ST Engineering Group (STE, S63.SI) – Bear Case by Sakura Research

STE Group (SGX: S63) Share Price: S$7.91
Market Cap: ≈S$24.70B (≈US$19B)
Public/free float: 48.54%
Singapore's Temasek Fund: 51.02% ownership
Average volume (3-month): 7.65M shares (~$47m USD daily)
Short interest (as of June 13): 0.11% of Outstanding Shares
End-2024: Cash at 430m vs. total borrowings at $6,108 million
Performance: **YTD** +70% vs. STI index +3%**.** [**1Y** +90% vs. STI index's +18%]

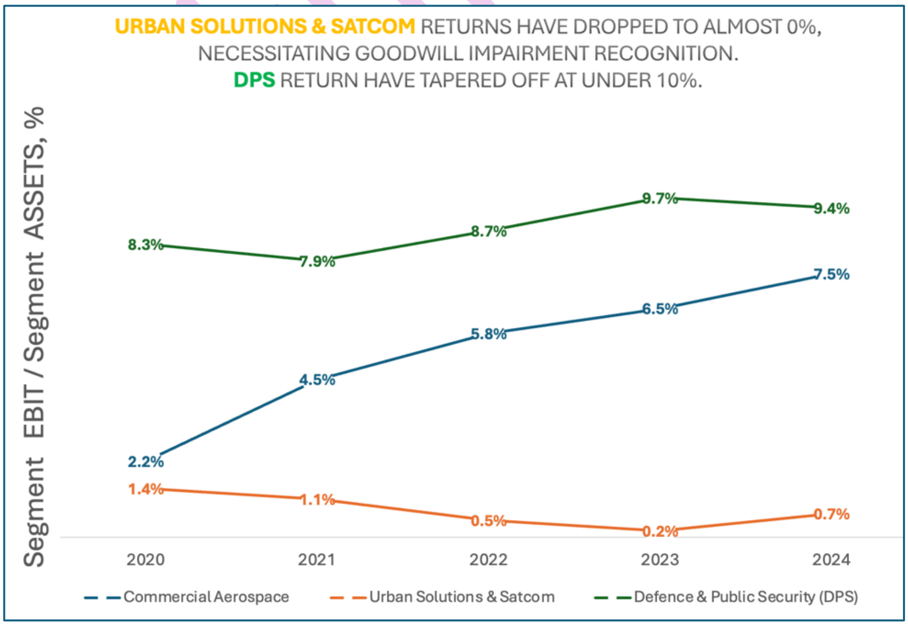
In our view, STE is an overpriced overleveraged defence play handicapped by high debt load, high annual capital expenditure spend, negative tangible net asset value and unrecognized goodwill impairment (about S$1.7b). The Group's reported annual net income has not been able to cover its annual capital expenditures together with its annual Dividends paid to shareholders every single year since 2015. We estimate goodwill impairment of S$1.7B resulting from US TransCore Partners acquisition in 2022, when the interest rates were at about 0%.

The STE Group is an integrated engineering group with 3 segments: Commercial Aerospace (CA), Urban Solutions & Satcom (USS), defence and public security (DPS) segments. Recently, its share performance has been on a tear and we took a close look at the Group's asset efficiency, as a whole and by each segment.

STE Group, S$, millions	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
Total Annual Capital Expenditures	-335	-295	-196	-312	-763	-542	-577
Dividends paid to shareholders of the Company	-468	-468	-468	-468	-686	-499	-499
Interest paid	-49	-56	-58	-34	-72	-282	-211
Net income	494	578	521.8	571	535	586	702
"Deficit" (Net income after Capex and paid dividends)	**-309**	**-185**	**-142**	**-209**	**-914**	**-677**	**-374**

The Group has faced a significant financial strain over the past seven years, from 2015 to 2024, running a "deficit" between net income and the combined outflows for CapEx and dividends. This suggests that the company cannot sustainably fund both capital expenditures and shareholder returns, a typical red flag for capital-intensive businesses that cannot create shareholder value. Furthermore, **between 2022 and 2024 alone, the Group's CapEx totaled approximately S$1.88B, surpassing the cumulative net income of S$1.82B in the same period.**

Moreover, interest payments surged more than eightfold, from S$34M in 2021 to S$282M in 2023, a stark reflection of the increasing debt burden, exacerbated by the debt-fuelled gigantic TransCore acquisition in 2022.



EBIT generation efficiency of 3 segments. The USS segment has been performing poorly since 2020.

