

11 November 2019

Industrials | Machinery

Frencken Group (FRKN SP)

Buy (Maintained)

Riding The Industrial Automation Boom; BUY

Target Price (Return)	SGD0.82 (+8%)
Price:	SGD0.76
Market Cap:	USD236.9m
Avg Daily Turnover (SGD/USD)	4.3m/3.2m

- **Maintain BUY, DCF-based SGD0.82 TP**, 8% upside plus 4% yield FY20F. As the bulk of Frencken's factories are in Europe – along with its business activity – the group has been unaffected by the US-China trade war until now. Management is guiding for a more muted outlook, with a likely slowdown in industrial automation in 4Q19 due to the segment's lumpy business nature. However, it is still positive on the medical and semiconductor segments for 4Q19F.
- **Muted 4Q19F.** Sales at the industrial automation segment, which are typically lumpy, increased 23.3% YoY in 3Q19. This was boosted by increased orders for storage drive production equipment, from a key customer setting up a new factory. Management expects a revenue decline in 4Q19 (also a quarterly drop), as orders for these segments are usually lumpy. Frencken also expects its analytical and automatic segments' growth to tone down in 4Q, but anticipates YoY growth in the semiconductor and medical divisions, driven by new customers and projects.
- **Higher dividends ahead.** With a 30% dividend payout ratio and our projection of continued YoY growth in earnings, we believe dividends will increase despite its payout ratio staying unchanged. We expect the FY19 yield to increase to c.3.6%.
- **One of the rare manufacturing companies delivering growth in FY19.** We believe Frencken's technology – which has been making rapid advancements in recent years – will provide more solutions to its customers and support future projects in terms of margins and profitability. As the stock is trading at just 8.4x FY19F P/E – well below the peer average of 9.9x – and offering a 3.6% yield for this FY, we believe this counter is undervalued. Despite a muted 4Q19F ahead, Frencken is still one of the rare manufacturing firms likely to deliver YoY growth this year. As a result, we stick to our call and DCF-backed TP.
- **Key downside risks** to our call include an economic slowdown and customers delaying orders.

Analysts

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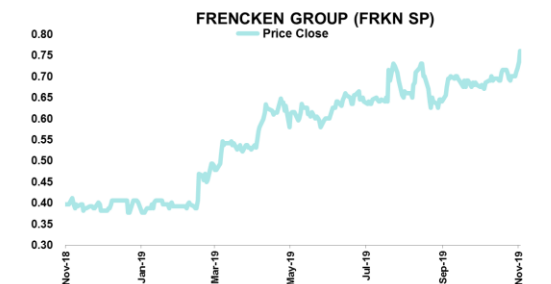


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	81.0	11.8	15.2	23.6	81.0
Relative	74.7	6.9	12.2	24.2	75.5
52-wk Price low/high (SGD)	0.37 - 0.77				



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)	13.9	9.4	8.4	8.1	7.9
P/BV (x)	1.3	1.2	1.1	1.0	0.9
P/CF (x)	7.6	9.2	4.7	4.5	4.3
Dividend Yield (%)	3.1	2.8	3.6	3.7	3.8
EV/EBITDA (x)	5.6	5.4	4.6	4.2	3.9
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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Financial Exhibits

