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## **Independent auditors' report**

Members of the Company  
Singapore Technologies Engineering Ltd

### **Report on the financial statements**

#### *Opinion*

We have audited the accompanying financial statements of Singapore Technologies Engineering Ltd (the Company) and its subsidiaries (the Group), which comprise the balance sheets of the Group and the Company as at 31 December 2016, the statement of changes in equity of the Group and Company, the consolidated income statement, the consolidated statement of comprehensive income and the consolidated statement of cash flows of the Group for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, as set out on pages 24 to 142.

In our opinion, the accompanying consolidated financial statements of the Group and the balance sheet and statement of changes in equity of the Company are properly drawn up in accordance with the provisions of the Singapore Companies Act, Chapter 50 (the Act) and Financial Reporting Standards in Singapore (FRSs) so as to give a true and fair view of the financial position of the Group and Company as at 31 December 2016, and changes in equity of the Group and Company and the financial performance and cash flows of the Group for the year ended on that date.

#### *Basis for opinion*

We conducted our audit in accordance with Singapore Standards on Auditing (SSAs). Our responsibilities under those standards are further described in the '*Auditor's responsibilities for the audit of the financial statements*' section of our report. We are independent of the Group in accordance with the Accounting and Corporate Regulatory Authority *Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities* (ACRA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Singapore, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the ACRA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### *Key audit matters*

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.



THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
<p><b><i>Impairment of non-financial assets, including goodwill and other intangible assets</i></b>  <i>Refer to Note 3.17(i) – Key sources of estimation uncertainty: Expected future cash flows and discount rates and Note 16 – Intangible assets of S\$1,019.6 million.</i></p> <p>Goodwill and intangible assets form 12% of the Group's total assets. There is a risk of impairment due to the uncertain economic conditions in specific markets that the Group operates in, which increases the level of judgement and estimation uncertainties within management's cash flow forecast.</p> <p>The Group uses the discounted cash flow technique to determine the recoverable amounts of each cash-generating units ("CGU") and based on management's assessment, an impairment loss of \$3.4 million was recognised in respect of one CGU during the year.</p>	<p>Our procedures included, among others:</p> <ul style="list-style-type: none"> <li>• We evaluated the identification of CGUs within the Group against the requirements of the accounting standards.</li> <li>• We reviewed the basis and methodology adopted to arrive at the recoverable amounts of the CGUs.</li> <li>• We assessed the key assumptions used in the cash flow projections, namely sales growth rates, earnings before interest, depreciation and amortisation ("EBIDA") growth rates, discount rates, terminal growth rates by comparing the Group's assumptions to externally derived data where available.</li> <li>• We reviewed the historical accuracy of the Group's estimates in the previous periods, identification and analysis of changes in the assumptions from prior periods, focusing particularly on those CGUs where cash flow projections are sensitive to changes in key assumptions and/or are operating in challenging economic conditions.</li> <li>• We have also assessed the adequacy of related disclosures in Note 16 to the financial statements.</li> </ul>



THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
<p><b>Impairment of non-financial assets, including goodwill and other intangible assets (cont'd)</b></p>	<p><b>Findings:</b></p> <p>We found that the assumptions and resulting estimates used in the discounted cash flow projections for all the CGUs were within acceptable range, except for a CGU in the United States, which includes growth estimates that exceeded historical performance. In this instance, we have re-computed the recoverable amount using reduced growth estimates and we agree with management that no impairment charge is required for this CGU.</p> <p>Overall, the results of our evaluation of the Group's impairment charge are consistent with management assessment.</p> <p>We found the Group's disclosure provides sufficient details on the sensitivity of the impairment charge to variations in key assumptions.</p>
<p><b>Impairment of property, plant and equipment – Roll-on/Roll-off Passenger ferry ("ROPAX")</b></p> <p>Refer to Note 3.17(i) – Key sources of estimation uncertainty: Expected future cash flows and discount rates and Note 12 – Property, plant and equipment of S\$1,670.1 million.</p> <p>The carrying amount of a ROPAX vessel, which was chartered out on a short term operating lease, representing a significant balance within the boats and barges class of property, plant and equipment.</p>	<p>Our procedures included, amongst others:</p> <ul style="list-style-type: none"> <li>• We assessed the factors relevant to the likelihood of the outcome of each scenario.</li> <li>• We considered two other possible scenarios that could happen and computed the recoverable amount after incorporating the additional scenarios and compared to the carrying amount of the ROPAX.</li> <li>• We evaluated the key assumptions used in the review, particularly charter rates by comparing to the rates used in existing lease arrangement and externally derived data where available.</li> <li>• We compared the discount rate used by management to our calculations based on market data.</li> </ul>



THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
<p><b><i>Impairment of property, plant and equipment – Roll-on/Roll-off Passenger ferry (“ROPAX”) (cont’d)</i></b></p> <p>ST Marine (“STM”) was awarded a contract to design and build the ROPAX vessel in 2007. The contract was subsequently terminated in 2011, resulting in STM taking title of the vessel. Since the repossession of the vessel, management has tried to realise the value of the vessel through sale and charter. Limited market demand for such a vessel led to difficulties in selling or chartering the vessel out on a long term basis, resulting in write downs on the carrying value of the ROPAX between 2011 and 2013, to reflect its net realisable value. Since then, the ROPAX has been put to use through short term chartering arrangements. The vessel is currently under a charter to provide ferry services between Spain and Morocco for a two-year period beginning January 2016.</p> <p>The Group evaluated the recoverable amount of the ROPAX using the discounted cash flow (“DCF”) technique across two scenarios where the ROPAX is chartered or disposed, weighted based on likelihood of outcomes to derive at a recoverable amount for the ROPAX.</p> <p>There are inherent uncertainties involved in estimating the recoverable amount of the ROPAX as it is dependent on the current economic conditions and whether the carrying amount can be realised through future sale or other chartering arrangements.</p>	<p><b>Findings:</b></p> <p>The results of our evaluation of the valuation of the ROPAX are consistent with management assessment that no further impairment charge is required. Nonetheless uncertainties remain in the future over the probability of securing longer term chartering arrangements or selling the vessel, that may change the estimated recoverable amount of ROPAX.</p>



THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
<p><b>Revenue recognition</b>  <i>Refer to Note 3.17(i) – Key sources of estimation uncertainty: Revenue recognition and Note 5– Revenue of S\$6,683.7 million.</i></p> <p>The Group's three largest revenue streams are derived from the sale of goods, rendering of services and long term contract revenues.</p> <p>Some of these revenue streams have contracts that account for revenue and profit based on the stage of completion of individual contracts. The amount of revenue and profit recognised is dependent on management's assessment on the stage of completion and the forecast cost profile of each long term contract. As long-term contracts can extend over multiple years, changes in conditions and circumstances over time can result in variations to the original contract terms, including cost overruns which may require further negotiation and settlements resulting in penalties and provisions for losses.</p> <p>Significant judgement is applied in forecasting the costs to be incurred, the overall margins of these contracts and assessment on the stage of completion. Such estimates are inherently judgemental.</p>	<p>Our procedures included, amongst others:</p> <ul style="list-style-type: none"> <li>• We tested the controls designed and applied by the Group to ensure that the estimates used in assessing revenue and costs are appropriate. The controls tested include, amongst others, controls over the preparation and authorisation of project evaluation, approval of revenue calculated and project costing, and accuracy and completeness over manpower and labour rates computed.</li> <li>• We selected a sample of contracts for testing based on a number of qualitative and quantitative factors, such as contracts with significant deterioration in margin, those contracts with variations, claims and other factors which indicated that a greater level of judgement is required in the estimates developed for current and forecast contract performance.</li> <li>• For each selected contracts, we assessed the appropriateness of estimates used in the forecasts and whether the estimates showed any evidence of management bias.</li> <li>• We reviewed the contractual terms and work status of the customer contracts and verified that revenue is recognised according to the stage of completion of each project.</li> </ul>



THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
<b>Revenue recognition (cont'd)</b>	<p><b>Findings:</b></p> <p>As a practical expedient, the Group recognised revenue for certain short term maintenance, repair and overhaul ("MRO") services below a certain threshold upon the completion of the service contract, instead of by reference to the stage of completion. Management assessed and quantified the impact on an annual basis and concluded that the resultant effect on the Group's financial statements was immaterial. We have reviewed management's quantification and agree that the effect was immaterial.</p> <p>We found that the actual results at completion of certain ship building contracts in the US that adopted first of class designs tend to be lower than the initial margins estimated at the inception of the contract. The changes in margins were due to revision in the quantity of materials calculated and the corresponding labour hours required as the design and engineering matures. We found that the estimates used to derive the revised margins were fair.</p> <p>For the other long term contracts of the Group, we found that the estimates used to derive budgeted margins were fair except for some projects where the actual profit margins at completion of the contracts tend to be marginally higher compared to the estimated margins used for profit recognition at various stages of completion.</p>



THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
<p><b>Net realisable value of inventories and work-in-progress</b>  Refer to Note 3.17 (i) – Key sources of estimation uncertainty: Allowance for inventory obsolescence and write down of finished goods to net realisable value ("NRV") and Note 19 – Inventories and work-in-progress of S\$1,898.3 million.</p> <p>There are judgement and estimates used in the valuation of the Group's inventories and work-in-progress.</p> <p>In particular, the Group holds significant amount of aircraft components for trading purposes which are slow moving. Due to the weak economic environment, resulting in a slower demand for aircraft components, there is a risk that the estimates of net realisable values exceed future selling prices, resulting in losses when the inventories are sold. Based on independent valuation reports, the Group recorded write downs of the carrying amount of the aircraft components in 2014 and 2015.</p>	<p><u>Valuation of aircraft components</u></p> <p><u>Our procedures included, amongst others:</u></p> <ul style="list-style-type: none"> <li>• We analysed the historical sales transactions and orders for future sales, and compared them to inventory levels.</li> <li>• We compared the remaining useful lives of the aircraft components to the projected remaining economic life of the respective aircraft types relating to the component pool.</li> <li>• We compared the written down values of the aircraft components to recent sale transactions and industry trends.</li> <li>• We evaluated the competence, capabilities and objectivity of the external valuer. We considered the limitations that impact the value attributed to individual component by understanding the valuation basis and assessed the historical transacted prices used to estimate the value of the components.</li> </ul> <p><b>Findings:</b></p> <p>We found that management's assessment to evaluate inventories at the lower of cost or net realisable value as at 31 December 2016 and the valuation methodologies used by the independent valuers to be fair. However, there remains volatility in the components trading market that may impact the realisation of the value of inventories in the future.</p>



THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
<p><b>Net realisable value of inventories and work-in-progress (cont'd)</b></p> <p>The recoverability of work-in-progress is assessed based on management's judgement and estimates on costs to complete these long term contracts, and the respective stage of completion.</p>	
<p><b>Acquisition of Elbe Flugzeugwerke GmbH</b> <i>Refer to Note 4 – Acquisition of controlling interests in Elbe Flugzeugwerke GmbH (EFW)</i></p> <p>On 1 January 2016, the Group increased its equity stake in EFW from 35% to 55%.</p> <p>Assessing whether the Group controls EFW is a critical accounting judgement. The rights of the Group are encapsulated in the shareholders' agreement and assessing whether the Group's rights are sufficient to give it control over EFW requires detailed consideration of the relevant provisions and a commercial assessment of which rights are more important.</p> <p>It was determined that control was obtained on the date of acquisition.</p> <p>There is also judgement and estimates used in determining the value of the purchase price, which comprised the cost of developing intellectual property ("IP") on A320 passenger to freighter ("PTF") conversion technology.</p>	<p><u>Recoverability of work-in-progress</u></p> <p><u>Our procedures included, amongst others:</u></p> <ul style="list-style-type: none"> <li>• We evaluated significant and long-outstanding work-in-progress accounts and assessed the Group's ability to complete contracts within budgeted margins by assessing management's underlying estimates and assumptions on forecasted margins and the relationship of cost versus billing status on contracts.</li> </ul> <p><b>Findings:</b></p> <p>Overall, our assessment is that the assumptions and resulting estimates used in determining the work-in-progress amounts were fair.</p> <p><u>Our procedures included, amongst others:</u></p> <ul style="list-style-type: none"> <li>• Reviewed the shareholders' agreement for the rights of the respective shareholders and the key matters that require voting by majority shareholders and other matters which require unanimous agreement.</li> <li>• Compared the methodologies and key assumptions used in deriving the allocated values to the components of the purchase price to generally accepted market practices and market data.</li> <li>• Evaluated the appropriateness of using cost of developing the A320 PTF conversion technology as a proxy to fair value.</li> </ul>





THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
<b>Acquisition of Elbe Flugzeugwerke GmbH (cont'd)</b>	
	<p><b>Findings:</b></p> <p>We found the Group's assessment of EFW being a controlled subsidiary is supported by key terms in the shareholders' agreement that provides the Group with the power to make key operating and capital decisions of EFW.</p> <p>We also found that the estimates used in determining the value of the to-be-developed IP on A320 PTF conversion technology and the resulting estimates used to determine the allocated values to the purchase price were fair.</p>
<b>Liquidation of Jiangsu Huatong Kinetics and Jiangsu Huaran Kinetics</b> Refer to Note 4 – Liquidation of JHK	
<p>Jiangsu Huatong Kinetics Co., Ltd and Jiangsu Huaran Kinetics Co., Ltd (collectively known as "JHK"), subsidiaries of the Land Systems Sector, continued to incur operating losses and are not expected to have adequate financial resources to continue their operations.</p> <p>On 18 October 2016, the Group announced that they have started the process to cease the production activities of JHK in order to reduce its operating losses. On this basis, the Group recognised a one-off charge of S\$61.1 million (net of non-controlling interest), comprising impairment losses on the carrying amounts of JHK's underlying assets and goodwill and a provision relating to the closure costs.</p>	<p>Our procedures included, amongst others:</p> <ul style="list-style-type: none"> <li>• We obtained relevant information, including recent market announcement made by the Group, and studied this information to obtain an understanding of the financial position and capital needs of JHK.</li> <li>• We read the Board papers supporting the proposals by management to cease production of JHK and subsequently to place JHK in members' voluntary liquidation.</li> <li>• We assessed the methods and assumptions used by management, in their estimation of the recoverable amounts of significant underlying assets including (i) the fair value less cost to sell of plant and equipment; (ii) the net realisable value of inventory; (iii) the recoverability of trade and other receivable balances, and the consequent impact of the cessation of production on these realisable values.</li> </ul>



THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
<p><b>Liquidation of Jiangsu Huatong Kinetics and Jiangsu Huaran Kinetics (cont'd)</b></p> <p>On 14 December 2016, JHK companies have been placed under members' voluntary liquidation.</p> <p>The recognition of impairment losses and closure costs involves significant judgement and estimates.</p>	
<p><b>Provision for warranties</b></p> <p>Refer to Note 3.17 (i) – Key sources of estimation uncertainty: Provision for warranties and Note 26 – Provision for warranties of S\$200.4 million.</p> <p>Warranties are provided as stipulated under each sale contract. Such specific provisions are assessed and decided by project managers based on their experience of the likelihood of claims and risks arising from contracts covered by warranty.</p> <p>For contracts that do not specifically indicate any warranty provision, warranties are provided based on a percentage of sales.</p> <p>Determining the amount of both specific and general warranties involves judgement and estimates.</p>	<ul style="list-style-type: none"> <li>• We assessed assumptions and estimates used by management in their estimation of the provision for closure costs, taking into account the legal or constructive obligations of JHK in the local jurisdiction, and other supporting information.</li> <li>• We considered the adequacy of the Group's disclosures in relation to the impairment charge recognised on the respective assets of JHK.</li> </ul> <p><b>Findings:</b></p> <p>We found that the estimates used in determining the recoverable amounts of JHK's underlying assets and provision for closure costs to be appropriate based on the information available to date, noting nonetheless that continuing developments in the future may result in changes of the estimates used in determining the impairment losses of JHK and the provision for closure costs.</p> <p><u>Our procedures included, amongst others:</u></p> <ul style="list-style-type: none"> <li>• We assessed the key assumptions applied in determining the Group's provision amount for warranties. This included a comparison of the provision for warranties to the historical amounts being utilised, to determine whether the Group's estimation techniques were reasonable.</li> </ul> <p><b>Findings:</b></p> <p>Based on our procedures, we found that the Group's provision falls within the upper range of the potential claims assessed by management.</p>



*Other information*

Management is responsible for the other information. The other information comprises Financial Highlights, Letter to Shareholders, Board of Directors, Senior Management, Operating & Financial Review, Investor Relations, Awards, Corporate Information, Sustainability Report, Corporate Governance, Directors' Statement, SGX Listing Manual Requirements, and Sectoral Financial Review which we obtained prior to the date of this auditors' report, and the Shareholding Statistics which is expected to be made available to us after that date.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditors' report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

When we read the Shareholding Statistics, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance and take appropriate actions in accordance with SSAs.

*Responsibilities of management and directors for the financial statements*

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with the provisions of the Act and FRSs, and for devising and maintaining a system of internal accounting controls sufficient to provide a reasonable assurance that assets are safeguarded against loss from unauthorised use or disposition; and transactions are properly authorised and that they are recorded as necessary to permit the preparation of true and fair financial statements and to maintain accountability of assets.

In preparing the financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

The directors' responsibilities include overseeing the Group's financial reporting process.

*Auditors' responsibilities for the audit of the financial statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.



As part of an audit in accordance with SSAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the directors, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.



**Singapore Technologies Engineering Ltd and its subsidiaries**  
*Independent auditors' report*  
Year ended 31 December 2016

**Report on other legal and regulatory requirements**

In our opinion, the accounting and other records required by the Act to be kept by the Company and by those subsidiary corporations incorporated in Singapore of which we are the auditors have been properly kept in accordance with the provisions of the Act.

The engagement partner on the audit resulting in this independent auditors' report is Ang Fung Fung.

*KPMG LLP*

**KPMG LLP**  
*Public Accountants and  
Chartered Accountants*

**Singapore**  
15 February 2017