News Release

# Statement on S&P Global Ratings' Announcement

***Singapore, 23 March 2022*** – Singapore Technologies Engineering Ltd (ST Engineering) refers to the announcement by S&P Global Ratings dated 23 March 2022 (as attached).

Following ST Engineering's announcement on 3 October 2021 on the proposed acquisition of TransCore Partners, LLC and TLP Holdings, LLC (collectively "TransCore") to be funded with additional debt, S&P placed ST Engineering's AAA credit rating on CreditWatch with negative implications in its article published on 7 October 2021.

With the closing of the TransCore acquisition announced on 18 March 2022, S&P concluded its review and announced that ST Engineering's credit rating is downgraded to AA+/Stable (high investment grade).

ST Engineering's credit rating by Moody's is currently Aaa (negative outlook).

*****

**ST Engineering** is a global technology, defence and engineering group with a diverse portfolio of businesses across the aerospace, smart city, defence and public security segments. The Group harnesses technology and innovation to solve real-world problems, enabling a more secure and sustainable world. Headquartered in Singapore, it has operations spanning across Asia, Europe, the Middle East and the U.S., serving customers in more than 100 countries. ST Engineering reported revenue of $7.7b in FY2021 and ranks among the largest companies listed on the Singapore Exchange. It is a component stock of the FTSE Straits Times Index, MSCI Singapore, iEdge SG ESG Transparency Index and iEdge SG ESG Leaders Index.

Media contact: Lina Poa
Group Head Corporate Communications & Investor Relations
ST Engineering
Tel: (65) 6722 1818
Email: linapoa@stengg.com

Research Update:

# ST Engineering Downgraded To 'AA+' On Elevated Leverage Post-Acquisition Of TransCore; Outlook Stable

**March 23, 2022**

PRIMARY CREDIT ANALYST

**Pauline Tang**
Singapore
+ 6562396390
pauline.tang
@spglobal.com

SECONDARY CONTACT

**Minh Hoang**
Singapore
+ 65 6216 1130
minh.hoang
@spglobal.com

## Rating Action Overview

- Aerospace and defense contractor Singapore Technologies Engineering Ltd. (ST Engineering) recently completed its acquisition of TransCore Partners LLC and TLP Holdings LLC (collectively TransCore), a U.S.-based toll collection solutions provider.
- The Singapore dollar (S$) 3.6 billion debt-funded acquisition will substantially increase ST Engineering's debt-to-EBITDA ratio to about 4.0x in 2022, while business synergies from TransCore will take some time to materialize.
- We are lowering our issuer credit rating on ST Engineering to 'AA+' from 'AAA'. We are also lowering our issue ratings on the company's US$750 million senior unsecured notes and S$5.0 billion multicurrency medium-term note (MTN) program to 'AA+'. At the same time, we removed the ratings from CreditWatch, where we had placed them with negative implications on Oct. 7, 2021. We also affirmed our 'A-1+' short-term issue ratings on the company's U.S. commercial paper program.
- The stable outlook on ST Engineering reflects our view that the company will generate steady cash flow from its existing and newly acquired businesses and maintain its dominant and critical role in Singapore's defense industry.

## Rating Action Rationale

**We downgraded ST Engineering given the company's growth appetite will keep its debt level elevated for at least the next two to three years.** The lowering of the issuer credit rating follows our revision of the company's stand-alone credit profile (SACP) to 'bbb+' from 'aa-'. This reflects our view of a more aggressive financial policy and its growth-orientated business strategy.

Our issuer credit rating of 'AA+' on ST Engineering incorporates a six-notch uplift from the company's SACP of 'bbb+'. This continues to reflect our view of an extremely high likelihood of extraordinary support to ST Engineering from the government of Singapore through Temasek

Holdings (Private) Ltd.

**Following the TransCore transaction, our view of ST Engineering's stand-alone creditworthiness has been significantly weakened by a notable increase in the company's leverage tolerance.** Although the acquisition of TransCore will immediately be cash flow accretive, the S$3.6 billion debt-funded acquisition will almost triple ST Engineering's debt to S$5.3 billion in 2022 from S$2.1 billion as of Dec. 31, 2021. We forecast ST Engineering's debt-to-EBITDA ratio will increase to about 4.0x in 2022, improving to about 3.0x-3.5x thereafter.

The addition of TransCore to ST Engineering's portfolio will provide a new product offering in the smart mobility segment and provide some geographical diversification for ST Engineering. TransCore specializes in electronic toll collection systems, congestion pricing, intelligent transportation systems, and radio-frequency identification system--predominantly in the U.S., where ST Engineering does not have a similar presence. More robust business synergies and cross-selling opportunities between TransCore and ST Engineering will provide the potential for higher earnings.

Nevertheless, we believe the benefits from potential business synergies will take some time to materialize. Compared with rated aerospace and defense peers, ST Engineering's size and product offering constrain the company's creditworthiness. In our view, the company's ability to bid for sizable overseas contracts is limited in the absence of a comprehensive enough suite of products to be able to provide full in-house manufacturing and engineering. Recently won contracts in shipbuilding projects with the U.S. Navy and the U.S. Coast Guard indicate the company's growing readiness to compete offshore, but it will take some time for ST Engineering to build its expertise and recognition to match those of sizable peers.

