

29 February 2024

Technology | Software & Services

Frencken Group (FRKN SP)

Buy (Maintained)

More Positive Ahead Of The Recovery; Maintain BUY

Target Price (Return): SGD1.80 (18.6%)
 Price (Market Cap): SGD1.52 (USD482m)
 ESG score: 3.0 (out of 4)
 Avg Daily Turnover (SGD/USD) 5.29m/3.95m

- **Maintain BUY, new SGD1.80 TP from SGD1.45, 19% upside.** We turn more positive on Frencken Group after 2H23 earnings showed a continued sequential improvement, supporting our earnings recovery thesis. A stronger 2H23 led to FY23 earnings outperforming our estimates by 18% on recovering semiconductor orders and outlook. We raise FY24F-25F earnings by 9-11% and lift our TP higher ahead of an anticipated recovery – both this year and next year – and pegging the stock to a loftier +1.5SD target P/E of 16x from 14x at +1SD previously.
- **FY23 beats our forecast.** A strong recovery in 2H23 helped FY23 earnings (SGD32m; -37% YoY) outperform our forecast (SGD28m) by 18%. 2H23 revenue of SGD392m (-1.3% YoY) was dragged by lower mechatronics (SGD343m; -1.5% YoY) and integrated manufacturing services or IMS divisions (SGD48m; -0.8% YoY) but supported by the semiconductor (SGD160m; +4.9% YoY) and analytical & life sciences (SGD89m; +24% YoY) segments within the mechatronics unit. An increase in key semiconductor customer orders helped drive the segment's growth. This leads us to believe that an earnings recovery is underway and a more pronounced recovery will take place from FY24. FRKN declared a final dividend of 2.28 SGD cents, amounting to a 30% payout ratio.
- **The semiconductor segment driving a more positive outlook.** FY23 earnings have outperformed our estimates on order acceleration in the semiconductor segment. We expect improving revenue trends to continue, as FRKN's key European customer continues to grow and expand into Asia. We believe this customer could be building up inventory for a near-term ramp-up over a number of systems and is ordering ahead as it needs some lead time ahead of its systems' launches. In the longer term, FRKN also has a new semiconductor customer that is supporting its utilisation in Asia. Additionally, a positive revenue outlook will be supported by the medical segment, in our view, where topline is also set to increase on more robust customer orders. Other segments such as analytical & life sciences (customer diversification and strengthening supply chain into Asia) and automotive (expansion into intelligent city with radar antenna products) are expected to register a stable revenue outlook. Meanwhile, industrial automation is set to decrease, as the segment's key customer there is not expected to undertake major capital expenditure. Given that FY23's net profit has outperformed our forecasts, we raise our FY24F-25F earnings by 9-11%, led largely by stronger revenue and recovery the semiconductor segment. We have also imputed better margins in anticipation of the semiconductor recovery going forward.
- **Key downside risks** to our forecasts include A later-than-expected demand recovery, which will pose downside risks to our forecasts and TP. 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 TP.

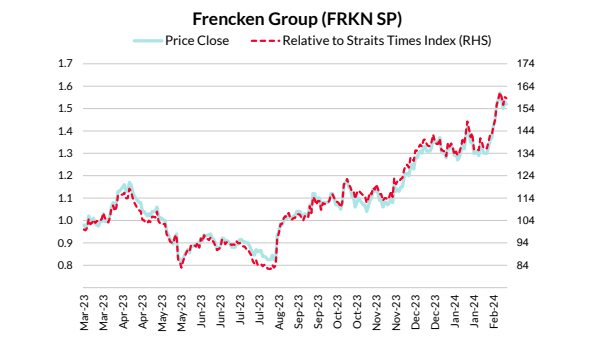
Analyst

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Share Performance (%)

| | YTD | 1m | 3m | 6m | 12m |
|----------------------------|-------------|------|------|------|------|
| Absolute | 12.6 | 9.4 | 34.5 | 50.5 | 47.6 |
| Relative | 15.7 | 10.1 | 32.1 | 52.8 | 51.4 |
| 52-wk Price low/high (SGD) | 0.80 – 1.57 | | | | |



Source: Bloomberg

Overall ESG Score: 3.0 (out of 4)

E: GOOD

The group 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 during the early days of the pandemic, the group worked to secure more than 30,000 masks, which were donated to the 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 which 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 | 845 | 886 | 930 |
| Recurring net profit (SGDm) | 52 | 32 | 49 | 54 | 59 |
| Recurring net profit growth (%) | (11.7) | (37.4) | 51.4 | 9.4 | 9.8 |
| Recurring P/E (x) | 12.51 | 19.99 | 13.21 | 12.07 | 10.99 |
| P/B (x) | 1.7 | 1.6 | 1.5 | 1.4 | 1.2 |
| P/CF (x) | 16.47 | 13.34 | 9.25 | 8.50 | 7.85 |
| Dividend Yield (%) | 2.7 | 2.4 | 1.5 | 2.3 | 2.5 |
| EV/EBITDA (x) | 6.25 | 7.84 | 5.49 | 4.74 | 4.00 |
| Return on average equity (%) | 13.5 | 8.2 | 11.7 | 11.7 | 11.8 |
| Net debt to equity (%) | net cash | net cash | net cash | net cash | net cash |

