



CHINA
DEVELOPMENT
FINANCIAL

CSE Global
(CSE SP/CSES.SI)

Healthy order wins

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- There were no surprises in CSE's 1Q19 earnings, which made up 22% of our full-year forecast.
- We are positive on CSE's outlook on the back of 13-20% EPS growth in the next 3 years from better industry prospects and from synergies with its new major shareholder.
- Maintain BUY. CSE's valuations are attractive, trading at 12/11/9x 2019/20/21F EPS. We expect downside risks to be mitigated by its above-industry 5.5% dividend yield.

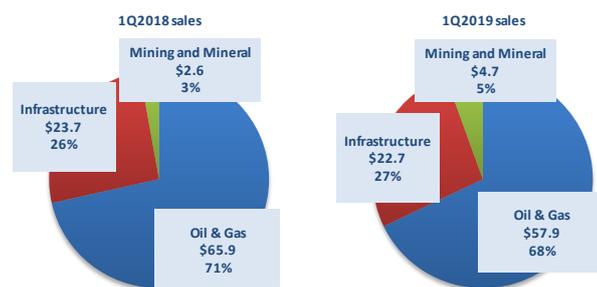
Financials & Key Operating Statistics

YE Dec (\$\$ m)	2017	2018	2019F	2020F	2021F
Revenue	362.4	376.8	399.4	423.4	448.8
PATMI	-45.1	20.1	22.0	24.8	29.6
Core PATMI	-3.5	18.6	21.5	24.3	29.1
Core EPS	-0.7	3.6	4.2	4.7	5.6
Core EPS grth (%)	-117.1	-629.5	15.4	13.3	19.6
Core P/E (x)	-73.5	13.9	12.0	10.6	8.9
DPS (SGCents)	2.8	2.8	2.8	2.8	2.8
Div Yield (%)	5.5	5.5	5.5	5.5	5.5
Net Margin (%)	-12.5	5.3	5.5	5.9	6.6
Gearing (%)	-8.8	-22.0	-7.4	-8.8	-12.4
Price / Book (x)	1.5	1.5	1.4	1.4	1.3
ROE (%)	-25.7	11.7	12.2	13.0	14.4

Source: Company Data, KGI Research

1Q19 review. Although revenue in 1Q19 declined 7% YoY to S\$85.4mn, net profit rose 0.5% YoY to S\$5.7mn on the back of a 90bps improvement in gross profit margins to 27.7%. Its Oil & Gas segment's contribution declined to 68% of total revenues, down from 71% in the prior year period. This was offset by an increase in its infrastructure segment, where contribution rose to 27% of total sales in the quarter, up from 26% in the prior year period.

Figure 1: Sales contribution 1Q19 vs 1Q18



Source: Company data, KGI Research

Healthy order wins. CSE won S\$87.5mn of new orders in 1Q19, bringing its net order book to S\$182.2mn as at the end of the latest quarter. 67% of CSE's outstanding orders are in the Asia-Pacific, and the remainder from the Americas and Europe/Middle East/Africa.

Figure 2: Outstanding orders by geography

\$\$'000	1Q2019	4Q2018	1Q2018
Asia-Pacific	122,006	127,149	75,373
The Americas	56,460	49,124	57,649
Europe/Middle East/Africa	3,694	4,757	15,572
Total	182,160	181,030	148,594

Source: Company data, KGI Research

Buy - Maintain

Price as of 21 May 19 (SGD)	0.50	Performance (Absolute)	
12M TP (\$)	0.58	1 Month (%)	-1.0
Previous TP (\$)	0.58	3 Month (%)	9.7
Upside, incl div (%)	22%	12 Month (%)	11.5
Trading data		Perf. vs STI Index (Red)	
Mkt Cap (\$mn)	254		
Issued Shares (mn)	508		
Vol - 3M Daily avg (mn)	1.7		
Val - 3M Daily avg (\$mn)	0.9		
Free Float (%)	71.5%		
Major Shareholders		Previous Recommendations	
Serba Dinamik	25.0%	4-Mar-19	BUY \$0.58
Fidelity Mg't & Research	10.1%	16-Jan-19	BUY \$0.57
		8-Oct-18	BUY \$0.57

Sector focus in 2019. CSE will be focusing on several opportunities in its key business segments. In the Oil & Gas, management will continue its push into onshore shale projects in the US, as well as small greenfield or brownfield projects in the Gulf of Mexico. Its infrastructure business will focus on Singapore government projects, and energy solutions and radio business in Australia.

