

CHINA  
DEVELOPMENT  
FINANCIAL

# CSE Global

(CSE SP/CSES.SI)

## Order wins gaining momentum

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- CSE reported a lower-than-expected set of 3Q19 results, with PATMI unchanged YoY at S\$5.0mn. The underperformance was mainly due to gross profit margins declining from 27.4% in 3Q18 to 25.9% in 3Q19 as it recognised new projects in the US. We expect to see seasonal year-end weakness in the US
- However, there are several tailwinds to take note going into 2020. CSE's order wins have started to gain momentum as capex in the oil & gas industry picks up, and this should translate to better earnings visibility going forward
- As a result of better utilisation of its strong balance sheet to capture growth opportunities, we also expect an uplift from the recent acquisition in the US to help maintain its double-digit ROEs
- We maintain OUTPERFORM give its attractive valuations of 13/9/8x 2019/20/21F EPS, and for its above-industry dividend yield of 5.2%.

### Financials & Key Operating Statistics

YE Dec (\$ m)	2017	2018	2019F	2020F	2021F
Revenue	362.4	376.8	420.6	501.7	526.7
PATMI	-45.1	20.1	21.9	31.1	35.4
Core PATMI	-3.5	18.6	21.4	30.6	34.9
Core EPS	-0.7	3.6	4.1	5.9	6.8
Core EPS grth (%)	-117.1	-629.5	15.0	43.1	14.0
Core P/E (x)	-77.9	14.7	12.8	8.9	7.8
DPS (\$GCents)	2.8	2.8	2.8	2.8	2.8
Div Yield (%)	5.2	5.2	5.2	5.2	5.2
Net Margin (%)	-12.5	5.3	5.2	6.2	6.7
Gearing (%)	-8.8	-22.0	23.0	22.5	12.8
Price / Book (x)	1.6	1.6	1.5	1.4	1.3
ROE (%)	-25.7	11.7	12.2	15.8	16.2

Source: Company Data, KGI Research

**Maximising its balance sheet.** Following CSE's latest acquisition of US-based Volta for US\$25mn (S\$35mn) in September, net gearing has increased to 27% as at end-3Q19 from a S\$9mn net cash position as at end-2Q19. Management has indicated an upper limit of around 40-50% net gearing ratio, which would still be at a conservative level given the group's ability to generate healthy free cash flows.

As a result of its higher gearing, we expect an uplift to its ROE. We do not expect further acquisitions in the next 12 months as the group focuses on balancing between the integration of its new acquisitions and the sustainability of its dividends. Based on the order win momentum and net order book, we are confident of CSE's ability to maintain its 2.8 Sing cents dividend in our forecast period.

**Diversified order wins.** CSE won S\$156mn of new orders in 3Q19, bringing its net order book to S\$233mn as at end-3Q19. With the recent US\$75mn (S\$104mn) oil & gas order win announced on 29 October, CSE's net order book now comprises a better mix between its two key business segments. Given its order win momentum and new project contributions from Volta, we expect CSE's outstanding order

### OUTPERFORM - Maintain

Price as of 7 Nov 19 (SGD)	0.53	<b>Performance (Absolute)</b>	
12M TP (\$)	0.61	1 Month (%)	15.2
Previous TP (\$)	0.64	3 Month (%)	21.2
Upside, incl div (%)	20%	12 Month (%)	23.4
<b>Trading data</b>		<b>Perf. vs STI Index (Red)</b>	
Mkt Cap (\$mn)	269		
Issued Shares (mn)	508		
Vol - 3M Daily avg (mn)	1.2		
Val - 3M Daily avg (\$mn)	0.6		
Free Float (%)	71.5%		
<b>Major Shareholders</b>		<b>Previous Recommendations</b>	
Serba Dinamik	25.0%	10-Sep-19	OP \$0.64
Fidelity Mg't & Research	10.1%	21-May-19	OP \$0.58
		4-Mar-19	OP \$0.58

book to finally surpass S\$300mm by the end-2019, giving more revenue visibility and therefore, a narrowing of the discount to its 10-year valuation averages.

