

Singapore

ADD (no change)

Consensus ratings*: Buy 14 Hold 1 Sell 1

Current price: S\$3.29
 Target price: S\$3.80
 Previous target: S\$3.80
 Up/downside: 15.6%
 CGS-CIMB / Consensus: -1.0%

Reuters: STEG.SI
 Bloomberg: STE SP
 Market cap: US\$7,498m
 S\$10,263m

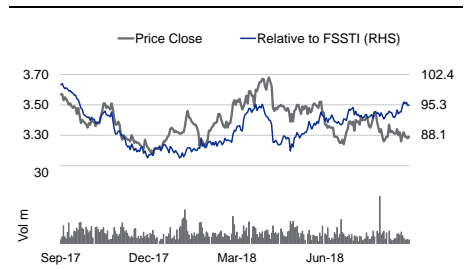
Average daily turnover: US\$8.30m
 S\$11.33m

Current shares o/s: 3,122m
 Free float: 37.8%

*Source: Bloomberg

Key changes in this note

➤ No change



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	-1.8	-6.5	-7.9
Relative (%)	1.7	1.2	-4.8

Major shareholders	% held
Temasek	50.8
Aberdeen Asset Management	6.0
Capital Research Global Investor	5.5

Analyst(s)



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ST Engineering

LEAP ahead

- We think the acquisition of nacelle manufacturer MRAS from GE for US\$630m could boost STE's profit by c.8-12% in FY19F-FY20F, conservatively.
- Assuming a 50/50 cash/debt funding on net consideration, STE would swing into net gearing of c.0.1x, which is reasonable, and a less lazy balance sheet.
- The purchase price implies a 10x EBITDA for the 12-month ended Jun 2018. On a forward basis, we estimate c.12.5x FY20F P/E.
- Maintain Add and S\$3.80 TP, based on blended valuations. Acquisition is slated to complete by 1Q19, subject to approval. Our TP would rise to S\$4.13 upon completion.

Becoming an OEM

STE is acquiring 100% of Baltimore-based nacelles manufacturer MRA Systems (MRAS) from General Electric Co for US\$630m (S\$868m). An engine nacelle is the casing that houses an aircraft engine, providing efficient aerodynamics during flight and thrust reversal capabilities. Each aircraft needs two units. The acquisition lifts STE's aerospace unit up the value chain to become an OEM of aircraft components and replacement parts. This also somewhat alleviates the fear that OEMs are stealing the lunch of independent maintenance, repair and overhaul (MRO) providers in the aftermarket segment.

The addressable market is big

MRAS is a single-source supplier for the new-generation A320neo aircraft powered by the next-generation CFM LEAP-1A engines. More than 6,000 A320neo aircraft have been ordered to-date, of which c.2,300 are to be equipped with the LEAP-1A engine. MRAS has delivered more than 500 Leap-1A units so far. We estimate MRAS delivered c.400 units of nacelles (a combination of new and mature programmes) in the 12-month ended Jun 2018. Management believes a 40-50% ramp-up in the LEAP-1A programme in the first year of MRAS acquisition is possible. Each LEAP-1A nacelle could fetch US\$1.2m-1.6m.

Base case: group net profit to rise 8-12% in FY19-20F

MRAS generated S\$33m net profit in 1H18. Revenue for the 12-month ended Jun 2018 was c.S\$723m. Its 1H18 net margin of c.9% is comparable to STE's existing aerospace margin. On an annualised basis, we expect MRAS to contribute c.S\$45m, or 8% to group earnings in FY19F. Assuming a gradual ramp up of 20% in FY20F, group earnings will rise c.S\$80m, adding another 12% to our current forecast. In a bull case of 40% ramp up, profit for MRAS could rise to S\$92m in FY20F. No major capex is required for the existing programmes. MRAS operates from a 1.7m sq ft facility on 180 acres of land, with 800 staff. It has a proud 90-year heritage.