Asia		Financial summary	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Singapore		Recurring EPS (SGD)	0.05	0.08	0.09	0.09	0.10
Industrials		EPS (SGD)	0.08	0.07	0.09	0.09	0.10
Machinery		DPS (SGD)	0.02	0.02	0.03	0.03	0.03
		BVPS (SGD)	0.59	0.63	0.69	0.76	0.83
		Weighted avg adjusted shares (m)	416	422	422	422	422
Major shareholders (%)		Valuation metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Thong Low Heang	6.3	Recurring P/E (x)	13.8	9.5	8.4	8.1	7.9
Micro Compact SB	6.2	P/E (x)	9.5	10.7	8.4	8.1	8.0
Precico Singapore	6.2	P/B (x)	1.3	1.2	1.1	1.0	0.9
		FCF Yield (%)	3.0	0.2	6.7	7.7	7.0
		Dividend Yield (%)	3.1	2.8	3.6	3.7	3.8
Valuation basis		EV/EBITDA (x)	5.6	5.4	4.6	4.2	3.9
Our DCF assumptions:		EV/EBIT (x)	7.8	7.9	6.2	5.8	5.5
i. WACC of 7%;							
ii. Terminal growth of 0%							
Key drivers		Income statement (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Our FY19 forecasts are most sensitive to changes in:		Total turnover	515	626	678	694	703
i. Demand for customers' products;		Gross profit	84	102	110	113	114
ii. Net interest margin;		EBITDA	57	60	68	72	75
iii. FX gains/losses.		Depreciation and amortisation	(16)	(16)	(18)	(20)	(22)
		Operating profit	30	45	51	52	53
Key risks		Net interest	(0)	(1)	(1)	(1)	(0)
Downside risks include:		Income from associates & JVs	0	0	0	0	0
i. Worsening trade war affecting consumer sentiment;		Exceptional income - net	(10)	4	0	0	0
ii. Economic slowdown;		Pre-tax profit	40	40	50	51	53
iii. Weaker demand for customer's products;		Taxation	(7)	(10)	(11)	(12)	(12)
iv. FX fluctuation risk.		Minority interests	0	0	0	0	0
		Recurring net profit (adj)	23	34	38	40	40
Company Profile		Cash flow (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Frencken Group is a global integrated technology solutions company that serves world-class multinational companies in the automotive, healthcare, industrial, life sciences and semiconductor industries.		Change in working capital	(5)	(27)	0	0	0
		Net cash from operating activities	35	25	56	60	62
		Capex	(25)	(24)	(35)	(35)	(40)
		Cash flow from investing activities	14	(23)	(35)	(35)	(40)
		Dividends paid	(5)	(10)	(12)	(12)	(12)
		Cash flow from financing activities	7	(2)	(12)	(12)	(12)
		Cash at beginning of period	(10)	45	45	55	67
		Net change in cash	56	0	10	13	10
		Ending balance cash	45	45	55	67	78
		Balance sheet (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
		Total cash and equivalents	68	67	77	90	100
		Tangible fixed assets	96	99	118	134	154
		Intangible assets	27	21	20	19	18
		Total investments	4	3	3	3	3
		Total other assets	226	273	283	286	288
		Total assets	420	464	500	532	562
		Short-term debt	62	67	67	67	67
		Total long-term debt	2	1	1	1	1
		Other payables, accruals and provisions	107	128	137	140	142
		Total liabilities	171	196	206	209	211
		Shareholders' equity	247	265	292	320	348
		Minority interests	2	3	3	3	3
		Total equity	250	268	294	322	351
		Net debt	(5)	2	(8)	(21)	(31)
		Total liabilities & equity	420	464	500	532	562
		Key metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
		Revenue growth (%)	10.4	21.5	8.3	2.4	1.2
		Recurrent EPS growth (%)	40.8	46.3	12.9	3.3	2.1
		Gross margin (%)	16.3	16.3	16.3	16.3	16.3
		Operating EBITDA margin (%)	11.0	4.2	10.1	10.3	10.6
		Net profit margin (%)	4.5	5.4	5.7	5.8	5.8
		Dividend payout ratio (%)	43.5	26.6	30.2	30.3	30.3
		Capex/sales (%)	4.9	3.9	5.2	5.0	5.7
		Interest cover (x)	25.0	16.2	20.0	20.6	20.9

Source: Company data, RHB

Source: Company data, RHB

Figure 1: 3QFY19 results review

SGDm	3QFY19	3QFY18	YoY +/- %	9MFY19	9MFY18	YoY +/- %
Revenue	170.2	163.9	3.8%	493.6	450.1	9.7%
Gross Profit	27.0	25.2	7.4%	80.1	72.4	10.6%
Gross Profit Margin	15.9%	15.3%		16.2%	16.1%	
Profit Before Tax	14.1	7.8	80.0%	39.4	25.8	52.8%
PATMI	11.4	5.3	117.4%	31.1	19.0	63.8%
PATMI Margin	6.7%	3.2%		6.3%	4.2%	

Source: Company Data

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