**Improved segment mix.** Infrastructure-related projects made up 54% of the outstanding order book, down from 70% in the prior quarter. Oil & gas outstanding orders has increased to 41% in 3Q19 from 26% in the prior quarter due to the acquisition of Volta, as well as a major project won for an oil & gas offshore project recently.. With the addition of Volta's business in the US, we expect revenue mix to revert back to 2016's level of 40% from oil & gas and 55% from infrastructure.

Figure 1: Outstanding orders by industry segments

Order book (\$m)	1Q		2Q		3Q	
	2018	2018	2018	2018	2019	2019
Oil & Gas	60.3	59.2	53.3	44.9	52.0	49.7
Infrastructure	83.5	82.9	79.7	132.1	126.5	131.1
Mining & Mineral	4.8	5.4	2.6	3.1	2.9	7.3
Total	148.6	147.5	135.6	180.1	181.4	188.1

Source: Company data, KGI Research

**Valuation & Action:** CSE is currently trading at 13/9/8x 2019/20/21F EPS, which is attractive in our view given its healthy balance sheet, asset light model and stable recurring free cash flows. We thus maintain our **OUTPERFORM** recommendation and believe that average EPS growth of around 16% p.a. over the next 3 years is achievable on the back of improving industry dynamics. Management has guided that it will maintain the 2.75 SG cents dividend in FY19 - the same as in the last four years - implying an above-industry yield of 5.2%.

**Risks:** Margin pressure due to competition and lower-than-expected new order wins. Foreign exchange risks due to its exposure to USD, AUD and EUR.

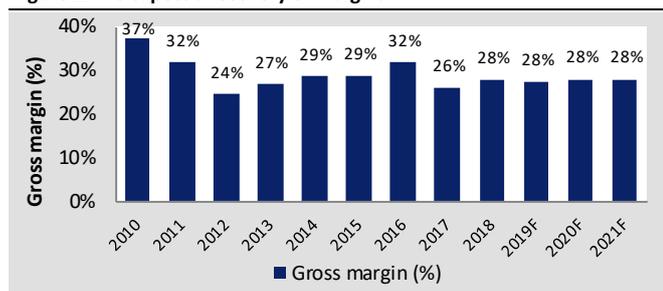
## Valuations

A peer comparison study may not accurately capture the value that CSE should be trading at, given the wide mix of geographical segment (SG, US, AU and potentially MENA) that it operates in and the business mix that it has.

As such, our valuation method for CSE involves a blended use of historical P/E and P/B multiples, with a heavier weighting towards P/B. The reason for giving P/B multiple a heavier weight is that we expect the company to only achieve full earnings growth potential from FY2020F onwards. It is only from FY2020F where we expect O&G capex and opex to recover to levels that would benefit CSE's core business and provide a meaningful uplift to margins.

**Improving margins.** Gross profit margins in FY2017 declined to 26% from an average of 30% during FY2010 to FY2015 and recently recovered to 28% in FY2018. Although the O&G service industry is still plague by overcapacity, we are seeing indications that supply and demand is balancing. Thus, it is not unreasonable to expect gross margins to stabilise at around 28% going forward.

**Figure 2: We expect a recovery of margins**



Source: Company data, KGI Research

**Blended P/E and P/B valuations.** We used CSE's 10-year historical average for both P/E and P/B valuation metrics, and derived a fair value of \$0.72 based on 12.0x 2020F P/E and \$0.53 based on 2.0x 2019F P/B. Our blended TP based on 40% weighting for P/E and 60% on P/B valuation resulted in a fair value of \$0.61. Including an attractive dividend yield of 5.2%, we derive a total potential upside of 20%.