**In our view, the company's commercially oriented growth strategies signal a step-change in growth appetite.** The company has become more growth-orientated since its acquisitions in nacelle manufacturing and satellite communication in 2019, which increased its debt-to-EBITDA ratio to close to 2.0x from below 1.0x the year before. ST Engineering has been increasingly keen to pursue both domestic and overseas opportunities in various businesses through joint ventures and partnership. For example, ST Engineering announced in 2021 to join a joint venture with Temasek Holdings Ltd. to operate a freighter aircraft leasing business. We believe ST Engineering's growth-orientated strategy is likely to continue over the next two to three years.

**The slow recovery in the aviation industry is likely to hinder any meaningful deleveraging, and the company's sizable debt burden will weigh on its balance sheet over the next one to two years.** We believe earnings growth, rather than proactive debt reduction, is likely to facilitate any deleveraging plan. However, the pace of earnings growth is unlikely to offset debts incurred from the acquisition. TransCore's earnings contribution of S$200 million-S$250 million over the next one to two years pales in comparison to the S$3.6 billion of debt taken on to fund the acquisition.

ST Engineering reported a new record-high orderbook of S$19.3 billion for the period ending Dec. 31, 2021, however we expect revenue generation to be gradual and will span several years. We forecast EBITDA of S$1.3 billion-S$1.5 billion annually in 2022 and 2023, including contributions from TransCore. This represents annual growth of between 10%-20% from 2021.

**ST Engineering's relationship with the Singapore government remains intact given its critical role to Singapore's defense industry.** ST Engineering's commercially oriented expansion does not weaken its importance to the Singapore government, in our view. We also do not foresee the government of Singapore reducing its ownership, through Temasek Holdings (Private) Ltd., nor giving up its special share in ST Engineering.

In our view, ST Engineering will remain the country's primary defense contractor and provider of repair and maintenance services to air, land, and marine military equipment and infrastructure in Singapore. The sensitivity of information on national security will keep substitution risk low.

ST Engineering's know-how and expertise from commercial businesses are transferable to the company's defense product and service offerings. Further, ST Engineering's orderbook enjoys greater diversity, with commercial contracts typically being awarded with shorter lead time and investment as compared to government projects.

## Outlook

The stable outlook reflects our expectation that ST Engineering will generate steady cash flow from its existing and newly acquired businesses and maintain its dominant and critical role in Singapore's defense industry. The outlook also reflects our view that the company will adjust spending, if necessary, so that it can absorb potential adverse impacts stemming from slow economic recovery and intense competition overseas.

### Downside scenario

We could lower the issuer credit rating on ST Engineering if any of the following scenarios occur:

- We lower our sovereign credit rating on Singapore (AAA/Stable/--).
- We believe the likelihood of extraordinary government support to the company has fallen. This could happen if the Ministry for Finance converts its special share to an ordinary share.
- ST Engineering's 'bbb+' SACP weakens by more than three notches.

We could lower ST Engineering's SACP to 'bbb' from 'bbb+' if the company's growth appetite leads to elevated capital and investment spending or if there is an earnings or margin erosion due to stiff competition and unfavorable economic conditions. This could be reflected by ST Engineering's ratio of debt-to-EBITDA approaching 4.0x without any prospect of recovery.

### Upside scenario

An upgrade would require either a perceived strengthening in ST Engineering's link to the government, or an increase in the company's SACP to 'aa-', both of which we see as unlikely.

## Company Description

Singapore-based ST Engineering was formed through the amalgamation of a number of engineering-related companies in 1997. The companies provide integrated defense and engineering services for both the Singapore government and other customers globally. As of Dec. 31, 2021, the commercial aerospace segment accounted for 32% of sales. The defense and public security segment contributed to 52.5% of total sales, and the urban solutions and satellite communication business contributed to the remaining 15.5% of sales. Temasek holds 51.5% stakes in ST Engineering.

## Our Base-Case Scenario

We forecast ST Engineering's EBITDA to be S$1.3 billion-S$1.5 billion annually in 2022 and 2023, including contributions from TransCore. ST Engineering's earnings from the commercial aerospace segment have yet to resume to pre-COVID levels. Although passenger-to-freight aircraft conversion services partially mitigated the effects from low international air traffic in the past two years, ST Engineering's maintenance, repair, and operations business is still trailing a recovery in passenger-to-freight business.

In addition, ST Engineering's urban solutions and satellite communication business will likely see 2%-2.5% annual growth over the next one to two years, in our view. The company's strong orderbook in urban solutions and satellite communication business will mitigate the impact from policymakers being more cautious in pursuing infrastructure investment amid the fragile economic recovery.

