)	17.9	20.3	13.2	11.9
Reported net profit growth	(5.0)	9.6	20.5	12.8	17.0
Core net profit growth	(5.0)	9.6	20.5	12.8	17.0
Profitability ratios (%)					
EBITDA margin	13.9	14.4	15.1	16.2	17.6
EBIT margin	8.1	9.1	9.1	9.3	9.4
Pretax profit margin	6.6	7.0	7.7	8.2	8.5
Payout ratio	93.4	85.2	93.4	93.4	93.4
DuPont analysis					
Net profit margin (%)	5.9	5.8	6.4	6.8	7.3
Revenue/Assets (x)	0.6	0.7	0.7	0.7	0.7
Assets/Equity (x)	6.2	6.3	6.2	5.8	5.3
ROAE (%)	22.2	24.1	27.6	28.3	29.5
ROAA (%)	4.2	3.9	4.4	4.7	5.3
Liquidity & Efficiency					
Cash conversion cycle	94.6	107.5	105.0	100.9	102.6
Days receivable outstanding	65.6	69.2	69.7	67.1	66.8
Days inventory outstanding	155.2	164.5	170.3	174.2	175.6
Days payables outstanding	126.3	126.1	135.0	140.4	139.9
Dividend cover (x)	1.1	1.2	1.1	1.1	1.1
Current ratio (x)	0.8	0.9	1.0	1.0	1.1
Leverage & Expense Analysis					
Asset/Liability (x)	1.2	1.2	1.2	1.2	1.3
Net gearing (%) (incl perps)	223.6	209.1	160.3	130.7	111.1
Net gearing (%) (excl. perps)	223.6	209.1	160.3	130.7	111.1
Net interest cover (x)	5.3	4.3	4.5	5.2	6.3
Debt/EBITDA (x)	5.2	4.2	3.5	2.9	2.4
Capex/revenue (%)	11.7	2.0	5.6	5.3	5.0
Net debt/ (net cash)	5,932.8	5,754.8	4,764.2	4,296.2	4,114.2

Source: Company; Maybank IBG Research

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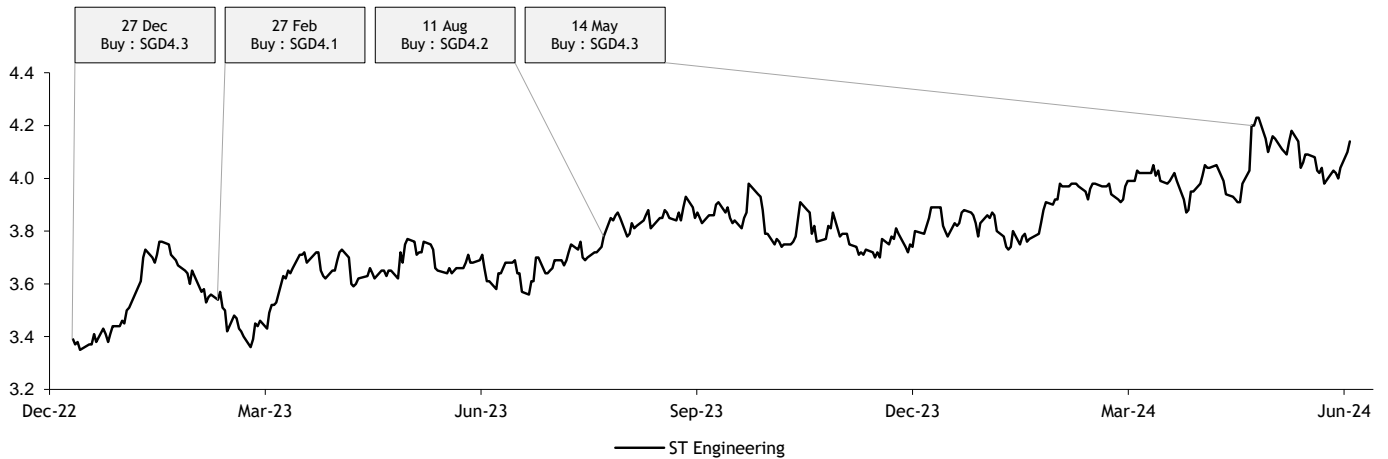
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