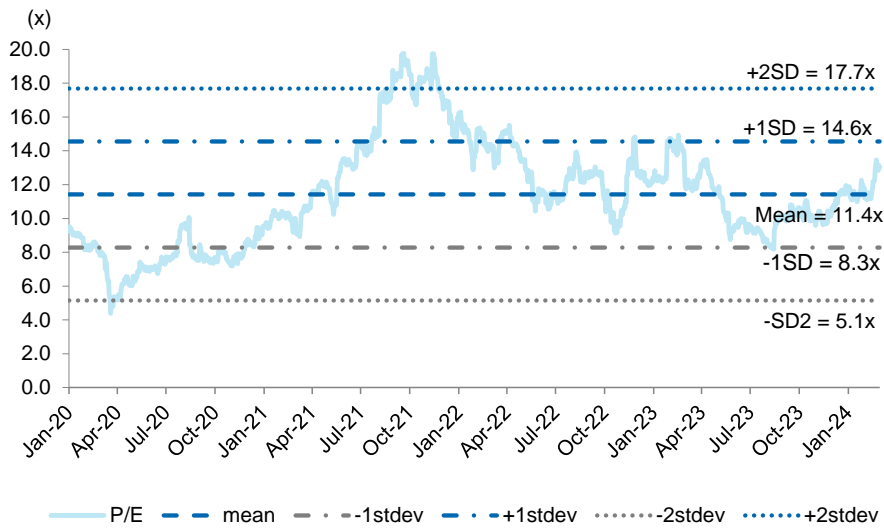
Source: Company data, RHB

Financial Exhibits

| | | | | | | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|---------------|---------------|----------------|----------------|----------------|
| Asia | Financial summary (SGD) | Dec-22 | Dec-23 | Dec-24F | Dec-25F | Dec-26F |
| Singapore | Recurring EPS | 0.12 | 0.08 | 0.12 | 0.13 | 0.14 |
| Technology | DPS | 0.04 | 0.04 | 0.02 | 0.03 | 0.04 |
| Frencken Group | BVPS | 0.92 | 0.94 | 1.03 | 1.12 | 1.22 |
| FRKN SP | Return on average equity (%) | 13.5 | 8.2 | 11.7 | 11.7 | 11.8 |
| Buy | | | | | | |
| | Valuation metrics | Dec-22 | Dec-23 | Dec-24F | Dec-25F | Dec-26F |
| Valuation basis | Recurring P/E (x) | 12.51 | 19.99 | 13.21 | 12.07 | 10.99 |
| 16x FY25F P/E | P/B (x) | 1.7 | 1.6 | 1.5 | 1.4 | 1.2 |
| | FCF Yield (%) | (0.5) | 3.4 | 7.7 | 8.7 | 9.7 |
| | Dividend Yield (%) | 2.7 | 2.4 | 1.5 | 2.3 | 2.5 |
| Key drivers | EV/EBITDA (x) | 6.25 | 7.84 | 5.49 | 4.74 | 4.00 |
| Demand for customers' products. | EV/EBIT (x) | 8.89 | 12.93 | 8.27 | 7.07 | 5.90 |
| | Income statement (SGDm) | Dec-22 | Dec-23 | Dec-24F | Dec-25F | Dec-26F |
| Key risks | Total turnover | 786 | 743 | 845 | 886 | 930 |
| i. Worsening trade war affecting consumer sentiment; | Gross profit | 119 | 98 | 126 | 135 | 144 |
| ii. Economic slowdown; | EBITDA | 95 | 76 | 102 | 109 | 117 |
| iii. Weaker demand for customer's products; | Depreciation and amortisation | (28) | (30) | (34) | (36) | (38) |
| iv. FX fluctuation risk. | Operating profit | 67 | 46 | 67 | 73 | 79 |
| | Net interest | (4) | (5) | (5) | (4) | (4) |
| | Pre-tax profit | 63 | 42 | 63 | 69 | 75 |
| Company Profile | Taxation | (11) | (10) | (14) | (16) | (17) |
| 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. | Reported net profit | 52 | 32 | 49 | 54 | 59 |
| | Recurring net profit | 52 | 32 | 49 | 54 | 59 |
| | Cash flow (SGDm) | Dec-22 | Dec-23 | Dec-24F | Dec-25F | Dec-26F |
| | Change in working capital | (43) | (10) | (12) | (12) | (13) |
| | Cash flow from operations | 39 | 49 | 70 | 76 | 83 |
| | Capex | (43) | (27) | (20) | (20) | (20) |
| | Cash flow from investing activities | (41) | (27) | (19) | (18) | (18) |
| | Dividends paid | (18) | (16) | (10) | (15) | (16) |
| | Cash flow from financing activities | (19) | (53) | (10) | (15) | (16) |
| | Cash at beginning of period | 193 | 167 | 143 | 183 | 225 |
| | Net change in cash | (20) | (31) | 42 | 43 | 49 |
| | Ending balance cash | 167 | 131 | 184 | 226 | 273 |
| | Balance sheet (SGDm) | Dec-22 | Dec-23 | Dec-24F | Dec-25F | Dec-26F |
| | Total cash and equivalents | 167 | 143 | 183 | 225 | 271 |
| | Tangible fixed assets | 128 | 130 | 116 | 100 | 83 |
| | Total investments | 3 | 3 | 3 | 3 | 3 |
| | Total assets | 725 | 735 | 766 | 809 | 857 |
| | Short-term debt | 108 | 92 | 92 | 92 | 92 |
| | Total long-term debt | 1 | 0 | 0 | 0 | 0 |
| | Total liabilities | 329 | 330 | 322 | 327 | 333 |
| | Total equity | 396 | 405 | 444 | 482 | 524 |
| | Total liabilities & equity | 725 | 735 | 766 | 809 | 857 |
| | Key metrics | Dec-22 | Dec-23 | Dec-24F | Dec-25F | Dec-26F |
| | Revenue growth (%) | 2.5 | (5.5) | 13.7 | 4.9 | 4.9 |
| | Recurrent EPS growth (%) | (11.7) | (37.4) | 51.4 | 9.4 | 9.8 |
| | Gross margin (%) | 15.1 | 13.2 | 14.9 | 15.2 | 15.5 |
| | Operating EBITDA margin (%) | 12.1 | 10.3 | 12.0 | 12.3 | 12.6 |
| | Net profit margin (%) | 6.6 | 4.4 | 5.8 | 6.1 | 6.4 |
| | Dividend payout ratio (%) | 34.0 | 47.9 | 19.8 | 27.4 | 27.3 |
| | Capex/sales (%) | 5.4 | 3.6 | 2.4 | 2.3 | 2.2 |
| | Interest cover (x) | 16.0 | 7.7 | 11.2 | 12.1 | 13.2 |

