

23 August 2024

Technology | Software & Services

## Frencken Group (FRKN SP)

**Buy** (Maintained)

### Recovery At Play; Maintain BUY

Target Price (Return): SGD1.71 (25.1%)  
 Price (Market Cap): SGD1.37 (USD447m)  
 ESG score: 3.0 (out of 4)  
 Avg Daily Turnover (SGD/USD) 7.33m/5.46m

- **Maintain BUY, new SGD1.71 TP from SGD1.81, 25% upside.** We maintain our positive stance on Frencken Group even though 1H24's results were slower than expected. Nonetheless, we see FRKN as a beneficiary of the anticipated semiconductor recovery going forward. We also expect revenue to continue strengthening on the back of demand recovery and inventory levels in the supply chain coming down going into FY25. The stock trades at c.12x FY25F earnings P/E, ie near its historical mean average.
- **1H24 slower than expected.** 1H24 revenue grew 6.2% YoY to SGD373m while earnings surged 50% YoY to SGD18m on the back of recovering topline and better gross margins. Revenue growth was mainly driven by the mechatronics division, which grew by 8% YoY to SGD327m, offset by the integrated manufacturing services (IMS) division's 4% YoY revenue decline to SGD44m. The mechatronics unit's semiconductor segment (+27.8%; SGD156m) saw increased orders from a key customer in Europe and recovery in sales from Asia operations. Meanwhile, the medical and analytical & life science segments grew by 5% and 13% YoY to SGD62m and SGD91m. The industrial automation segment declined by 60% YoY to SGD14m. The IMS division's automotive segment's revenue decline (-9% YoY; SGD32m) was mitigated by the consumer and industrial electronics business' revenue growth (+13% YoY; SGD10m). Gross margin rose by 2.5ppts to 14.8% from better operating leverage. EBIT grew 42% YoY to SGD26m on better gross margins and opex.
- **FY24F earnings change (-11.6%), with FY25 and FY26F earnings cut by 7.6% each.** Both revenue and margins in 1H24 have come in lower than expected. Although recovery continues to be in play, it is slower than the pace which we have anticipated. Hence, we lower our revenue estimates in view of a slower-than-expected recovery. We also lower our margin assumptions, as higher value programmes may take more time to kick in, affecting the pace of our previous recovery expectations. In spite of our earnings cut, we still see a better 2H24 and FY25, driven by a recovery in customer orders going forward.
- **Semiconductor segment to drive growth.** We see earnings growth outlook mainly driven by the semiconductor segment, where inventory levels in the supply chain continue to come down, with overall demand gradually improving first from the front end. In line with our earnings revision, our 16x P/E-based TP is reduced to SGD1.71. The 5% reduction is smaller than our earnings cut, as we roll over our earnings base from FY24F P/E to blended FY24F-25F.
- **Key downside risks** to our forecasts and TP include a later-than-expected demand recovery. As FRKN's 3.0 ESG score is below our 3.1 country median, we apply a 2% discount to its intrinsic value to derive our new SGD1.71 TP.

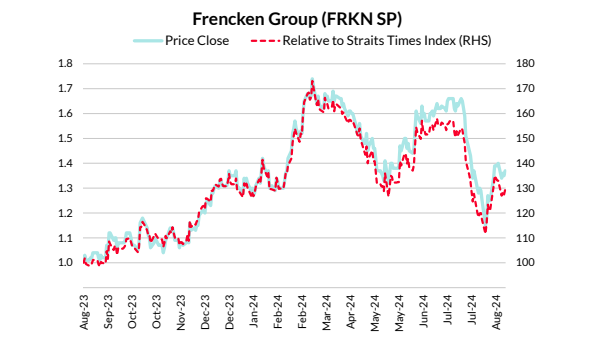
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	1.5	(5.5)	(0.7)	(12.7)	35.6
Relative	(2.6)	(3.6)	(2.7)	(17.4)	28.8
52-wk Price low/high (SGD)				1.01	1.74



Source: Bloomberg

#### Overall ESG Score: 3.0 (out of 4)

##### E: GOOD

The company is working on expanding the market share of its proprietary and niche eco-PVD (Physical Vapour Deposition) technology, which is an environmentally-friendly surface coating process compared to conventional methods.

##### S: GOOD

Frencken has also taken steps to support local communities and help keep frontlines safe. When there was a severe shortage of masks in the early days of the pandemic, the company worked to secure more than 30,000 masks, which were donated to frontlines and hospitals in Malaysia, Europe, and the US.

