23 May 2022

Technology | Software & Services

Frencken Group (FRKN SP)

Hit By Rising Cost Pressures

Neutral (from Buy)

Target Price (Return):	SGD1.24 (5.1%)
Price (Market Cap):	SGD1.18 (USD365m)
ESG score:	3.00 (out of 4)
Avg Daily Turnover (SGD/USD)	6.23m/4.57m

- **Downgrade to NEUTRAL, from Buy, with a lower TP of SGD1.24 from SGD2.10, 5% upside.** Frencken reported higher YoY revenue growth of 9.3% to SGD198.36m but NPAT declined 12.6% to SGD12.8m due to higher raw material, freight, and overhead costs. We cut our FY22F earnings by 17.5% to factor in lower margins. In addition, we also lowered our pegged TP P/E to 10x from 14x as NPAT growth will probably be hampered by higher costs, along with the devaluation of global tech stocks.
- **Margins likely to be muted in the near term.** Gross profit margins remain around 15.4% as compared to 17.3% a year ago, mainly due to higher prices of materials, freight, energy, and increased production overheads costs. Depreciation also surged due to significant capital investments of around SGD28.6m during FY21. These were in relation to upgrading and expansion programs for the group's global manufacturing facilities and the acquisition of Avimac Pte Ltd in Singapore as part of its strategy to add space, capacity, and capability to generate sustainable growth. Management will likely pass on some of these costs to their customers which may help to improve margins. However, we expect these to only flow in majority in 3Q22 and expect margins in the near term to remain muted at 15.3-16.0% which would impact profitability.
- **Semiconductors and analytical segments are still going strong but automotive declines.** Semiconductors segment increased by 15.5% YoY to SGD76.1m, while analytical and life sciences are up 16.7% YoY to SGD38.9m and will likely continue to do so for the rest of FY22F. However, the automotive segment dropped 10.7% YoY to SGD19.3m mainly due to one of its key customers not being able to procure other key components to complete the products, resulting in lower volumes ordered by the customer. We understand that the particular customer is trying to mitigate this and expect orders to gradually recover in the following quarters ahead.
- **Headwinds ahead with muted margins.** We expect margins for the next quarter to remain low as costs remains high while the company tries to pass on some costs to its customers. In addition, shortage on components impacting clients, especially in the automotive industry, will continue to be a dampener to orders from its automotive key client. As a result, we downgrade to NEUTRAL from Buy with a lower TP of SGD1.24, pegged to a 10x FY22F P/E, lower than the average five years peer's multiple of 12x due to the negative growth ahead. Key risks include a rise in material costs and overhead costs, plus a downturn in semiconductors demand.
- **ESG.** Using our in-house proprietary methodology, we derive an ESG score of 3.0, which is on par with the country median. As a result, we apply a 0% discount to our TP.

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (SGDm)	622	767	794	828	863
Recurring net profit (SGDm)	48	59	52	54	57
Recurring net profit growth (%)	5.1	22.4	(11.2)	4.1	4.5
Recurring P/E (x)	10.37	8.47	9.53	9.16	8.77
P/B (x)	1.5	1.3	1.2	1.1	1.0
P/CF (x)	5.79	12.32	13.52	6.63	6.40
Dividend Yield (%)	2.6	2.6	3.2	3.3	3.4
EV/EBITDA (x)	4.81	4.22	4.92	4.31	3.71
Return on average equity (%)	13.6	16.5	13.2	12.6	12.0
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

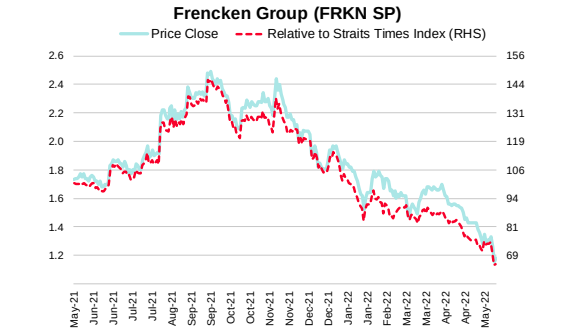
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(40.1)	(23.4)	(28.5)	(47.8)	(27.6)
Relative	(43.8)	(20.5)	(23.0)	(48.1)	(31.8)
52-wk Price low/high (SGD)					1.15 – 2.49



Source: Bloomberg

Overall ESG Score: 3.00 (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 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 USA.

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 capitalization of less than USD0.5bn.

Financial Exhibits

Asia
Singapore
Technology
Frencken Group
FRKN SP
Neutral

Valuation basis

10x FY22F P/E

Key drivers

Demand for customers' products;

Key risks

i. Worsening trade war affecting consumer sentiment;
ii. Economic slowdown;
iii. Weaker demand for customer's products;
iv. FX fluctuation risk.

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.