A less lazy balance sheet, dividends intact

As at end-1H18, STE had net cash of c.S\$150m (cash at hand of S\$1.2bn). The purchase price of US\$630m (S\$886m) is on a cash-free and debt-free basis, subject to closing adjustments (underfunded pension obligations, other debt-like items, transaction expenses, net working capital). The net consideration post adjustments is c.US\$440m (S\$606m), to be funded by cash and borrowings; the mix is undisclosed. Assuming a 50/50 cash/debt structure, STE would swing to c.0.1x net gearing. We think STE's dividend payout will not be compromised given the accretion MRAS brings.

Maintain Add and TP of S\$3.80 for now, S\$4.13 TP on completion

We keep our forecasts for now, pending the transaction's completion. If we factor in our base case expectation of 8-12% FY19-20F EPS uplift, our TP would rise to S\$4.13 upon the acquisition's completion. Successful deal completion is a potential key catalyst. Downside risks to our call include cost overrun and multiplier effects of a trade war.

Financial Summary

	Dec-16A	Dec-17A	Dec-18F	Dec-19F	Dec-20F
Revenue (S\$m)	6,684	6,619	6,935	7,312	7,771
Operating EBITDA (S\$m)	847.3	809.0	868.1	866.5	942.8
Net Profit (S\$m)	484.5	511.9	534.4	585.5	649.7
Core EPS (S\$)	0.17	0.16	0.17	0.19	0.21
Core EPS Growth	1.2%	(4.4%)	4.4%	9.6%	11.0%
FD Core P/E (x)	19.17	20.07	19.22	17.54	15.80
DPS (S\$)	0.15	0.15	0.15	0.15	0.17
Dividend Yield	4.56%	4.56%	4.42%	4.56%	5.06%
EV/EBITDA (x)	12.16	12.64	11.70	11.63	10.59
P/FCFE (x)	38.56	26.40	21.40	20.61	18.25
Net Gearing	7.25%	4.77%	3.61%	2.34%	0.75%
P/BV (x)	4.71	4.59	4.43	4.21	4.00
ROE	24.8%	23.2%	23.4%	24.6%	26.0%
% Change In Core EPS Estimates			0%	0%	0%
CIMB/consensus EPS (x)			0.98	0.98	1.02

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

LEAP ahead

More about MRAS >

With its 90 years of history in the aviation industry, MRAS is an established OEM of engine nacelle systems for both narrowbody and widebody aircraft. It is based in Baltimore, Maryland, USA, and has two principal business lines: (1) design, development, production and sale of nacelles, thrust reversers and aerostructures, and (2) spare parts sales.

Together with Safran Nacelles, MRAS was awarded a single-source contract by Airbus for A320neo's LEAP-1A engine nacelles in 2012. Other single-source programmes in MRAS portfolio are COMAC's C919 aircraft powered by LEAP 1-C engine, and COMAC's ARJ21 aircraft powered by GE's CF34 engine. There are more than 1,200 C919 and ARJ21 planes on order.

Figure 1: Blended valuations

Method	Value per share (S\$)	Basis
P/E	3.75	20x CY19F earnings
DCF	4.02	WACC 6%, LTG 2%
Dividend yield(%)	3.64	4% net yield on FY18F DPS
Average	3.80	

SOURCES: CIMB

Figure 2: Engine nacelle is the casing that houses aircraft engine

What is an Engine Nacelle?

- An engine nacelle is the casing that houses an aircraft engine, providing efficient aerodynamics during flight and thrust reversal capabilities.
- It is one of the first aerostructures to exploit the use of composite material.

