



CSE Global

(CSE SP/CSES.SI)

Earnings boost from US\$25mn acquisition

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- CSE acquired US-based Volta, LLC (Volta) for US\$25mn (S\$35mn) on 2nd September.
- The acquisition is EPS-accretive, boosting CSE's 2018 EPS by around 20%.
- Maintain OUTPERFORM. CSE's valuations are attractive, trading at 11/8/7x 2019/20/21F EPS. We expect downside risks to be mitigated by its above-industry 5.9% dividend yield.

Financials & Key Operating Statistics					
YE Dec (\$\$ m)	2017	2018	2019F	2020F	2021F
Revenue	362.4	376.8	424.4	525.6	551.9
PATMI	-45.1	20.1	23.0	32.6	37.0
Core PATMI	-3.5	18.6	22.5	32.1	36.5
Core EPS	-0.7	3.6	4.4	6.2	7.1
Core EPS grth (%)	-117.1	-629.5	21.2	42.3	14.0
Core P/E (x)	-69.1	13.0	10.8	7.6	6.6
DPS (SGCents)	2.8	2.8	2.8	2.8	2.8
Div Yield (%)	5.9	5.9	5.9	5.9	5.9
Net Margin (%)	-12.5	5.3	5.4	6.2	6.7
Gearing (%)	-8.8	-22.0	22.7	23.8	13.1
Price / Book (x)	1.4	1.4	1.3	1.2	1.1
ROE (%)	-25.7	11.7	12.7	16.3	16.7

Source: Company Data, KGI Research

S\$35mn acquisition. CSE will be paying a total of US\$25mn (S\$35mn) in cash for Volta, subject to any closing adjustments for working capital. The acquisition is fully funded using internal resources and bank borrowings, and hence is earnings accretive. Volta would have added S\$4.1mn, or a 20% increase, to CSE's 2018 profits but would reduce its NTA by 18% to S\$0.23, down from S\$0.28 prior to the acquisition. Following the acquisition, we adjust our 2019/20/21F EPS higher by between 2% and 7%.

Volta. Volta is a US-based company that develops, designs, manufactures, and services custom-engineered electrical equipment centers (EEC). The acquisition is expected to complement CSE's US operations and create opportunities to strengthen the group's position in the midstream oil and gas market.

Diversified order wins. CSE won S\$87.5mn and S\$106.3mn of new orders in 1Q19 and 2Q19, bringing its net order book to S\$188.1mn as at the end of 2Q19. 69% of CSE's outstanding orders are in the Asia-Pacific, and the remainder from the Americas and Europe/Middle East/Africa.

Infrastructure-related projects contributed 70% of the outstanding orders and this segment has been increasing at a much stronger pace relative to its Oil & Gas business. However, with the addition of Volta to its US business, the mix may once again return to 2016's levels of 40% for Oil & Gas and 55% for Infrastructure. CSE's infrastructure will focus on Singapore government projects, energy solutions and radio business in Australia. CSE had won S\$193.8mn of new orders in 1H19, making up 48% of our full-year forecast for 2019.

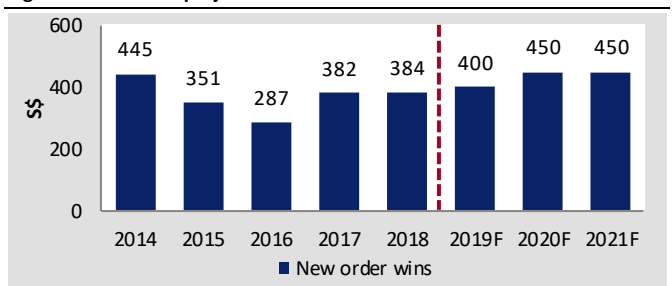
OUTPERFORM - Maintain			
Price as of 9 Sep 19 (SGD)	0.47	Performance (Absolute)	
12M TP (\$)	0.64	1 Month (%)	9.9
Previous TP (\$)	0.58	3 Month (%)	-0.3
Upside, incl div (%)	42%	12 Month (%)	15.8
Trading data		Perf. vs STI Index (Red)	
Mkt Cap (\$mn)	239		
Issued Shares (mn)	508		
Vol - 3M Daily avg (mn)	0.6		
Val - 3M Daily avg (\$mn)	0.3		
Free Float (%)	71.5%		
Major Shareholders		Previous Recommendations	
Serba Dinamik	25.0%	21-May-19	OP \$0.58
Fidelity Mgt & Research	10.1%	4-Mar-19	OP \$0.58
		16-Jan-19	OP \$0.57