### Assumptions

- Asia-Pacific GDP growth to be 6.7% in 2021. GDP to grow by 5.2% in 2022 and 4.6% in 2023. Singapore GDP growth to be 3.6% in 2022, 2.9% in 2023, and 3.3% in 2024.
- Singapore's economic growth implies steady defense spending, which will likely back ST Engineering's revenues from the Singapore government. Steady GDP growth in other countries will accelerate government spending on large infrastructure or Smart City-related projects, providing some growth prospects to ST Engineering.
- The aviation industry should resume to pre-pandemic levels in early 2024. Fresh lockdowns and resurgences of COVID-19 cases in some countries due to mutations of the coronavirus could stall a full recovery in the aviation industry. ST Engineering's passenger-to-freight conversion services, which remain robust due to high e-commerce activities, could partially offset the slow recovery in the aviation industry.
- ST Engineering's revenue growth of about 15% in 2022 due to contribution from TransCore. Annual revenue growth will normalize to 4%-5% annually from 2023.
- EBITDA margin of 14%-16% underpinned by existing contracts and TransCore's high-margin operations.
- ST Engineering's capital expenditure to be S$350 million-S$380 million through 2024.
- Acquisition debt of S$3.6 billion in 2022.
- Dividend payment of around S$490 million-S$500 million in 2022-2024. The company plans to pay 16 cents per share in 2022.
- We do not assume any additional material acquisitions.

### Key metrics

Based on the above assumptions, we have arrived at the following key metrics.

- Adjusted EBITDA of about S$1.3. billion in 2022 and S$1.5 billion-S$1.6 billion in 2023-2024.
- Debt-to-EBITDA ratio of about 4.0x in 2022, and 3.0x-3.5x in 2023-2024.

- EBITDA coverage ratio of about 16.0x in 2022, and 11.0x-13.0x in 2023-2024.

## Liquidity

We assess ST Engineering's liquidity as adequate, with the company's sources of liquidity likely to exceed its uses by about 1.2x over the next 12 months. We expect liquidity sources to be positive even if EBITDA contracts by 15%.

The company has a well-established presence in capital markets and solid relationships with banks, which will facilitate additional funding in time of need. ST Engineering also has US$3.0 billion in committed revolving facilities to provide additional liquidity, if needed. The facility includes a one-year extension option actionable at the company's discretion. To that extent, we consider this facility as having an effective maturity of two years. We expect the company will renew the back-up facility on a timely basis to maintain maturity of the instrument beyond 12 months at all times.

Our assessment of the company's liquidity over the next 12 months considers the following sources and uses as of Dec. 31, 2021:

Principal Liquidity Sources:

- Cash and cash equivalents of S$815.9 million;
- Committed revolving facilities of US$3.0 billion;
- Cash funds from operations of S$1.0 billion-S$1.1 billion; and
- Up to US$3.0 billion proceeds of the U.S. commercial paper issuance.

Principal Liquidity Uses:

- Short-term debt of S$559.9 million maturing within the next 12 months;
- Capital expenditure of up to S$380 million;
- TransCore acquisition expenses of S$3.6 billion; and
- Dividends of about S$490 million.

## Issue Ratings - Subordination Risk Analysis

### Capital structure

As of Dec. 31, 2021, ST Engineering reported S$2.1 billion in borrowings and lease obligations.

ST Engineering guarantees a US$750 million senior unsecured notes, with a five-year maturity and 1.5% coupon rate. The bond was issued by ST Engineering RHQ Ltd., a wholly owned subsidiary. The bond was issued under a S$5.0 billion multicurrency medium-term note program.

ST Engineering also guarantees a commercial paper (CP) program issued by its wholly owned U.S.-headquartered ST Engineering North America. The company upsized its CP program to US$3.0 billion on Dec. 22, 2021, and plans to utilize the program to fund the TransCore acquisition. As of Dec. 31, 2021, outstanding commercial paper amounted to about US$260 million.

### Analytical conclusions

We equalize our issue rating on the US$750 million senior unsecured notes with the issuer credit rating on ST Engineering. ST Engineering RHQ, the issuer of the notes, is a holding company for ST Engineering's businesses in Europe. To our knowledge, there is no other debt below ST Engineering RHQ; the priority debt ratio is therefore nil.

We also equalize our issue rating on the CP program with the short-term issuer credit rating on ST Engineering.

ST Engineering fully, irrevocably, and unconditionally guarantees both the CP and bond.

## Ratings Score Snapshot

Issuer Credit Rating: AA+/Stable/--

Business risk: Strong

- Country risk: Low
- Industry risk: Intermediate
- Competitive position: Strong

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb+

- Related government rating: AAA
- Likelihood of government support: Extremely high (+6 notches from SACP)

## Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019

- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

## Ratings List

**Downgraded; CreditWatch/Outlook Action**

| | To | From |
|---|---|---|
| **Singapore Technologies Engineering Ltd.** | | |
| Issuer Credit Rating | AA+/Stable/-- | AAA/Watch Neg/-- |
| **ST Engineering RHQ Ltd.** | | |
| Senior Unsecured | AA+ | AAA/Watch Neg |
| **Ratings Affirmed** | | |
| **ST Engineering North America Inc** | | |
| Commercial Paper | A-1+ | |