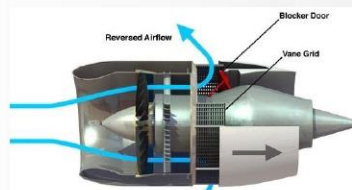
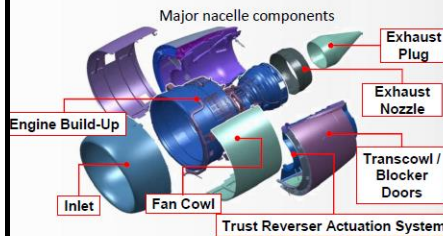


Illustration of reversed airflow created by a nacelle system during aircraft landing



Nacelle

Engine

ST Engineering

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Figure 3: MRAS nacelles programme

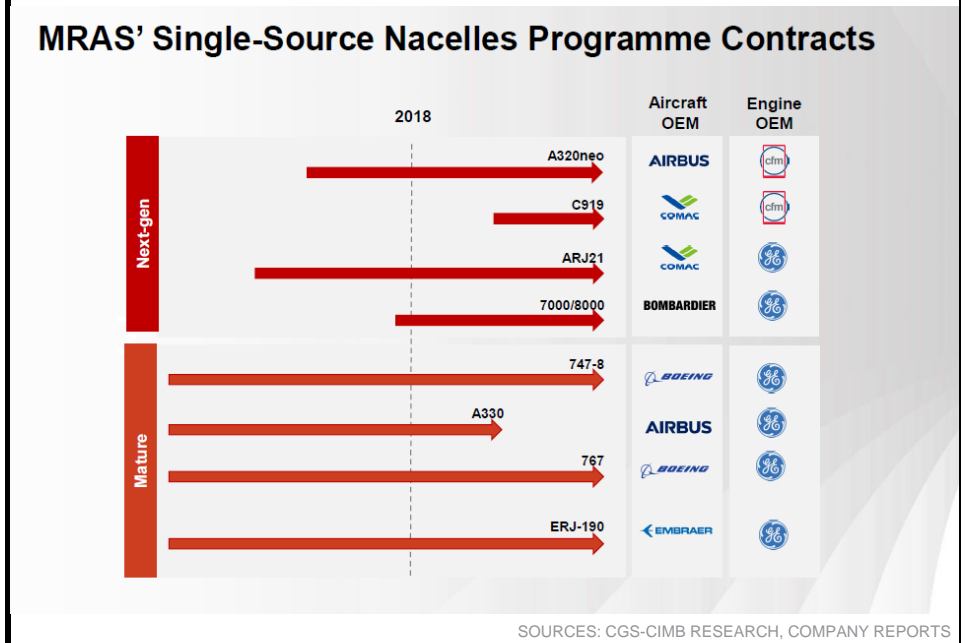


Figure 4: STE's P/E trend

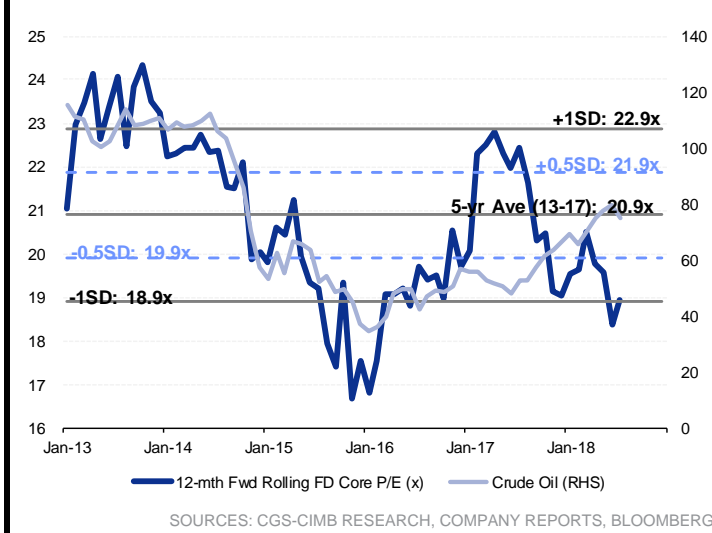


Figure 5: STE's P/BV trend

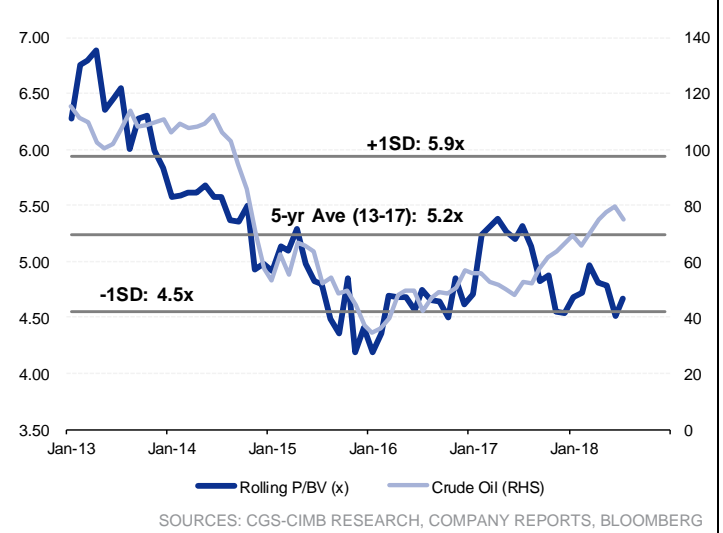
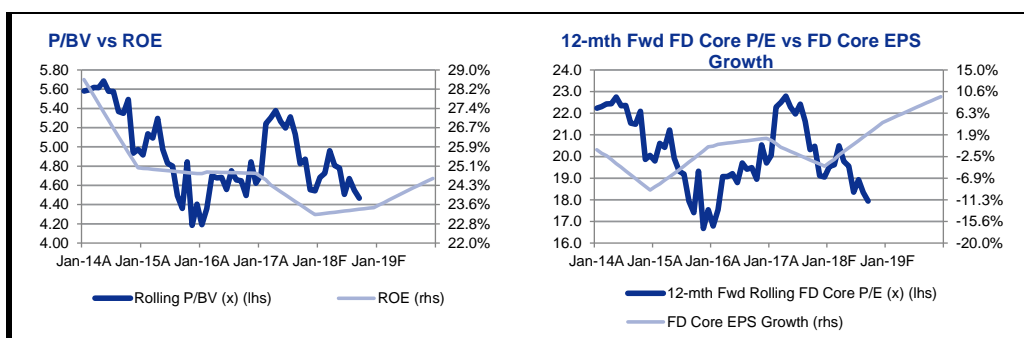


Figure 6: Peer comparison

Company	Bbg Ticker	Recom.	Price (lcl curr)	Target Price (lcl curr)	Market Cap (US\$ m)	Core P/E (x)			3-year EPS CAGR (%)	P/BV (x) CY18F	Recurring ROE (%) CY18F	Dividend Yield (%) CY18F
						CY18F	CY19F	CY20F				
SIA Engineering	SIE SP	Add	2.96	3.31	2,420	18.8	18.1	17.2	5.4%	2.18	11.7%	4.6%
ST Engineering	STE SP	Add	3.29	3.80	7,498	19.2	17.5	15.8	8.7%	4.43	23.7%	4.4%
SATS Ltd	SATS SP	Hold	5.02	5.06	4,097	21.0	19.4	18.2	7.0%	3.26	16.1%	3.5%
HK Aircraft Engineering	44 HK	NR	69.30	NA	1,469	na	na	na	na	na	na	na
Simple Average (all co)						19.7	18.3	17.1	7.0%	3.29	17.2%	4.2%

SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

BY THE NUMBERS

Profit & Loss

(\$M)	Dec-16A	Dec-17A	Dec-18F	Dec-19F	Dec-20F
Total Net Revenues	6,684	6,619	6,935	7,312	7,771
Gross Profit	1,305	1,323	1,418	1,511	1,637
Operating EBITDA	847	809	868	867	943
Depreciation And Amortisation	(247)	(217)	(248)	(205)	(214)
Operating EBIT	600	592	620	662	729
Financial Income/(Expense)	(12)	(18)	(28)	11	10
Pretax Income/(Loss) from Assoc.	64	49	58	61	67
Non-Operating Income/(Expense)	0	0	0	0	0
Profit Before Tax (pre-EI)	652	623	650	734	805
Exceptional Items	(61)	0	0	0	0
Pre-tax Profit	591	623	650	734	805
Taxation	(98)	(88)	(100)	(130)	(135)
Exceptional Income - post-tax					
Profit After Tax	493	535	551	604	670
Minority Interests	(8)	(24)	(17)	(18)	(20)
Preferred Dividends	0	0	0	0	0
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	485	512	534	586	650
Recurring Net Profit	535	512	534	586	650
Fully Diluted Recurring Net Profit	535	512	534	586	650

Cash Flow

(\$M)	Dec-16A	Dec-17A	Dec-18F	Dec-19F	Dec-20F
EBITDA	847.3	809.0	868.1	866.5	942.8
Cash Flow from Inv. & Assoc.					
Change In Working Capital	(3.5)	(1.9)	14.7	12.1	(6.4)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow					
Net Interest (Paid)/Received	(11.0)	(14.9)	(27.8)	10.6	9.6
Tax Paid	(76.7)	(91.7)	(99.5)	(130.1)	(135.3)
Cashflow From Operations	756.1	700.5	755.5	759.0	810.8
Capex	(250.9)	(272.6)	(280.0)	(230.0)	(230.0)
Disposals Of FAs/subsidiaries	3.8	2.0	0.0	0.0	0.0
Acq. Of Subsidiaries/investments	(216.3)	(171.4)	0.0	0.0	0.0
Other Investing Cashflow	196.2	196.1	4.5	(30.7)	(18.2)
Cash Flow From Investing	(267.2)	(245.9)	(275.5)	(260.7)	(248.2)
Debt Raised/(repaid)	(222.6)	(65.7)	0.0	0.0	0.0
Proceeds From Issue Of Shares	0.0	0.0	0.0	0.0	0.0
Shares Repurchased					
Dividends Paid	(465.9)	(467.6)	(454.2)	(468.4)	(519.8)
Preferred Dividends					
Other Financing Cashflow					
Cash Flow From Financing	(688.5)	(533.3)	(454.2)	(468.4)	(519.8)
Total Cash Generated	(199.7)	(78.7)	25.8	29.9	42.8
Free Cashflow To Equity	266.2	389.0	480.0	498.3	562.6
Free Cashflow To Firm	529.7	496.5	568.4	527.7	593.4

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

BY THE NUMBERS... cont'd
Balance Sheet

(\$m)	Dec-16A	Dec-17A	Dec-18F	Dec-19F	Dec-20F
Total Cash And Equivalents	905	999	1,025	1,055	1,097
Total Debtors	1,821	1,961	2,048	2,139	2,258
Inventories	1,898	1,764	1,873	1,974	2,098
Total Other Current Assets	189	0	0	0	0
Total Current Assets	4,813	4,724	4,946	5,169	5,454
Fixed Assets	1,670	1,719	1,751	1,777	1,792
Total Investments	728	809	863	955	1,040
Intangible Assets	1,020	1,087	1,087	1,087	1,087
Total Other Non-Current Assets	135	134	134	134	134
Total Non-current Assets	3,552	3,749	3,835	3,952	4,053
Short-term Debt	89	225	225	225	225
Current Portion of Long-Term Debt					
Total Creditors	2,655	2,435	2,649	2,775	2,958
Other Current Liabilities	1,057	1,240	1,236	1,265	1,282
Total Current Liabilities	3,801	3,901	4,110	4,265	4,465
Total Long-term Debt	993	894	894	894	894
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	910	952	953	1,003	1,038
Total Non-current Liabilities	1,903	1,846	1,847	1,898	1,933
Total Provisions	217	205	205	205	205
Total Liabilities	5,921	5,952	6,162	6,367	6,604
Shareholders' Equity	2,182	2,240	2,320	2,437	2,567
Minority Interests	262	281	298	316	336
Total Equity	2,444	2,521	2,618	2,753	2,903