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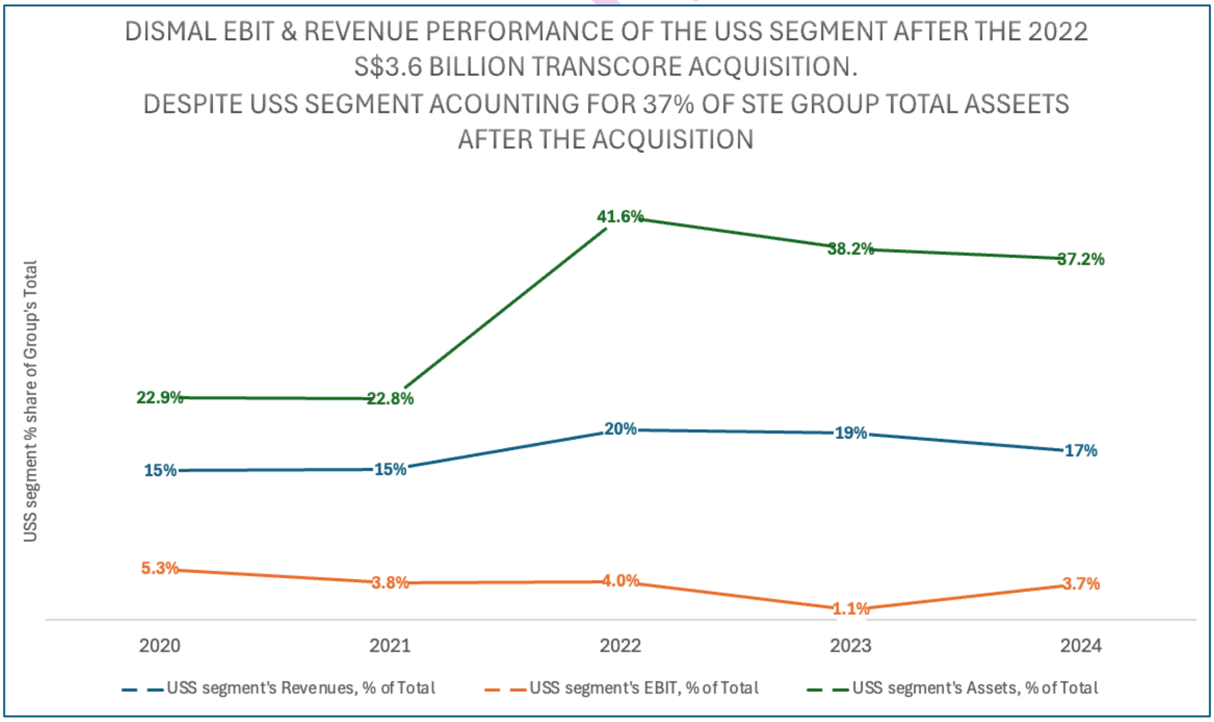
STE Group has 3 operating segments. The DPS segment EBIT (Earnings Before Interest & Taxes) returns have tapered off under 10% yield, while the Commercial Aviation segment's EBIT/Asset yield picture is getting cloudy under the global trade wars, protectionism, higher jet fuel prices, wars, and closed airspaces with the resulting travel disruptions.
The Group's 3 operating segments and their EBIT generation efficiency per segment assets. The TransCore-container USS segment EBIT generation efficiency has dropped off significantly from 2022 to 2024. Of note, TransCore (TC) Partners generated US$143 million in EBITDA in 2020, before the acquisition by the Group.

ST Engineering marks biggest-ever investment with $3.6b TransCore (TC) purchase in early 2022
A pivotal moment for the Group's negative performance was the overpayment for the US-based transportation and tolling tech company, TransCore, in March 2022. At that time, the Fed funds rate was around 0.50%. The Group acquired TransCore for US$2.68 billion (S$3.62 billion) at a time when financing conditions were exceptionally favorable. TC assets were mostly added to the Urban Solutions & Satcom (USS) segment, especially by adding $2.3 billion in goodwill.

However, the Fed funds rate has since risen significantly, now sitting at 4.25%–4.50%, placing strain on the Group's debt-servicing capacity. **While the Fed rates rose since early 2022 to 2024, STE management actually decreased the pre-tax discount rates used for S$2.3 billion goodwill valuation from 8.9% in 2022 to 7% in 2024.** The TC acquisition was based on overly optimistic assumptions, expecting TransCore to be cash-flow positive from year one and earnings-accretive by year two. **In reality, the Urban Solutions & Satcom (USS) segment, which includes acquired TransCore, <u>posted the worst EBIT performance in 2023 since 2020. Furthermore, in January 2024, Mr Tracy Marks, TransCore President & CEO, announced his departure.</u>**

TransCore's contribution in 2022 was S$620.6M in revenue and S$61.9M in net profit. The USS segment's overall EBIT remained stagnant from 2020 to 2024, despite a sharp increase in USS assets—from S$2.39B in 2021 to S$6B in 2024. This represents an abysmal EBIT-to-assets yield of less than 0.7% over the same period. In other words, the Group's investment in this USS segment has grown without delivering a proportional return.
Further complicating matters, TransCore's involvement in the US infrastructure sector is facing increased challenges. US company Conduent is contesting the US$1.7B New Jersey E-ZPass contract awarded to TransCore, highlighting the rising protectionist sentiment against foreign-owned companies in US infrastructure procurements.



