

9 March 2020

Technology | Software & Services

Frencken Group (FRKN SP)

Buy (from Neutral)

Outlook Still Bright For FY20F; U/G To BUY

Target Price (Return): SGD1.05 (26.5%)
 Price: SGD0.83
 Market Cap: USD256m
 Avg Daily Turnover (SGD/USD) 1.22m/0.90m

- **Upgrade to BUY, from Neutral, with a higher DCF-backed TP of SGD1.05, from SGD0.91, 26.5% upside and c.4% yield.** We had a call with the management of Frencken and came out optimistic as Frencken should continue to benefit from its key customer in the industrial automation segment, and from an uplift in the semiconductors sector. We raise our FY20F EPS by 14%, which results in a higher DCF-backed TP of SGD1.05.
- **Benefitting from expanding sourcing in the global supply chain.** The trade war already prompted many global companies to look for alternative supply chains, besides relaying solely on China; COVID-19 added an extra incentive to do so. With Frencken's production base located outside China, we believe the company could be one of the beneficiaries of this trend. Management revealed that it is in talks with several customers and, provided these talks materialize, it would have to increase its capex.
- **Riding the semiconductor sector uplift.** Frencken's semiconductor segment is likely to see a strong double digit growth this year, riding the expected uplift in the overall semiconductor space. Management has also guided for an YoY growth in 1Q20F due to higher sales from its customers in Asia and Europe. Based on our channel checks and performance of companies in the supply chain in the semiconductor sector, we believe that this segment will be a key positive catalyst for Frencken's EPS in 2020F
- **Outlook still positive; upgrade to BUY.** Management remains bullish to benefit from its key customer's new product in the industrial automation segment for FY20F, despite expecting a drop just for 1Q20F. 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. With a positive outlook ahead, despite current macroeconomic conditions, we think Frencken is one of the rare manufacturing firms that is still likely to deliver YoY growth this year. As a result, we lift our FY20F EPS by 14%, which results in a higher DCF-backed TP of SGD1.05 (from SGD0.91) and lift our call to BUY from Neutral.
- Key risks include an economic slowdown and customers delaying orders

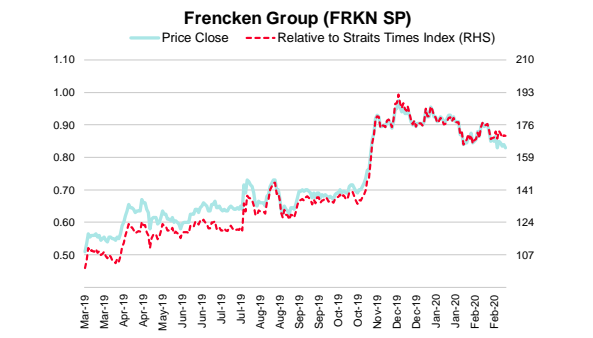
Analyst

Jarick Seet
 +65 6232 3891
jarick.seet@rhbgroup.com



Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(10.3)	(5.2)	(13.1)	29.7	64.4
Relative	(2.2)	3.2	(5.8)	35.5	72.5
52-wk Price low/high (SGD)	0.50 – 0.98				



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (SGDm)	626	659	693	702	708
Recurring net profit (SGDm)	33	46	47	48	49
Recurring net profit growth (%)	33.6	38.4	3.8	1.3	1.5
Recurring P/E (x)	10.57	7.66	7.38	7.29	7.18
P/B (x)	1.3	1.2	1.1	1.0	0.9
P/CF (x)	12.03	3.53	9.19	5.12	5.00
Dividend Yield (%)	2.6	3.6	4.1	4.1	4.2
EV/EBITDA (x)	5.66	3.46	3.61	3.17	2.74
Return on average equity (%)	11.7	15.1	15.2	13.9	12.8
Net debt to equity (%)	0.6	(23.2)	(20.1)	(25.8)	(30.9)