Key Ratios

	Dec-16A	Dec-17A	Dec-18F	Dec-19F	Dec-20F
Revenue Growth	5.50%	(0.96%)	4.77%	5.42%	6.28%
Operating EBITDA Growth	12.5%	(4.5%)	7.3%	(0.2%)	8.8%
Operating EBITDA Margin	12.7%	12.2%	12.5%	11.9%	12.1%
Net Cash Per Share (S\$)	(0.057)	(0.038)	(0.030)	(0.021)	(0.007)
BVPS (S\$)	0.70	0.72	0.74	0.78	0.82
Gross Interest Cover	13.13	10.52	7.01	22.52	23.60
Effective Tax Rate	16.6%	14.1%	15.3%	17.7%	16.8%
Net Dividend Payout Ratio	85.4%	91.4%	85.0%	80.0%	80.0%
Accounts Receivables Days	76.06	85.57	88.93	88.78	88.62
Inventory Days	130.7	126.2	120.3	121.0	121.5
Accounts Payables Days	61.37	60.49	57.49	58.25	58.09
ROIC (%)	17.3%	16.3%	17.2%	18.3%	19.7%
ROCE (%)	17.3%	16.6%	17.5%	17.5%	18.5%
Return On Average Assets	6.82%	6.54%	6.65%	6.65%	7.11%

Key Drivers

	Dec-16A	Dec-17A	Dec-18F	Dec-19F	Dec-20F
Rev. growth (% , main biz.)	19.0%	0.0%	0.0%	0.0%	0.0%
EBITDA mgns (% , main biz.)	N/A	N/A	N/A	N/A	N/A
Rev. as % of total (main biz.)	33.1%	37.3%	38.5%	38.9%	39.0%
EBITDA as % of total (main biz.)	N/A	N/A	N/A	N/A	N/A
Rev. growth (% , 2ndary biz.)	9.6%	0.0%	0.0%	0.0%	0.0%
EBITDA mgns (% , 2ndary biz.)	28.6%	5.5%	6.1%	6.0%	6.7%
Rev. as % of total (2ndary biz.)	N/A	N/A	N/A	N/A	N/A
EBITDA as % of total (2ndary biz.)	N/A	N/A	N/A	N/A	N/A
Rev. growth (% , tertiary biz.)	N/A	N/A	N/A	N/A	N/A
EBITDA mgns (% , tertiary biz.)	N/A	N/A	N/A	N/A	N/A
Rev.as % of total (tertiary biz.)	N/A	N/A	N/A	N/A	N/A
EBITDA as % of total (tertiary biz.)	N/A	N/A	N/A	N/A	N/A