In early 2022, ST Engineering made its biggest-ever investment with the $3.6 billion TransCore purchase, bringing the USS segment's assets to about 40% of the Group's total assets. Yet, after this purchase, the USS segment's share of Total Group EBIT has remained below 4%.

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In fact, in 2023, the Group's USS segment reported its lowest annual EBIT, at just 10 million SGD since 2020, despite the massive TransCore acquisition. TransCore's EBITDA (earnings before interest, tax, depreciation and amortisation) was much higher at US$143 million as at end-December 2020 (before the 2022 acquisition).

We estimate a $1.7 billion goodwill impairment from the TransCore acquisition, which equals about 240% of ST Engineering Group's 2024 net income of 702 million SGD.

SGD, millions	2020	2021	2022	2023	2024
Total EBIT, STE Group	596.4	673.6	735.1	914.6	1076.5
EBIT of USS segment	31.4	25.8	29.2	10	39.9
Annual CapEx of USS segment	31.36	31.2	25	32	118
USS segment Assets	2,283	2,396	6,221	5,880	6,031
Segment EBIT / Segment Assets, %	1.38%	1.08%	0.47%	0.17%	0.66%

Table. The Urban Solutions & Satcom segment has failed to generate a meaningful EBIT return on its capital-intensive operations, especially after 2022 TransCore Acquisition.

From 2022 to 2024, the USS segment produced approximately S$79.1 million in EBIT, while USS capital expenditures over the same three-year period totalled S$175 million—more than double the EBIT. From 2021 to 2024, the USS segment's assets have grown by approximately 151%, reaching a staggering S$6 billion.

Intangibles-rich highly leveraged balance sheet of STE Group.

SGD, '000	31-Dec-2024
Total Assets	16,221,299
Goodwill	3,147,820
Intangibles excluding Goodwill	1,841,955
Total Liabilities	13,270,452

Net Equity	2,950,847
Remove Goodwill	3,147,820
Net Equity after removing Goodwill	-196,973

Table. The correct valuation of Goodwill is critical as Goodwill balances makes up about 20% of the Total Assets and it is more than STE Group shareholder equity. Removing the goodwill would actually create a shareholder equity deficit, i.e., negative equity, showing the tenuous position of the Group's balance sheet.

STE Group (S$)	2020	2021	2022	2023	2024
Total Assets	9,963,914,000	10,515,659,000	14,963,985,000	15,378,901,000	16,221,299,000
Shareholder equity	2,574,789,000	2,668,215,000	2,652,854,000	2,752,336,000	2,950,847,000
Goodwill	786,379,000	796,676,000	3,091,354,000	3,036,232,000	3,147,820,000
Goodwill impairment	14,431,000	5,000,000	5,000,000	0	0
Goodwill to Total Assets ratio, %	7.9%	7.6%	20.7%	19.7%	19.4%
Goodwill to Shareholder Equity ratio, %	30.5%	29.9%	116.5%	110.3%	106.7%

The expensive TransCore acquisition in early 2022 has destroyed the tangible net asset value of STE stock.

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CapEx vs. EBIT – A Red Flag for Impairment

Urban Solutions & Satcom segment (2022–2024):

- **Total EBIT:** S$79.1 million
- **Total CapEx:** S$175 million
- **CapEx-to-EBIT ratio: 2.2×**

1. **Goodwill is supported by expected future profits.** When a segment consistently generates **low returns on large capital investments**, it signals that:
    - The underlying asset performance may not justify the goodwill.
    - Forecasts used in valuation may be overly optimistic.
2. **EBIT margin is very low:**
    - USS segment's EBIT/Assets was just **0.17% in 2023**, and still below 1% in 2024.
    - This implies poor capital productivity and limited value creation.
3. **CapEx inefficiency:**
    - High CapEx with little EBIT growth suggests the business needs more cash just to maintain or slightly grow, not a sign of strong future cash flows.

