KGI CHINA DEVELOPMENT FINANCIAL

CSE Global

(CSE SP/CSES.SI)

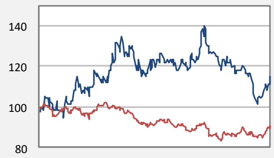
Great start to the new year; 2018 infra order wins increased 44% YoY

Joel Ng / 62 6202 1192 / joel.ng@kgi.com

- CSE announced on 14 January 2019 that it had secured S$84m in infrastructure-related projects in 4Q18, bringing its 2018 infrastructure orders to S$151mn, a 44% increase YoY.
- We are positive on CSE's outlook on the back of 22-26% 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 14/11/9x 2018/19/20F EPS. We expect downside risks to be mitigated by its above-industry 6.4% dividend yield.

Buy - Maintain

Price as of 16 Jan 19 (SGD)	0.43	**Performance (Absolute)**	
12M TP ($)	0.57	1 Month (%)	1.2
Previous TP ($)	na	3 Month (%)	-8.7
Upside, incl div (%)	38%	12 Month (%)	25.6
Trading data		**Perf. vs STI Index (Red)**	
Mkt Cap ($mn)	219		
Issued Shares (mn)	509		
Vol - 3M Daily avg (mn)	0.7		
Val - 3M Daily avg ($mn)	0.3		
Free Float (%)	71.9%		
Major Shareholders		**Previous Recommendations**	
Serba Dinamik	25.0%	8-Oct-18	BUY $0.57
Fidelity Mg't & Research	10.1%		
CAM-GTF	6.8%		



Financials & Key Operating Statistics

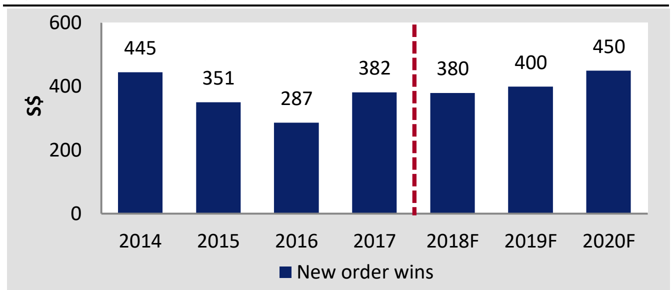
YE Dec (S$ m)	2016	2017	2018F	2019F	2020F
Revenue	317.8	362.4	376.8	399.5	423.4
PATMI	21.2	-45.1	17.8	20.9	25.3
Core PATMI	20.6	-3.5	16.1	20.4	24.8
Core EPS	4.0	-0.7	3.1	4.0	4.8
Core EPS grth (%)	-34.0	na	na	26.6	21.6
Core P/E (x)	10.8	-63.2	13.8	10.9	8.9
DPS (SGCents)	2.8	2.8	2.8	2.8	2.8
Div Yield (%)	6.4	6.4	6.4	6.4	6.4
Net Margin (%)	6.7	-12.5	4.7	5.2	6.0
Gearing (%)	-27.5	-8.8	-11.3	-10.4	-11.7
Price / Book (x)	0.9	1.3	1.2	1.2	1.1
ROE (%)	8.3	-25.7	9.9	11.3	12.9

Source: Company Data, KGI Research

Diversification. Since the oil and mining downturn began in 2015, CSE Global has successfully diversified into the infrastructure sector, mainly with the supply and servicing of 2-way radio communication systems in Australia. The recent order wins of a total combined S$84mn infrastructure work reinforces our view of CSE's value-added proposition to clients in the infrastructure sector in Singapore and Australia. Our site visit to CSE's Australian facilities in September 2018 (please refer to report published on 8-Oct-18) further strengthened our view of the recovery in Australia's O&G, mining and infrastructure sectors. All the nine companies we met during the site visit cited expansion plans, which at least indicated to us that we are past the cyclical troughs.

Potential to surpass expectations. CSE managed to win between S$69-89mn of new orders per quarter in 9M18, or a combined S$239mn.Meaning that CSE would need US$57mn of non-infrastructure new orders to surpass our estimates of S$380mn for full-year 2018F.

Figure 1: Order wins - potential to surpass



Source: Company data, KGI Research

Good momentum. CSE has done commendably well by winning S$382mn of new orders in FY2017, the first year-on-year increase in four years. We expect CSE to secure a similar level of new orders in FY2018F, increasing to S$400mn and S$450mn in FY2019F and FY2020F, respectively.

Attractive 6.4% dividend yield. Management had previously guided a 2.75 SG cents full-year dividend, which would mean a final 1.0 SG cents dividend. That would imply an attractive full-year 6.4% dividend yield. It has consistently paid 2.75 SG cents p.a. over the past 4 years. We estimate that CSE can sustain this dividend amount going forward as balance sheet remains in net cash position of S$20.9mn while free cash flows are sufficient to cover the annual dividend payout of S$14mn.