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

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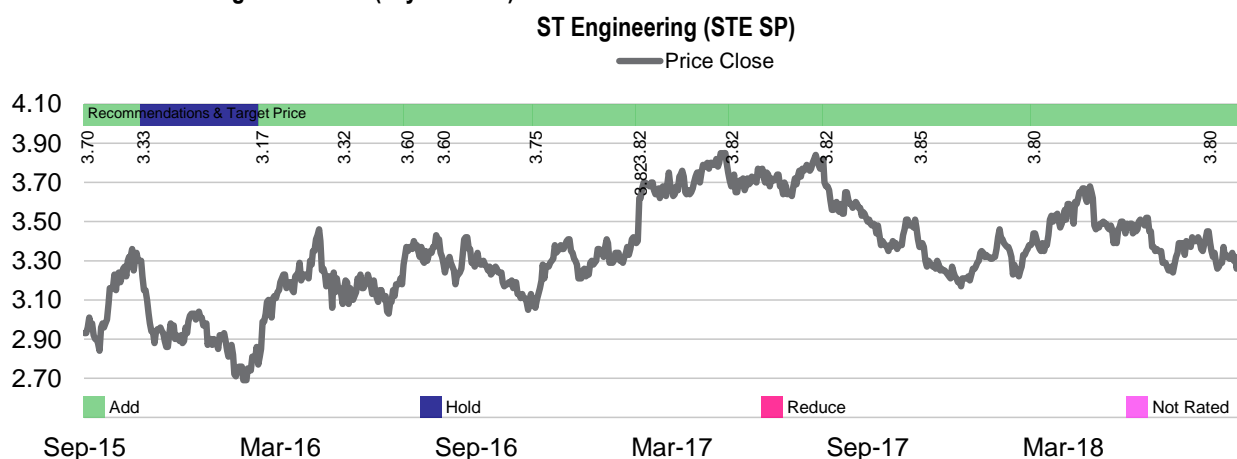
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1203 companies under coverage for quarter ended on 30 June 2018		
	Rating Distribution (%)	Investment Banking clients (%)
Add	62.3%	4.5%
Hold	26.2%	2.5%
Reduce	9.3%	0.8%

Spitzer Chart for stock being researched (2 year data)



Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (Thai IOD) in 2017, Anti-Corruption 2017

AAV – Very Good, n/a, **ADVANC** – Excellent, Certified, **AEONTS** – Good, n/a, **AMATA** – Very Good, n/a, **ANAN** – Excellent, n/a, **AOT** – Excellent, Declared, **AP** – Excellent, Declared, **ASK** – Very Good, Declared, **ASP** – Very Good, Certified, **BANPU** – Excellent, Certified, **BAY** – Excellent, Certified, **BBL** – Very Good, Certified, **BCH** – Good, Declared, **BCP** - Excellent, Certified, **BCPG** – Very Good, n/a, **BEM** – Very Good, n/a, **BDMS** – Very Good, n/a, **BEAUTY** – Good, n/a, **BEC** – Very Good, n/a, **BGRIM** – not available, n/a, **BH** - Good, n/a, **BJC** – Very Good, Declared, **BJCHI** – Very Good, Declared, **BLA** – Very Good, Certified, **BPP** – Good, n/a, **BR** - Good, Declared, **BTS** - Excellent, Certified, **CBG** – Good, n/a, **CCET** – Good, n/a, **CENDEL** – Very Good, Certified, **CHG** – Very Good, Declared, **CK** – Excellent, n/a, **COL** – Very Good, Declared, **CPALL** – not available, Declared, **CPF** – Excellent, Declared, **CPN** - Excellent, Certified, **DELTA** - Excellent, n/a, **DEMCO** – Excellent, Certified, **DIF** – not available, n/a, **DTAC** – Excellent, Certified, **EA** – Very Good, n/a, **ECL** – Very Good, Certified, **EGCO** - Excellent, Certified, **EPG** – Very Good, n/a, **GFPT** - Excellent, Declared, **GGC** – not available, Declared, **GLOBAL** – Very Good, Declared, **GLOW** – Very Good, Certified, **GPSC** – Excellent, Declared, **GRAMMY** - Excellent, n/a, **GUNKUL** – Excellent, Declared, **HANA** - Excellent, Certified, **HMPRO** - Excellent, Certified, **ICHI** – Excellent, n/a, **III** – not available, n/a, **INTUCH** - Excellent, Certified, **IRPC** – Excellent, Certified, **ITD** – Very Good, n/a, **IVL** - Excellent, Certified, **JAS** – not available, Declared, **JASIF** – not available, n/a, **JUBILE** – Good, Declared, **KAMART** – not available, n/a, **KBANK** - Excellent, Certified, **KCE** - Excellent,

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Stock Ratings

Definition:

- Add** The stock's total return is expected to exceed 10% over the next 12 months.
- Hold** The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
- Reduce** The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

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Definition:

- Overweight** An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
- Neutral** A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight** An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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Definition:

- Overweight** An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
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