**Figure 3: Blended P/E and P/B based valuation for CSE**

Blended valuation	Remarks
PE-based TP	\$0.72 Based on 12.0x P/E, 10-yrs avg
PB-based TP	\$0.53 Based on 2.0x P/B, 10-yrs avg
Weight P/E	40%
Weight P/B	60% Higher weight to P/B based multiple
P/E	\$0.29
P/B	\$0.32
Blended TP	\$0.61
Upside/(Downside)	15%
Dividend yield	5.2%
Upside, inc div	20%

Source: KGI Research

**Figure 4: Order win projections**



Source: Company data, KGI Research

YE 31 Dec

INCOME STATEMENT (S\$m)	2017	2018	2019F	2020F	2021F
<b>Revenue</b>	<b>362.4</b>	<b>376.8</b>	<b>420.6</b>	<b>501.7</b>	<b>526.7</b>
Cost of sales	(268.2)	(271.6)	(306.2)	(361.2)	(379.3)
<b>Gross Profit</b>	<b>94.1</b>	<b>105.2</b>	<b>114.4</b>	<b>140.5</b>	<b>147.5</b>
Other operating income/(expenses)	(17.8)	(4.3)	0.0	0.0	0.0
Selling and distribution	(3.8)	(4.3)	(4.2)	(5.0)	(5.3)
Admin	(67.9)	(71.4)	(79.9)	(92.8)	(93.8)
<b>Profit from Operations</b>	<b>4.5</b>	<b>25.1</b>	<b>30.3</b>	<b>42.6</b>	<b>48.5</b>
Finance income/(expenses)	(0.3)	(0.6)	(1.4)	(1.4)	(1.5)
Share of JV results	0.0	0.0	0.0	0.0	0.0
Exceptionals/Investment income	(41.6)	1.5	0.5	0.5	0.5
<b>Profit before Tax</b>	<b>(37.4)</b>	<b>26.1</b>	<b>29.4</b>	<b>41.8</b>	<b>47.5</b>
Income tax	(9.5)	(6.6)	(7.5)	(10.6)	(12.1)
Non-controlling interests	1.7	0.7	0.0	0.0	0.0
<b>PATMI</b>	<b>(45.1)</b>	<b>20.1</b>	<b>21.9</b>	<b>31.1</b>	<b>35.4</b>
PATMI Normalized	(3.5)	18.6	21.4	30.6	34.9
BALANCE SHEET (US\$m)	2017	2018	2019F	2020F	2021F
Cash and cash equivalents	46.9	74.1	15.2	22.5	41.5
Trade and other receivables	159.6	116.2	171.1	204.1	214.3
Inventory	14.6	16.5	12.3	14.5	15.3
Other current assets	3.0	3.7	3.7	3.7	3.7
<b>Current Assets</b>	<b>224.1</b>	<b>210.5</b>	<b>202.4</b>	<b>244.9</b>	<b>274.8</b>
Property, plant and equipment	28.0	28.2	63.0	61.2	59.0
Other non-current assets	31.8	30.4	46.0	48.2	50.4
<b>Non-current Assets</b>	<b>59.8</b>	<b>58.6</b>	<b>109.0</b>	<b>109.4</b>	<b>109.4</b>
<b>Total assets</b>	<b>283.9</b>	<b>269.1</b>	<b>311.4</b>	<b>354.3</b>	<b>384.2</b>
Trade and other payables	70.5	56.4	65.9	77.8	81.7
Borrowings (current)	31.4	36.1	56.7	67.6	71.0
Other current liabilities	2.9	3.4	8.0	11.1	12.6
<b>Current Liabilities</b>	<b>104.8</b>	<b>95.9</b>	<b>130.6</b>	<b>156.5</b>	<b>165.2</b>
Borrowings (non-current)	0.0	0.0	0.0	0.0	0.0
Other non-current liabilities	3.4	0.8	0.8	0.8	0.8
<b>Non-current liabilities</b>	<b>3.4</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>