Valuation & Action: CSE is currently trading at 14/11/9x 2018/19/20F 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 EPS growth of >20% over the next 3 years is achievable on the back of improving industry dynamics.

Full-year earnings; key date to watch out for. A key date to watch out for would be the upcoming full-year earnings, which we think would be scheduled on Friday, 22 Feb. With 9M18 earnings already making up 84% of our FY2018F forecasts, we can expect an earnings beat or higher DPU guidance to lead to a positive re-rating catalyst.

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. While the US contributed 50-57% of CSE's FY2016 and FY2017 revenues, it only made up 26-32% of EBIT. 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$15.2mn or 78% of EBIT in FY2017. 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.

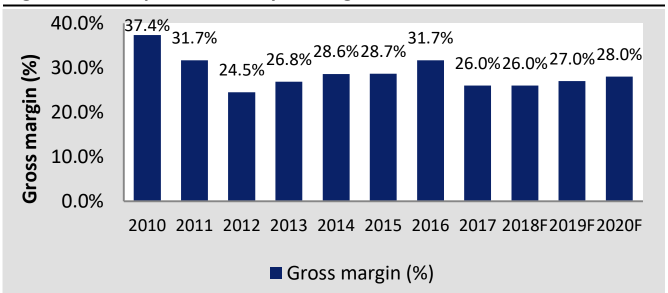
Valuations

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. 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 gradually improve to around 28.0% by FY2020F.

Figure 2: 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 $0.51 based on 12.5x 2019F P/E and $0.60 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 $0.57. Including an attractive dividend yield of 5.8%, we derive total potential upside of 38%.

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

Blended valuation		Remarks
PE-based TP	$0.51	Based on 12.5x P/E, 20% disc to +1SD above 10-yrs avg
PB-based TP	$0.60	Based on 2.1x P/B, 20% disc to +1SD above 10-yrs avg
Weight P/E	*40%*	
Weight P/B	*60%*	Higher weight to P/B based multiple
P/E	$0.20	
P/B	$0.36	
Blended TP	$0.57	
Upside/(Downside)	*31%*	
Dividend yield	*6.4%*	
Upside, inc div	*38%*	

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 4: 10-years P/B graph

Source: Bloomberg, KGI Research

Appendix: Additional charts and tables

Figure 5: 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.

Figure 6: CSE's segmental breakdown by revenues and operating profit

Revenue by Industries

S$'m	FY2015	FY2016	FY2017	Change in FY17/FY15
Oil & Gas	345.0	236.8	246.2	-29%
Infrastructure	53.9	58.9	90.5	68%
Mining & Mineral	13.1	22.0	25.7	96%
Group	412.0	317.8	362.4	-12%

EBIT by Industries

S$'m	FY2015	FY2016	FY2017	Change in FY17/FY15
Oil & Gas	30.6	17.3	4.7	-85%
Infrastructure	8.2	8.4	15.2	85%
Mining & Mineral	1.6	1.9	(0.2)	n.m
Group	40.5	27.6	19.6	-52%