Figure 1: Outstanding orders by industry segments

Order wins (\$\$m)	1Q	2Q	3Q	4Q	1Q	2Q
	2018	2018	2018	2018	2019	2019
Oil & Gas	60.3	60.4	54.2	45.8	52.7	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	148.7	136.5	181.0	182.1	188.1

Source: Company data, KGI Research

Figure 2: Order win projections



Source: Company data, KGI Research

Valuation & Action: CSE is currently trading at 11/8/7x 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 **OVERWEIGHT** 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 5.9%.

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.

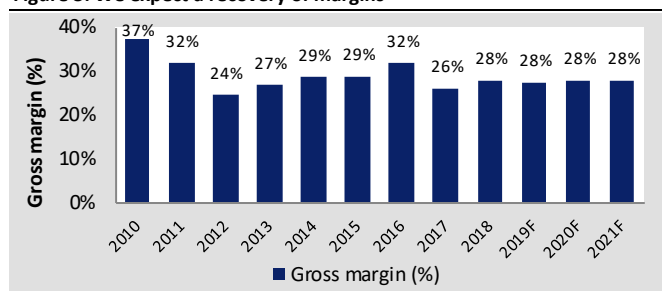
Valuations

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 3: 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 \$0.78 based on 12.0x 2020F P/E and \$0.55 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 \$0.64. Including an attractive dividend yield of 5.9%, we derive a total potential upside of 42%.

Figure 4: Blended P/E and P/B based valuation for CSE

Blended valuation	Remarks
PE-based TP	\$0.78 Based on 12.0x P/E, 10-yrs avg
PB-based TP	\$0.55 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	\$0.31
P/B	\$0.33
Blended TP	\$0.64
Upside/(Downside)	37%
Dividend yield	5.9%
Upside, inc div	42%