Figure 3: Order wins - potential to surpass



Source: Company data, KGI Research

Valuation & Action: CSE is currently trading at 13/11/9x 2019/20/21F EPS, which is attractive in our view given its solid balance sheet, asset light model and stable recurring free cash flows. We thus maintain our **BUY** 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 5.6%. Its balance sheet remains in an enviable net cash position of S\$35mn as at end 1Q19.

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.

Investment Thesis

We believe markets may be undervaluing CSE's key businesses as we see several positive trends that could cause a share price re-rating over the next few quarters:

- There has been a dramatic increase in US oil production, a majority from shale production such as in the Permian basin. Hence, we see significant upside to margins and earnings from its US operations, which mainly serves the O&G sector.
- CSE's infrastructure business has been a bright spot, contributing S\$15mn or around 55-77% of EBIT in FY2017 and FY2018. It is currently working and bidding for mining and infrastructure projects in Australia. After our site visit to Australia, we are more confident of the growth prospects of CSE in the country as it has made significant inroads into the 2-way radio communications through its acquisitions.
- Re-entry into the Middle East with its new shareholder, Serba Dinamik, which could boost its order book. CSE scaled down its Middle East operations in past years due to issues with clients' payment. But with Serba Dinamik now as a strong partner, CSE would be in a better position to once again capitalise on the world's largest oil producing region.

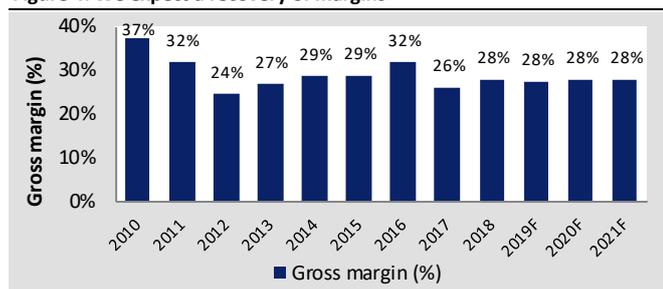
Valuations

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 in 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 on P/B for now. The reason for giving P/B multiple a heavier weight is that the company may only hit full earnings growth potential in FY2020F, where we expect O&G capex and opex to recover to levels that would benefit CSE's core business and provide a meaningful margin uplift.

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% or higher going forward.

Figure 4: We expect a recovery of margins



Source: Company data, KGI Research

Blended P/E and P/B valuations. We applied a 20% discount to the +1SD multiples of CSE's 10-year historical average for both P/E and P/B valuation metrics, and derived a fair value of \$0.53 based on 12.5x 2019F P/E and \$0.62 based on 2.1x 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 \$0.58. Including an attractive dividend yield of 5.5%, we derive a total potential upside of 22%.

Figure 5: Blended P/E and P/B based valuation for CSE

Blended valuation	Remarks
PE-based TP	\$0.53 Based on 12.5x P/E, 20% disc to +1SD above 10-yr avg
PB-based TP	\$0.62 Based on 2.1x P/B, 20% disc to +1SD above 10-yr avg
Weight P/E	40%
Weight P/B	60% Higher weight to P/B based multiple
P/E	\$0.21
P/B	\$0.37
Blended TP	\$0.58
Upside/(Downside)	17%
Dividend yield	5.5%
Upside, inc div	22%

Source: KGI Research

P/B valuation still below 10-year average. Despite improving industry and company fundamentals for CSE, its valuations are still close to 1SD below its 10-year average. We expect valuations to re-rate higher on improving earnings across its three business segments (O&G, Infrastructure and Mining & Mineral).

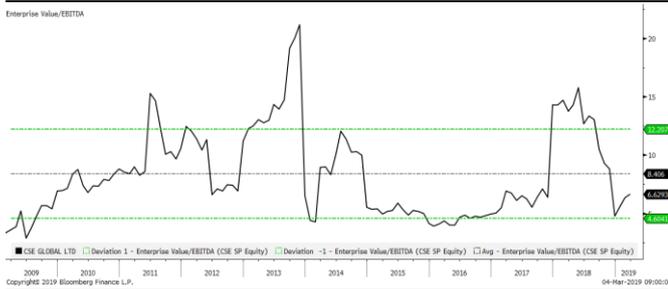
Figure 6: 10-years P/B graph



Source: Bloomberg, KGI Research

Appendix: Additional charts and tables

Figure 7: CSE's 10-year EV/EBITDA graph



Source: Bloomberg, KGI Research

CSE's segments. CSE's diversification into Australia's infrastructure segment managed to offset the decline in O&G and Mining & Minerals. Infrastructure EBIT accounted for 78% of the group's FY2017 EBIT. In FY2018, its infrastructure segment's EBIT has remained stable and overall EBIT was helped by the recovery in its O&G business, particularly in the US.