Source: Company

YE 31 Dec					
INCOME STATEMENT (S$m)	**2016**	**2017**	**2018F**	**2019F**	**2020F**
Revenue	**317.8**	**362.4**	**376.8**	**399.5**	**423.4**
Cost of sales	(217.1)	(268.2)	(278.9)	(291.6)	(304.9)
Gross Profit	**100.7**	**94.1**	**98.0**	**107.9**	**118.6**
Other operating income/(expenses)	(3.8)	(17.8)	0.0	0.0	0.0
Selling and distribution	(3.8)	(3.8)	(3.8)	(4.0)	(4.2)
Admin	(66.1)	(67.9)	(71.6)	(75.9)	(80.5)
Profit from Operations	**27.0**	**4.5**	**22.6**	**28.0**	**33.9**
Finance income/(expenses)	0.2	(0.3)	(0.7)	(0.8)	(0.8)
Share of JV results	0.0	0.0	0.0	0.0	0.0
Exceptionals/Investment income	0.6	(41.6)	1.7	0.5	0.5
Profit before Tax	**27.7**	**(37.4)**	**23.6**	**27.7**	**33.5**
Income tax	(6.5)	(9.5)	(6.1)	(7.2)	(8.7)
Non-controlling interests	(0.0)	1.7	0.3	0.4	0.5
PATMI	**21.2**	**(45.1)**	**17.8**	**20.9**	**25.3**
PATMI Normalized	20.6	(3.5)	16.1	20.4	24.8
BALANCE SHEET (US$m)	**2016**	**2017**	**2018F**	**2019F**	**2020F**
Cash and cash equivalents	90.8	46.9	71.1	73.1	80.1
Trade and other receivables	130.6	159.6	153.3	162.5	172.3
Inventory	14.7	14.6	11.2	11.7	12.3
Other current assets	3.7	3.0	3.0	3.0	3.0
Current Assets	**239.7**	**224.1**	**238.6**	**250.3**	**267.5**
Property, plant and equipment	26.5	28.0	28.4	28.3	27.7
Other non-current assets	72.4	31.8	33.2	34.7	36.3
Non-current Assets	**98.9**	**59.8**	**61.6**	**63.0**	**64.0**
Total assets	**338.6**	**283.9**	**300.2**	**313.3**	**331.6**
Trade and other payables	48.0	70.5	60.0	62.8	65.6
Borrowings (current)	20.6	31.4	50.8	53.8	57.1
Other current liabilities	5.5	2.9	7.0	8.0	9.5
Current Liabilities	**74.1**	**104.8**	**117.8**	**124.6**	**132.2**
Borrowings (non-current)	0.0	0.0	0.0	0.0	0.0
Other non-current liabilities	9.7	3.4	3.4	3.4	3.4
Non-current liabilities	**9.7**	**3.4**	**3.4**	**3.4**	**3.4**
Shareholders equity	251.4	174.0	177.6	184.3	195.4
Non-controlling interests	3.5	1.8	1.4	1.0	0.5
Total Equity	**254.8**	**175.8**	**179.0**	**185.3**	**195.9**
Total Liabilities and Equity	**338.6**	**283.9**	**300.2**	**313.3**	**331.6**
CASH FLOW STATEMENT (US$m)	**2016**	**2017**	**2018F**	**2019F**	**2020F**
Net income before tax	27.7	(37.4)	23.6	27.7	33.5
Depreciation & non cash adjustments	18.7	24.3	13.5	13.9	14.4
Change in Working Capital	18.9	(6.5)	(0.4)	(6.7)	(7.1)
Income Tax Paid	(6.2)	(2.6)	(2.1)	(6.1)	(7.2)
Interest Paid	(0.7)	(0.8)	(1.0)	(1.1)	(1.1)
CF from operating activities	**58.4**	**(23.0)**	**33.5**	**27.7**	**32.5**
Purchase/Disposal of PPE	(7.5)	(8.3)	(8.0)	(8.0)	(8.0)
Other CFI	(14.4)	(8.5)	0.0	0.0	0.0
CF from investing activities	**(28.3)**	**(10.5)**	**(8.0)**	**(8.0)**	**(8.0)**
Dividends Paid	(14.2)	(14.2)	(14.2)	(14.2)	(14.2)
Debt Raised / (Repaid)	0.0	0.0	19.4	3.0	3.2
Equity Raised / (Bought Back)	0.0	0.0	0.0	0.0	0.0
Other Cash from Financing	0.0	0.0	0.0	0.0	0.0
CF from financing activities	**(49.2)**	**(3.8)**	**5.2**	**(11.1)**	**(11.0)**
Net increase in cash & cash equiv.	(18.9)	(43.9)	24.2	2.0	7.0
FX effects	0.2	(6.6)	(6.6)	(6.6)	(6.6)
Beginning Cash	109.7	90.8	46.9	71.1	73.1
Ending Cash	**90.8**	**46.9**	**71.1**	**73.1**	**80.1**

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

Disclaimer

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities. This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. You should independently evaluate particular investments and consult an independent financial adviser before dealing in any securities mentioned in this report.

This report is confidential. This report may not be published, circulated, reproduced or distributed and/or redistributed in whole or in part by any recipient of this report to any other person without the prior written consent of KGI Securities. This report is not intended for distribution and/or redistribution, publication to or use by any person in any jurisdiction outside Singapore or any other jurisdiction as KGI Securities may determine in its absolute discretion, where the distribution, publication or use of this report would be contrary to applicable law or would subject KGI Securities and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by KGI Securities to be reliable. However, KGI Securities makes no representation as to the accuracy or completeness of such sources or the Information and KGI Securities accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. KGI Securities and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of KGI Securities and its connected persons are subject to change without notice. KGI Securities reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) KGI Securities, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) KGI Securities, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; and (3) the officers, employees and representatives of KGI Securities may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business".)

However, as of the date of this report, neither KGI Securities nor its representative(s) who produced this report (each a "research analyst"), has any proprietary position or material interest in, and KGI Securities does not make any market in, the securities which are recommended in this report.

Each research analyst of KGI Securities who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of KGI Securities or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including KGI Securities' total revenues, a portion of which are generated from KGI Securities' business of dealing in securities.