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Independent auditors' report

Members of the Company
Singapore Technologies Engineering Ltd

Report on the audit of 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 2017, 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 21 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 2017, 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
<i>Impairment of non-financial assets, including goodwill and other intangible assets</i>	
<p>Goodwill and intangible assets form 13% of the Group's total assets.</p> <p>The Group uses the discounted cash flow technique to determine the recoverable amounts of each cash-generating unit ("CGU").</p> <p>There is a risk of impairment of certain CGUs in United States which are operating in challenging business environment. This increases the level of judgement and estimation uncertainties within management's cash flow forecast.</p>	<p>Our procedures included, among others:</p> <ul style="list-style-type: none"> • We evaluated the identification of CGUs within the Group against the requirements of the accounting standards. • We reviewed the basis and methodology adopted to arrive at the recoverable amounts of the CGUs. • 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. • We reviewed the historical accuracy of the Group's estimates in the previous periods, identified and analysed changes in the assumptions from prior periods, focusing particularly on those CGUs operating in challenging business environment. • We have also assessed the adequacy of related disclosures in Note 15 to the financial statements.



THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
<i>Impairment of non-financial assets, including goodwill and other intangible assets (cont'd)</i>	<p>Findings:</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 2 CGUs in the United States, which includes growth estimates that exceeded historical performance. In these instances, we have re-computed the recoverable amount using reduced growth estimates and we agree with management that no impairment charge is required for these CGUs.</p> <p>Overall, the results of our evaluation of the Group's impairment charge are consistent with management's assessment.</p> <p>We found the Group's disclosure provides sufficient details on the sensitivity of the impairment assessment to variations in key assumptions.</p>
<i>Impairment of property, plant and equipment – Roll-on/Roll-off Passenger ferry ("ROPAX")</i>	<p>The carrying amount of a ROPAX vessel, which is chartered out on a short term operating lease, representing a significant balance within the boats and barges class of property, plant and equipment may exceed its recoverable amount.</p> <p>Our procedures included, amongst others:</p> <ul style="list-style-type: none"> • We assessed the factors relevant to the likelihood of the outcome of each scenario. • We considered two other possible leasing scenarios that could happen and computed the recoverable amount after incorporating the additional scenarios and compared to the carrying amount of the ROPAX. • We evaluated the key assumptions used in the review, particularly charter rates by comparing to the rates used in the existing lease arrangement and externally derived data where available. • We compared the discount rate used by management to our calculations based on market data.



THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
<i>Impairment of property, plant and equipment – Roll-on/Roll-off Passenger ferry ("ROPAX") (cont'd)</i>	
<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 of 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>Findings:</p> <p>The results of our evaluation of the valuation of the ROPAX are consistent with management's assessment that no further impairment charge is required. Nonetheless, uncertainties remain over the probability of securing longer term chartering arrangements or selling the vessel that may change the estimated recoverable amount.</p>



THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
Revenue recognition	
<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 are accounted for based on the stage of completion of each individual contract. 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 changes in the nature or extent of project cost incurred. In addition, variations to the original contract terms, including cost overruns may require further negotiations and settlements resulting in penalties and provisions for losses.</p> <p>Judgement is applied in forecasting the costs to be incurred, the overall margins of these contracts and assessment of the stage of completion. Such estimates are inherently judgemental.</p>	<p>Our procedures included, amongst others:</p> <ul style="list-style-type: none"> • We evaluated the revenue recognition policies of the Group for the different revenue streams to ensure revenue is recognised appropriately. • 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 budgets, and accuracy and completeness over manpower and labour rates computed. • 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 judgement is required in the estimates developed for current and forecast contract performance. • For each selected contract, we assessed the appropriateness of estimates used in the forecasts and whether the estimates showed any evidence of management bias. • 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.



THE KEY AUDIT MATTER	HOW WAS THE MATTER ADDRESSED IN OUR AUDIT
Revenue recognition (cont'd)	
	<p>Findings:</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 contracts. The changes in margins were due to revisions 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
Net realisable value of inventories	
<p>There are judgement and estimates used in the valuation of the Group's inventories.</p> <p>In particular, the Group holds a 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>In 2016, the Group revised its inventory obsolescence policy for components related to younger fleet to better reflect the obsolescence rate based on industry data and trends. The policy was assessed to remain appropriate in FY2017.</p>	<p><u>Our procedures included, amongst others:</u></p> <ul style="list-style-type: none"> • We evaluated management's basis of deriving the obsolescence policy by considering the current economic conditions and industry trends. • We analysed the historical sales transactions and orders for future sales, and compared them to inventory levels. • 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. <p>Findings:</p> <p>We found that management's assessment to evaluate inventories at the lower of cost or net realisable value as at 31 December 2017 and the assumptions made by management on the valuation of aircraft components 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
<i>Provision for warranties</i>	
<p>Warranties are provided as stipulated under each sales 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>	<p><u>Our procedures included, amongst others:</u></p> <ul style="list-style-type: none"> • 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. <p>Findings:</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 contained in the annual report. Other information is defined as all information in the annual report other than the financial statements and our auditors' report thereon.

We have obtained all other information prior to the date of this auditors' report except for 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 and will 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 identified above 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 controls.
- Obtain an understanding of internal controls 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 controls.
- 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 the law or regulations preclude 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.

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 Quek Shu Ping.

A handwritten signature in black ink, appearing to be 'Quek Shu Ping', written over the KPMG logo.

KPMG LLP
*Public Accountants and
Chartered Accountants*

Singapore
22 February 2018