Figure 8: CSE's segmental operating profit

S\$m	FY 2018	FY 2017	Var %
Oil & Gas	12.0	4.8	152.3%
Infrastructure	14.6	15.1	-3.7%
Mining & Mineral	0.1	(0.2)	N.M.
Total	26.6	19.6	35.7%

Source: Company

YE 31 Dec

INCOME STATEMENT (S\$m)	2017	2018	2019F	2020F	2021F
Revenue	362.4	376.8	399.4	423.4	448.8
Cost of sales	(268.2)	(271.6)	(289.6)	(304.8)	(320.9)
Gross Profit	94.1	105.2	109.8	118.5	127.9
Other operating income/(expenses)	(17.8)	(4.3)	0.0	0.0	0.0
Selling and distribution	(3.8)	(4.3)	(4.0)	(4.2)	(4.5)
Admin	(67.9)	(71.4)	(75.9)	(80.4)	(83.0)
Profit from Operations	4.5	25.1	30.0	33.9	40.4
Finance income/(expenses)	(0.3)	(0.6)	(0.8)	(0.8)	(0.9)
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
Profit before Tax	(37.4)	26.1	29.7	33.5	40.0
Income tax	(9.5)	(6.6)	(7.7)	(8.7)	(10.4)
Non-controlling interests	1.7	0.7	0.0	0.0	0.0
PATMI	(45.1)	20.1	22.0	24.8	29.6
PATMI Normalized	(3.5)	18.6	21.5	24.3	29.1

BALANCE SHEET (US\$m)	2017	2018	2019F	2020F	2021F
Cash and cash equivalents	46.9	74.1	67.2	73.8	86.1
Trade and other receivables	159.6	116.2	162.5	172.2	182.6
Inventory	14.6	16.5	11.7	12.3	12.9
Other current assets	3.0	3.7	3.7	3.7	3.7
Current Assets	224.1	210.5	245.1	262.1	285.3
Property, plant and equipment	28.0	28.2	28.4	28.2	27.4
Other non-current assets	31.8	30.4	31.8	33.2	34.6
Non-current Assets	59.8	58.6	60.2	61.3	62.1
Total assets	283.9	269.1	305.3	323.4	347.4
Trade and other payables	70.5	56.4	62.4	65.6	69.1
Borrowings (current)	31.4	36.1	53.8	57.1	60.5
Other current liabilities	2.9	3.4	8.2	9.2	10.9
Current Liabilities	104.8	95.9	124.4	131.9	140.4
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
Non-current liabilities	3.4	0.8	0.8	0.8	0.8
Shareholders equity	174.0	171.2	179.0	189.6	205.0
Non-controlling interests	1.8	1.1	1.1	1.1	1.1
Total Equity	175.8	172.3	180.1	190.7	206.1
Total Liabilities and Equity	283.9	269.1	305.3	323.4	347.4

CASH FLOW STATEMENT (US\$m)	2017	2018	2019F	2020F	2021F
Net income before tax	(37.4)	26.1	29.7	33.5	40.0
Depreciation & non cash adjustments	24.3	(3.9)	20.2	14.2	14.7
Change in Working Capital	(6.5)	27.5	(35.3)	(6.8)	(7.2)
Income Tax Paid	(2.6)	(1.7)	(2.9)	(7.7)	(8.7)
Interest Paid	(0.8)	(0.8)	(1.1)	(1.1)	(1.2)
CF from operating activities	(23.0)	47.2	10.7	32.1	37.6
Purchase/Disposal of PPE	(8.3)	(6.7)	(8.0)	(8.0)	(8.0)
Other CFI	(8.5)	(0.9)	0.0	0.0	0.0
CF from investing activities	(10.5)	(7.2)	(8.0)	(8.0)	(8.0)
Dividends Paid	(14.2)	(14.2)	(14.2)	(14.2)	(14.2)
Debt Raised / (Repaid)	0.0	4.7	17.7	3.2	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
CF from financing activities	(3.8)	(12.7)	3.5	(11.0)	(10.8)
Net increase in cash & cash equiv.	(43.9)	20.7	(0.4)	6.6	12.2
FX effects	(6.6)	(6.6)	(6.6)	(6.6)	(6.6)
Beginning Cash	90.8	46.9	67.6	67.2	73.8
Ending Cash	46.9	67.6	67.2	73.8	86.1

KGI's Ratings**Rating Definition**

KGI Securities Research's recommendations are based on an Absolute Return rating system.

BUY >10% total return over the next 12 months

HOLD -10% to +10% total return over the next 12 months

SELL <-10% total return over the next 12 months

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