##### G: GOOD

In addition to a robust corporate governance structure, an internal controls system is in place to ensure proper and ethical conduct. This includes policies on areas such as personal data protection, anti-corruption, anti-money laundering and counter terrorism financing, conflict of interest, business continuity, insider dealing, enterprise risk management, and outsourcing

#### Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (SGDm)	786	743	770	855	897
Recurring net profit (SGDm)	52	32	44	50	55
Recurring net profit growth (%)	(11.7)	(37.4)	34.2	14.3	9.8
Recurring P/E (x)	11.28	18.02	13.43	11.74	10.69
P/B (x)	1.5	1.5	1.3	1.2	1.1
P/CF (x)	14.85	12.03	6.89	10.12	7.54
Dividend Yield (%)	3.0	2.7	1.7	2.2	2.6
EV/EBITDA (x)	5.57	7.00	5.24	4.43	3.73
Return on average equity (%)	13.5	8.2	10.4	11.0	11.1
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

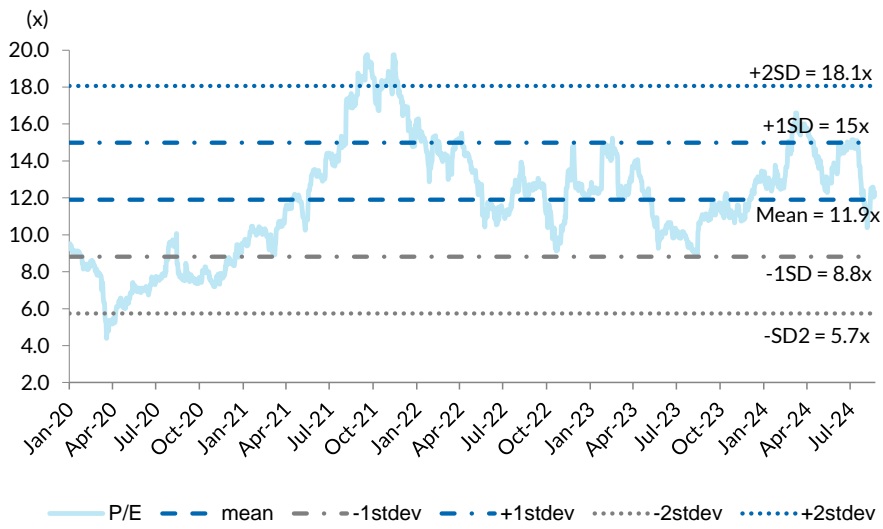
Source: Company data, RHB

## Financial Exhibits

Asia	Financial summary (SGD)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Singapore	Recurring EPS	0.12	0.08	0.10	0.12	0.13
Technology	DPS	0.04	0.04	0.02	0.03	0.03
<b>Frencken Group</b>	BVPS	0.92	0.94	1.02	1.10	1.20
FRKN SP	Return on average equity (%)	13.5	8.2	10.4	11.0	11.1
Buy						
	<b>Valuation metrics</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
<b>Valuation basis</b>	Recurring P/E (x)	11.28	18.02	13.43	11.74	10.69
16x blended FY24-25F P/E	P/B (x)	1.5	1.5	1.3	1.2	1.1
	FCF Yield (%)	(0.5)	3.7	11.1	6.5	9.8
<b>Key drivers</b>	Dividend Yield (%)	3.0	2.7	1.7	2.2	2.6
Demand for customers' products.	EV/EBITDA (x)	5.57	7.00	5.24	4.43	3.73
	EV/EBIT (x)	7.92	11.55	7.95	6.69	5.56
<b>Key risks</b>						
i. Worsening trade war affecting consumer sentiment;						
ii. Economic slowdown;						
iii. Weaker demand for customer's products;						
iv. FX fluctuation risk.						
	<b>Income statement (SGDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
<b>Company Profile</b>	Total turnover	786	743	770	855	897
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.	Gross profit	119	98	115	130	139
	EBITDA	95	76	92	102	110
	Depreciation and amortisation	(28)	(30)	(31)	(35)	(36)
	Operating profit	67	46	60	68	74
	Net interest	(4)	(5)	(5)	(4)	(4)
	Pre-tax profit	63	42	56	64	70
	Taxation	(11)	(10)	(13)	(14)	(16)
	Reported net profit	52	32	44	50	55
	Recurring net profit	52	32	44	50	55
	<b>Cash flow (SGDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	Change in working capital	(43)	(10)	11	(26)	(13)
	Cash flow from operations	39	49	85	58	78
	Capex	(43)	(27)	(20)	(20)	(20)
	Cash flow from investing activities	(41)	(27)	(19)	(18)	(18)
	Dividends paid	(18)	(16)	(10)	(13)	(15)
	Cash flow from financing activities	(19)	(53)	(10)	(13)	(15)
	Cash at beginning of period	193	167	143	198	223
	Net change in cash	(20)	(31)	56	26	45
	Ending balance cash	167	131	199	224	267
	<b>Balance sheet (SGDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	Total cash and equivalents	167	143	198	223	265
	Tangible fixed assets	128	130	119	105	89
	Total investments	3	3	3	3	3
	Total assets	725	735	750	797	842
	Short-term debt	108	92	92	92	92
	Total long-term debt	1	0	0	0	0
	Total liabilities	329	330	312	323	328
	Total equity	396	405	438	474	513
	Total liabilities & equity	725	735	750	797	842
	<b>Key metrics</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	Revenue growth (%)	2.5	(5.5)	3.6	11.0	4.9
	Recurrent EPS growth (%)	(11.7)	(37.4)	34.2	14.3	9.8
	Gross margin (%)	15.1	13.2	14.9	15.2	15.5
	Operating EBITDA margin (%)	12.1	10.3	11.9	12.0	12.3
	Net profit margin (%)	6.6	4.4	5.7	5.8	6.1
	Dividend payout ratio (%)	34.0	47.9	22.3	26.2	27.3
	Capex/sales (%)	5.4	3.6	2.6	2.3	2.2
	Interest cover (x)	16.0	7.7	10.0	11.3	12.3