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (SGD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Singapore	Recurring EPS	0.08	0.11	0.11	0.11	0.12
Technology	DPS	0.02	0.03	0.03	0.03	0.03
Frencken Group	BVPS	0.63	0.70	0.78	0.86	0.94
FRKN SP	Return on average equity (%)	11.7	15.1	15.2	13.9	12.8
Buy						
	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Valuation basis	Recurring P/E (x)	10.57	7.66	7.38	7.29	7.18
DCF-backed TP of SGD1.05	P/B (x)	1.3	1.2	1.1	1.0	0.9
	FCF Yield (%)	1.3	24.0	3.7	12.4	12.9
Key drivers	Dividend Yield (%)	2.6	3.6	4.1	4.1	4.2
i. Demand for customers' products;	EV/EBITDA (x)	5.66	3.46	3.61	3.17	2.74
	EV/EBIT (x)	7.72	4.70	4.65	4.14	3.63
Key risks						
i. Worsening trade war affecting consumer sentiment;	Income statement (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
ii. Economic slowdown;	Total turnover	626	659	693	702	708
iii. Weaker demand for customer's products;	Gross profit	102	111	117	119	120
iv. FX fluctuation risk.	EBITDA	61	80	78	80	82
	Depreciation and amortisation	(16)	(21)	(17)	(19)	(20)
	Operating profit	45	59	61	61	62
	Net interest	(1)	(1)	(1)	(1)	(1)
	Pre-tax profit	40	54	59	60	61
	Taxation	(10)	(11)	(12)	(12)	(12)
	Reported net profit	30	42	47	48	49
	Recurring net profit	33	46	47	48	49
Company Profile						
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.	Cash flow (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Change in working capital	(26.8)	26.0	(28.2)	0.0	0.0
	Cash flow from operations	29.0	99.0	38.1	68.3	70.0
	Capex	(24.3)	(15.2)	(25.0)	(25.0)	(25.0)
	Cash flow from investing activities	(23.2)	(11.7)	(25.0)	(25.0)	(25.0)
	Dividends paid	(10.1)	(9.1)	(14.3)	(14.5)	(14.7)
	Cash flow from financing activities	(1.8)	(19.1)	(14.3)	(14.5)	(14.7)
	Cash at beginning of period	68.2	67.1	122.4	119.9	147.3
	Net change in cash	4.0	68.2	(1.2)	28.8	30.3
	Ending balance cash	67.1	122.4	120.2	146.7	175.7
	Balance sheet (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	67	122	120	147	177
	Tangible fixed assets	97	92	100	107	113
	Total investments	5	5	5	5	5
	Total assets	464	506	542	577	613
	Short-term debt	67	53	53	53	53
	Total long-term debt	1	0	0	0	0
	Total liabilities	196	208	211	212	213
	Total equity	268	298	331	365	400
	Total liabilities & equity	464	506	542	577	613
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	21.5	5.3	5.2	1.2	0.8
	Recurrent EPS growth (%)	31.5	37.9	3.8	1.3	1.5
	Gross margin (%)	16.3	16.9	16.9	16.9	16.9
	Operating EBITDA margin (%)	9.8	12.2	11.2	11.4	11.6
	Net profit margin (%)	4.8	6.4	6.8	6.8	6.9
	Capex/sales (%)	3.9	2.3	3.6	3.6	3.5
	Interest cover (x)	17.7	20.4	20.8	21.1	21.3

Source: Company data, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2019-11-11	Buy	0.82	0.76
2019-08-13	Buy	0.82	0.65
2019-06-12	Buy	0.82	0.63
2019-05-10	Buy	0.82	0.62

Source: RHB, Bloomberg

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KUALA LUMPUR

RHB Investment Bank Bhd
Level 3A, Tower One, RHB Centre
Jalan Tun Razak
Kuala Lumpur 50400
Malaysia
Tel : +603 9280 8888
Fax : +603 9200 2216

JAKARTA

PT RHB Sekuritas Indonesia
Revenue Tower, 11th Floor, District 8
- SCBD
Jl. Jendral Sudirman Kav 52-53
Jakarta 12190
Indonesia
Tel : +6221 509 39 888
Fax : +6221 509 39 777

HONG KONG

RHB Securities Hong Kong Ltd.
12th Floor, World-Wide House
19 Des Voeux Road
Central
Hong Kong
Tel : +852 2525 1118
Fax : +852 2810 0908

BANGKOK

RHB Securities (Thailand) PCL
10th Floor, Sathorn Square Office
Tower
98, North Sathorn Road, Silom
Bangrak, Bangkok 10500
Thailand
Tel: +66 2088 9999
Fax :+66 2088 9799

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**RHB Securities Singapore
Pte Ltd.**
10 Collyer Quay
#09-08 Ocean Financial Centre
Singapore 049315
Tel : +65 6533 1818
Fax : +65 6532 6211