Financial summary (SGD)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Recurring EPS	0.11	0.14	0.12	0.13	0.13
DPS	0.03	0.03	0.04	0.04	0.04
BVPS	0.79	0.89	0.98	1.07	1.16
Return on average equity (%)	13.6	16.5	13.2	12.6	12.0

Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Recurring P/E (x)	10.37	8.47	9.53	9.16	8.77
P/B (x)	1.5	1.3	1.2	1.1	1.0
FCF Yield (%)	12.5	4.6	3.4	11.1	11.6
Dividend Yield (%)	2.6	2.6	3.2	3.3	3.4
EV/EBITDA (x)	4.81	4.22	4.92	4.31	3.71
EV/EBIT (x)	6.58	5.58	6.27	5.47	4.69

Income statement (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover	622	767	794	828	863
Gross profit	105	129	127	132	138
EBITDA	81	95	82	85	88
Depreciation and amortisation	(22)	(23)	(18)	(18)	(18)
Operating profit	59	72	64	67	69
Net interest	(1)	(1)	(1)	(1)	(1)
Pre-tax profit	52	71	63	65	68
Taxation	(9)	(11)	(10)	(11)	(11)
Reported net profit	43	59	52	54	57
Recurring net profit	48	59	52	54	57

Cash flow (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Change in working capital	8	(37)	(35)	1	1
Cash flow from operations	86	40	37	75	78
Capex	(24)	(17)	(20)	(20)	(20)
Cash flow from investing activities	(23)	(29)	(20)	(20)	(20)
Dividends paid	(13)	(13)	(16)	(16)	(17)
Cash flow from financing activities	(15)	(9)	(16)	(16)	(17)
Cash at beginning of period	122	174	193	192	229
Net change in cash	48	2	1	39	41
Ending balance cash	170	176	194	231	270

Balance sheet (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total cash and equivalents	174	193	192	229	269
Tangible fixed assets	100	111	114	116	118
Total investments	5	3	3	3	3
Total assets	564	688	695	739	786
Short-term debt	67	96	96	96	96
Total long-term debt	0	2	2	2	2
Total liabilities	228	309	279	285	292
Total equity	336	379	416	454	494
Total liabilities & equity	564	688	695	739	786

Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Revenue growth (%)	(5.7)	23.4	3.6	4.2	4.3
Recurrent EPS growth (%)	5.1	22.4	(11.2)	4.1	4.5
Gross margin (%)	17.0	16.8	16.0	16.0	16.0
Operating EBITDA margin (%)	13.0	12.4	10.3	10.2	10.2
Net profit margin (%)	6.9	7.7	6.6	6.6	6.6
Dividend payout ratio (%)	29.8	21.8	30.2	30.2	30.2
Capex/sales (%)	3.8	2.3	2.5	2.4	2.3
Interest cover (x)	24.4	30.4	27.1	28.2	29.3

Source: Company data, RHB

Recommendation Chart

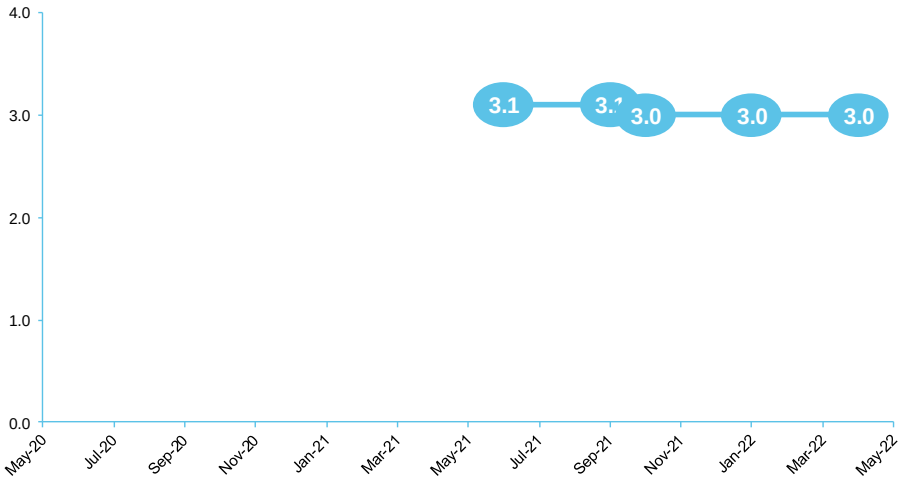


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-03-03	Buy	2.10	1.62
2021-11-14	Buy	2.64	2.44
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
2020-12-23	Buy	1.37	1.24
2020-11-16	Buy	1.22	1.05
2020-08-19	Buy	1.16	0.98
2020-04-14	Buy	0.90	0.71
2020-03-08	Buy	1.05	0.83
2019-08-13	Buy	0.82	0.65

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

RHB Guide to Investment Ratings

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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
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Analyst	Company
-	-

(2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.



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