Source: Company data, RHB

Figure 1: FRKN's historical forward P/E



Source: RHB, Bloomberg

## Emissions And ESG

### Trend analysis

FRKN has yet to report Scope 1 and Scope 2 data for now, and is currently undergoing ESG performance Phase 1 (2022), which is to strengthen its current ESG practices.

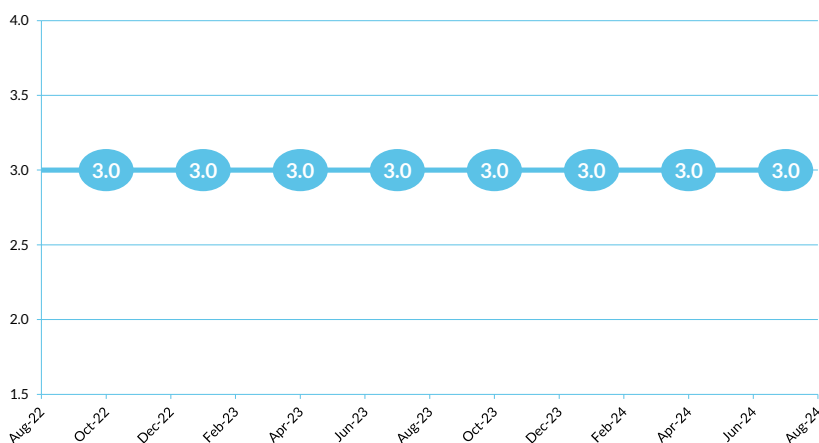
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	-	-	-
Scope 2	-	-	-
Scope 3	-	-	-
Total emissions	na	na	na

Source: Company data, RHB

## Latest ESG-Related Developments

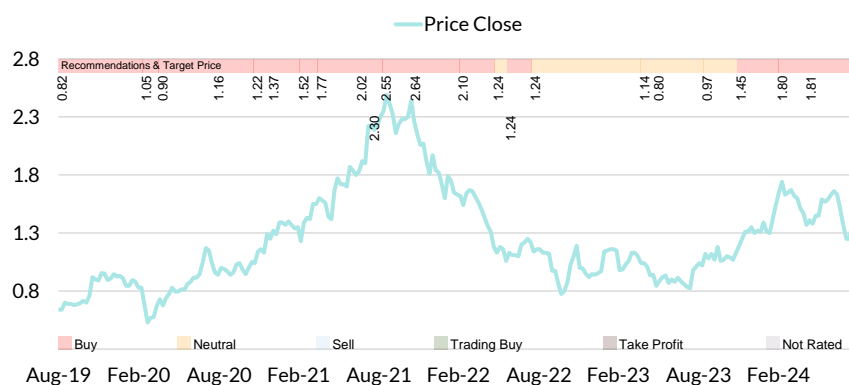
- FRKN is committed to disclose Scope 1 and Scope 2 emissions in 2023 under Phase 2 of its sustainability reporting.

## ESG Rating History



Source: RHB

## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-05-16	Buy	1.81	1.40
2024-02-29	Buy	1.80	1.60
2023-11-26	Buy	1.45	1.13
2023-09-10	Neutral	0.97	1.02
2023-05-23	Neutral	0.80	0.83
2023-04-20	Neutral	1.14	1.04
2022-08-15	Neutral	1.24	1.19
2022-06-20	Buy	1.24	1.07
2022-05-22	Neutral	1.24	1.18
2022-03-03	Buy	2.10	1.62
2021-11-14	Buy	2.64	2.44
2021-10-25	Buy	2.55	2.26
2021-09-07	Buy	2.55	2.33
2021-08-12	Buy	2.30	2.16
2021-07-13	Buy	2.02	1.80

Source: RHB, Bloomberg

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