Source: Company data, RHB

Figure 1: FRKN's historical P/E mean



Source: Bloomberg

Emissions And ESG

Trend analysis

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

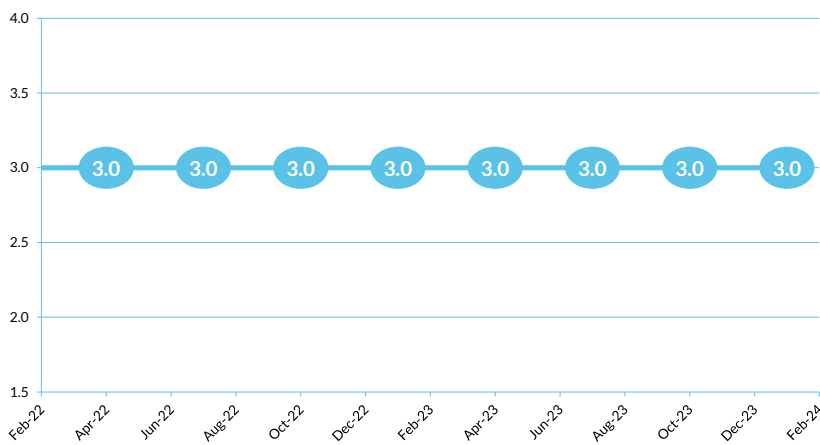
| Emissions (tCO2e) | Dec-21 | Dec-22 | Dec-23 |
|-------------------|--------|--------|--------|
| Scope 1 | - | - | - |
| Scope 2 | - | - | - |
| Scope 3 | - | - | - |
| Total emissions | na | na | na |

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 |
|------------|----------------|--------------|-------|
| 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 |
| 2021-04-13 | Buy | 1.77 | 1.59 |
| 2021-03-02 | Buy | 1.52 | 1.27 |

Source: RHB, Bloomberg

RHB Guide to Investment Ratings

| | |
|---------------------|--------------------------------------------------------------------------------------------------|
| Buy: | Share price may exceed 10% over the next 12 months |
| Trading Buy: | Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain |
| Neutral: | Share price may fall within the range of +/- 10% over the next 12 months |
| Take Profit: | Target price has been attained. Look to accumulate at lower levels |
| Sell: | Share price may fall by more than 10% over the next 12 months |
| Not Rated: | Stock is not within regular research coverage |

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