Realistic Goodwill Impairment Estimation (2022–2024)

Assumptions Recap:

- **Goodwill recorded in 2022 after the TransCore acquisition:** S$2.3 billion
- **Average EBIT (2022–2024):** ~S$26.4 million/year
- **CapEx is growing and not generating meaningful EBIT growth of the USS segment**
- Use 2 different pre-tax discount rates (8.9% by management in 2022, 7% by management in 2024)
- Terminal growth: **4%**
- Forecast horizon: **5 years + terminal value (TV)**

Goodwill Impairment Scenarios (5-Year DCF Model)

Discount Rate Assumption	PV of Cash Flows (SGD)	PV of Terminal Value (SGD)	Total Business Value (NPV)	Estimated Goodwill Impairment
More Realistic Rate (8.9%)	~S$103.3 million	~S$367.4 million	**S$470.7 million**	**S$1,850 million**
Management Rate (7.0%)	~S$113.1 million	~S$519.5 million	**S$632.6 million**	**S$1,688 million**

The Group has recognized about S$20 million goodwill impairment for 2020 and 2021, with on about $800 million goodwill on its balance sheet prior to TransCore acquisition. After TC acquisition, from 2022 to 2024, it has recognized just S$5 million in goodwill impairment on a much larger $3.1 billion goodwill balance. We estimate about $1.7 billion in goodwill impairment to be recognized by STE (about 7% of its current market capitalization, or **about 2.5 times of its 2024 annual net income of S$702 million**).

Difficulty converting rising order book values to net income

On March 3, the Singapore government announced a 12.4% increase in its defence budget for FY2025, bringing total defence spending to S$23.4 billion. The hike is intended to support projects that were deferred or disrupted due to COVID-19. However, then Defence Minister Ng Eng Hen noted that such increases will moderate in FY2026, as the government aims to keep defence expenditure within 3% of GDP (ref).

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SGD (S$)	2020	2021	2022	2023	2024	Growth, 2020 to 2024
End-year Order book	$15.4b	$19.3b	$23.0b	$27.4b	$28.5b	85%
Total revenues	7,158,286,000	7,692,865,000	9,035,103,000	10,101,021,000	11,275,659,000	58%
Net income	521,800,000	570,540,000	535,012,000	586,467,000	702,256,000	35%

While the Group's reported order book has grown approximately 85% from 2020 to 2024, net income over the same period has increased by only 35%, implying a modest compound annual growth rate (CAGR) of around 7.55%. This highlights the ongoing challenge of translating order book growth into high net income yields—largely due to the Group's elevated borrowing levels and associated interest costs.
Compounding these issues, the World Bank recently cut its global growth forecast for 2025 from 2.7% to 2.3%, citing rising tariffs and increased geopolitical uncertainty as significant headwinds for most economies. Additionally, persistent high oil and jet fuel prices—along with restricted access to major airspaces such as Russian and Iranian—are expected to lengthen flight durations and negatively impact airline profitability.
In this challenging macroeconomic environment, protectionist trade policies by major economies may become more common, further dampening global demand.
Reflecting some of this pressure, STE reported Q1 2025 revenue of S$2.9 billion, a 1.8% decline from Q4 2024.

STE Group	2019	2020	2021	2022	2023	2024
Return on Assets	6.1%	5.2%	5.4%	3.6%	3.8%	4.3%

The Group's capital-intensive business generate dismal returns, still lower than even during the COVID19 pandemic peaks in 2020 and 2021, despite supposed growth in Defence & Public Security (DPS) segment. The Group's average Return on Assets over the past 3 years has been at a miserable 3.9%.

STE Group: Weak current and quick ratios after TransCore Acquisition
An analysis of the Group's financial position reveals a **persistently weak quick ratio**, indicating **liquidity stress** and a potential inability to cover short-term liabilities without relying on inventory sales or long-term assets.

STE Group	2021	2022	2023	2024
Current Ratio	1.15	0.77	0.91	0.89
Quick ratio	0.51	0.29	0.34	0.33

Benchmark: A quick ratio below 1.0 suggests that the company may not have sufficient liquid assets to meet its short-term obligations.

- The Group's current liabilities (S$8.2B at the end of 2024) significantly surpass its liquid current assets (S$2.7B).
- By excluding inventories and contract assets, which are less liquid in nature, the STE's true reliance on cash flow becomes apparent.
- This financial imbalance heightens risk, especially when combined with substantial interest obligations, capital expenditures (CapEx), and large annual dividend payouts.
- The ongoing financial "deficits" point to several concerns:
  1. Financial Overextension: The Group is struggling to meet its financial commitments.
  2. Insufficient Retained Earnings: The company is not generating enough retained earnings to support its strategic initiatives or dividend policy.
  3. Risk of Dividend Cuts or Capital Raising: The Group may soon be forced to either cut dividends, raise additional capital, or consider restructuring.

The Group faces significant working capital pressure, particularly during periods of economic downturn or credit tightening. Despite STE management's focus on AI, GenAI, and increasing defence spending, the company remains highly capital-intensive, with low asset returns and a highly leveraged balance sheet.

In conclusion, the Group's growing financial strain—compounded by a poorly executed acquisition, poor EBIT generation and a stressed balance sheet, signals that difficult financial decisions are imminent. These may include dividend cuts, capital raises, or a restructuring of operations.

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