Source: KGI Research

YE 31 Dec

INCOME STATEMENT (S\$m)					
	2017	2018	2019F	2020F	2021F
Revenue	362.4	376.8	424.4	525.6	551.9
Cost of sales	(268.2)	(271.6)	(307.7)	(378.4)	(397.4)
Gross Profit	94.1	105.2	116.7	147.2	154.5
Other operating income/(expenses)	(17.8)	(4.3)	0.0	0.0	0.0
Selling and distribution	(3.8)	(4.3)	(4.2)	(5.3)	(5.5)
Admin	(67.9)	(71.4)	(80.6)	(97.2)	(98.2)
Profit from Operations	4.5	25.1	31.8	44.7	50.8
Finance income/(expenses)	(0.3)	(0.6)	(1.4)	(1.5)	(1.6)
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	30.9	43.7	49.7
Income tax	(9.5)	(6.6)	(7.9)	(11.1)	(12.7)
Non-controlling interests	1.7	0.7	0.0	0.0	0.0
PATMI	(45.1)	20.1	23.0	32.6	37.0
PATMI Normalized	(3.5)	18.6	22.5	32.1	36.5
BALANCE SHEET (US\$m)					
	2017	2018	2019F	2020F	2021F
Cash and cash equivalents	46.9	74.1	16.1	23.4	45.1
Trade and other receivables	159.6	116.2	172.7	213.8	224.5
Inventory	14.6	16.5	12.4	15.2	16.0
Other current assets	3.0	3.7	3.7	3.7	3.7
Current Assets	224.1	210.5	204.9	256.2	289.4
Property, plant and equipment	28.0	28.2	62.9	60.7	57.9
Other non-current assets	31.8	30.4	46.0	48.2	50.4
Non-current Assets	59.8	58.6	109.0	108.9	108.3
Total assets	283.9	269.1	313.9	365.0	397.7
Trade and other payables	70.5	56.4	66.3	81.5	85.6
Borrowings (current)	31.4	36.1	57.2	70.8	74.4
Other current liabilities	2.9	3.4	8.4	11.6	13.2
Current Liabilities	104.8	95.9	131.8	163.9	173.1
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	180.1	198.4	221.3
Non-controlling interests	1.8	1.1	1.1	1.1	1.1
Total Equity	175.8	172.3	181.2	199.5	222.4
Total Liabilities and Equity	283.9	269.1	313.8	364.3	396.3
CASH FLOW STATEMENT (US\$m)					
	2017	2018	2019F	2020F	2021F
Net income before tax	(37.4)	26.1	30.9	43.7	49.7
Depreciation & non cash adjustments	24.3	(3.9)	7.1	16.8	17.3
Change in Working Capital	(6.5)	27.5	(42.3)	(28.5)	(7.1)
Income Tax Paid	(2.6)	(1.7)	(2.9)	(7.9)	(11.1)
Interest Paid	(0.8)	(0.8)	(1.7)	(1.8)	(1.9)
CF from operating activities	(23.0)	47.2	(8.8)	22.4	47.0
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
CF from investing activities	(10.5)	(7.2)	(43.0)	(8.0)	(8.0)
Dividends Paid	(14.2)	(14.2)	(14.2)	(14.2)	(14.2)
Debt Raised / (Repaid)	0.0	4.7	21.1	13.6	3.5
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)	6.9	(0.6)	(10.7)
Net increase in cash & cash equiv.	(43.9)	20.7	(51.5)	7.3	21.8
FX effects	(6.6)	(6.6)	(6.6)	(6.6)	(6.6)
Beginning Cash	90.8	46.9	67.6	16.1	23.4
Ending Cash	46.9	67.6	16.1	23.4	45.1
KEY RATIOS					
	2017	2018	2019F	2020F	2021F
Profitability					
Core EPS	(0.7)	3.6	4.4	6.2	7.1
Core EPS Growth (%)	(117.1)	(629.5)	21.2	42.3	14.0
DPS (SGD Cents)	2.8	2.8	2.8	2.8	2.8
Dividend Yield (%)	5.9	5.9	5.9	5.9	5.9
Profitability					
Gross margin	26.0%	27.9%	27.5%	28.0%	28.0%
EBITDA margin	3.3%	8.6%	9.4%	10.4%	11.1%
Net margin	-12.5%	5.3%	5.4%	6.2%	6.7%
ROE	-25.7%	11.7%	12.7%	16.3%	16.7%
ROA	-15.9%	7.5%	7.3%	8.9%	9.3%
Growth (% Y-o-Y)					
Revenue	14.0%	4.0%	6.0%	5.0%	5.0%
EBITDA	-65.2%	173.5%	23.5%	37.0%	12.0%
Net income (core)	-313.1%	-144.5%	14.6%	41.4%	13.7%
Diluted EPS (core)	-117.1%	-629.5%	21.2%	42.3%	14.0%
Financial Structure (x)					
Interest coverage	5.5	30.1	18.6	25.2	27.3
Total Debt/Equity	0.2	0.2	0.3	0.4	0.3
Net Gearing	-0.1	-0.2	0.2	0.2	0.1
Market Valuation (x)					
Price / Earnings	-69.1	13.0	10.8	7.6	6.6
Price / Book	1.4	1.4	1.3	1.2	1.1
Price / Sales	0.7	0.6	0.6	0.5	0.4
EV / EBITDA	5.7	2.1	1.7	1.2	1.1

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Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
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