

12 June 2019

Industrials | Machinery

Frencken Group (FRKN SP)

Buy (Maintained)

Robust Outlook Despite Trade War; Stay BUY

Target Price (Return) SGD0.82 (+30%)
 Price: SGD0.63
 Market Cap: USD195m
 Avg Daily Turnover (SGD/USD) 1.2m/0.9m

- **Stay BUY, SGD0.82 DCF-based TP**, 30% upside with 4.4% FY19F yield. Frencken has been unaffected by the US-China trade war, since most of its factories and business activities are in Europe. Management's outlook remains positive, and 2Q should see robust YOY growth for its industrial automation division, as well as continued expansion in the analytical and medical segments. We expect FY19F PATMI to surge 12.7% YoY. At 6.9x FY19F P/E (peer average: 9.9x), this stock is an undervalued gem.
- **Industrial automation still the key driver.** Sales at the industrial automation segment, which are typically lumpy, spiked up by 548.4% YoY in 4Q18 and 194.4% in 1Q19, boosted by increased orders for storage drive production equipment from a key customer that is setting up a new factory. Management expects to post robust YoY growth in 2Q19 due to the same reason. We expect these factors to continue driving sales in 2Q-3Q, which should be very positive for the company.
- **Management is also bullish on the outlook of its analytical and medical units**, which should record continued YoY growth in 2Q19. We expect the two businesses to expand YoY this year as well, driven by new customers and new projects.
- **Higher dividends expected.** With a 30% dividend payout ratio and our projection of continued YoY growth in earnings, we believe Frencken's dividends will increase even though its payout ratio remains unchanged. We expect FY19 dividend yield to increase to around 4.4%.
- **One of the rare manufacturing companies delivering growth in 2019.** We believe Frencken's technology, which has been making rapid advancements in recent years, will provide more solutions to customers and support future projects in terms of margins and profitability. The stock is trading at just 6.9x FY19 P/E, well below its peer average of 9.9x for FY19Fm with a 4.4% dividend yield for FY19F. As such, we believe Frencken is undervalued and will likely continue to rerate upwards, as earnings growth continues to pick up in subsequent quarters. It is also one of the rare manufacturing companies that will probably be delivering growth YoY in FY19. As a result, we maintain BUY with an unchanged DCF-backed TP of SGD0.82.
- **Key risks** include an economic slowdown, and customers delaying orders

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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	50.0	2.4	23.5	57.5	26.0
Relative	45.5	4.5	23.1	52.7	32.8
52-wk Price low/high (SGD)	0.37 - 0.68				



Source: Bloomberg

Forecasts and Valuations	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
Total turnover (SGDm)	515.1	625.8	677.8	694.3	702.8
Recurring net profit (SGDm)	23.0	33.9	38.2	39.5	40.3
Recurring net profit growth (%)	44.5	47.7	12.7	3.3	2.1
Recurring P/E (x)	11.6	7.8	6.9	6.7	6.6
P/BV (x)	1.1	1.0	0.9	0.8	0.8
P/CF (x)	6.3	7.6	3.9	3.7	3.6
Dividend Yield (%)	3.8	3.4	4.4	4.5	4.6
EV/EBITDA (x)	4.7	4.5	3.8	3.4	3.2
ROE (%)	9.3	12.8	13.1	12.4	11.6
Net debt to equity (%)	Net Cash	0.7	Net Cash	Net Cash	Net Cash
Interest coverage (x)	25.0	16.2	20.0	20.6	20.9

Source: Company data, RHB

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