Shareholders equity	174.0	171.2	178.9	195.8	217.0
Non-controlling interests	1.8	1.1	1.1	1.1	1.1
<b>Total Equity</b>	<b>175.8</b>	<b>172.3</b>	<b>180.0</b>	<b>196.9</b>	<b>218.1</b>
<b>Total Liabilities and Equity</b>	<b>283.9</b>	<b>269.1</b>	<b>311.4</b>	<b>354.3</b>	<b>384.2</b>
CASH FLOW STATEMENT (US\$m)	2017	2018	2019F	2020F	2021F
Net income before tax	(37.4)	26.1	29.4	41.8	47.5
Depreciation & non cash adjustments	24.3	(3.9)	7.0	15.6	16.1
Change in Working Capital	(6.5)	27.5	(41.0)	(23.0)	(6.7)
Income Tax Paid	(2.6)	(1.7)	(2.9)	(7.5)	(10.6)
Interest Paid	(0.8)	(0.8)	(1.7)	(1.7)	(1.8)
<b>CF from operating activities</b>	<b>(23.0)</b>	<b>47.2</b>	<b>(9.2)</b>	<b>25.1</b>	<b>44.4</b>
Purchase/Disposal of PPE	(8.3)	(6.7)	(43.0)	(8.0)	(8.0)
Other CFI	(8.5)	(0.9)	0.0	0.0	0.0
<b>CF from investing activities</b>	<b>(10.5)</b>	<b>(7.2)</b>	<b>(43.0)</b>	<b>(8.0)</b>	<b>(8.0)</b>
Dividends Paid	(14.2)	(14.2)	(14.2)	(14.2)	(14.2)
Debt Raised / (Repaid)	0.0	4.7	20.6	10.9	3.4
Equity Raised / (Bought Back)	0.0	0.0	0.0	0.0	0.0
Other Cash from Financing	0.0	(3.3)	0.0	0.0	0.0
<b>CF from financing activities</b>	<b>(3.8)</b>	<b>(12.7)</b>	<b>6.4</b>	<b>(3.3)</b>	<b>(10.8)</b>
Net increase in cash & cash equiv.	(43.9)	20.7	(52.4)	7.3	19.0
FX effects	(6.6)	(6.6)	(6.6)	(6.6)	(6.6)
Beginning Cash	90.8	46.9	67.6	15.2	22.5
<b>Ending Cash</b>	<b>46.9</b>	<b>67.6</b>	<b>15.2</b>	<b>22.5</b>	<b>41.5</b>
KEY RATIOS	2017	2018	2019F	2020F	2021F
<b>Profitability</b>					
Core EPS	(0.7)	3.6	4.1	5.9	6.8
Core EPS Growth (%)	(117.1)	(629.5)	15.0	43.1	14.0
DPS (SGD Cents)	2.8	2.8	2.8	2.8	2.8
Dividend Yield (%)	5.2	5.2	5.2	5.2	5.2
<b>Profitability</b>					
Gross margin	26.0%	27.9%	27.2%	28.0%	28.0%
EBITDA margin	3.3%	8.6%	9.1%	10.4%	11.1%
Net margin	-12.5%	5.3%	5.2%	6.2%	6.7%
ROE	-25.7%	11.7%	12.2%	15.8%	16.2%
ROA	-15.9%	7.5%	7.0%	8.8%	9.2%
<b>Growth (% Y-o-Y)</b>					
Revenue	14.0%	4.0%	5.0%	5.0%	5.0%
EBITDA	-65.2%	173.5%	18.5%	36.2%	12.0%
Net income (core)	-313.1%	-144.5%	8.9%	42.1%	13.7%
Diluted EPS (core)	-117.1%	-629.5%	15.0%	43.1%	14.0%
<b>Financial Structure (x)</b>					
Interest coverage	5.5	30.1	17.8	25.2	27.3
Total Debt/Equity	0.2	0.2	0.3	0.3	0.3
Net Gearing	-0.1	-0.2	0.2	0.2	0.1
<b>Market Valuation (x)</b>					
Price / Earnings	-77.9	14.7	12.8	8.9	7.8
Price / Book	1.6	1.6	1.5	1.4	1.3
Price / Sales	0.8	0.7	0.7	0.5	0.5
EV / EBITDA	8.4	3.1	2.6	1.9	1.7

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