

24 May 2023

Technology | Software & Services

Frencken Group (FRKN SP)

Neutral (Maintained)

Awaiting The Semiconductor Recovery To Kick In

- **Maintain NEUTRAL, new SGD0.80 TP from SGD1.14, 4% downside with c.4% FY23F yield.** We maintain our NEUTRAL call, as Frencken's 1Q23 update indicated weak demand and higher operating costs amid on-going excess inventory in the chip sector. We see low utilisation rates from expanded capacities straining near-term margins, as the semiconductor market waits for inventory levels undergo a correction. We slash earnings estimates by 31%, in view of weaker-than-expected sales and a dimmer margin outlook. Our TP is pegged to 10x FY23-24F P/E.
- **1Q23 net profit was below our estimate**, at SGD5.2m (-60% YoY). This was booked on a lower revenue of SGD173m, marking a 13% YoY decline from 1Q22's SGD198m. Revenue from the mechatronics division shrank 14% YoY (SGD149m), led by industrial automation (-40% YoY, to SGD19m) and Asia's semiconductor (-24% YoY, to SGD58m) segments. Turnover from the medical and analytical & life sciences units grew 31% and 3% YoY to SGD30m and SGD40m, due to an increase in orders from Europe and Asia. Meanwhile, revenue for the integrated manufacturing services division dropped by 10% YoY, as sales at both the automotive & consumer and industrial electronics segments declined. FRKN's GPM narrowed to 12.3% (-3.1ppts YoY). Net profit plunged by 60% YoY to SGD5.2m as a result of lower margins and higher costs.
- **Excess chip inventory continues to dominate sector trends.** Taiwan Semiconductor Manufacturing Co (TSMC) (2330 TT, NR) – FRKN's major client ASML's (ASML NA, NR) key customer – remains impacted by customers' excess inventory levels, and is awaiting adjustments. For now, TSMC's 2023 revenue outlook points to a decline by at least a low single-digit percentage YoY.
- **Margin drag at play – due to higher installed capacity, low utilisation.** FRKN now anticipates a drag in its margins, with the current sales decline expected to pull down its utilisation rate on a higher installed base. Note that its production capacity had been expanded ahead of an anticipated ramp-up in the utilisation rate. But, with the decline in semiconductor outlook and sales to customers, the higher depreciation costs and costs for the new capacities will drag on profitability. As 1Q23 net profit missed estimates, we cut FY23-25F earnings by 31% each year, to SGD33m, SGD35m, and SGD37m to reflect a weak 1Q23 and soft margins.
- **Key downside risks** to our forecasts include a later-than-expected recovery in semiconductor demand.
- **ESG.** As FRKN'S ESG score is 3 out of 4 – on par with our country median – we apply a 0% discount/premium to its intrinsic value to derive our new TP. As there is now greater focus on the E pillar due to critical climate change issues, we have tweaked our ESG weightage. Henceforth, we assign a weightage of 50% to the E pillar, followed by 25% each to the S and G pillars. Further details are in our 2 May thematic research note titled [Envisioning a Better Future](#).

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (SGDm)	767	786	706	743	782
Recurring net profit (SGDm)	59	52	33	35	37
Recurring net profit growth (%)	23.0	(11.7)	(35.6)	6.0	5.8
Recurring P/E (x)	6.07	6.87	10.67	10.07	9.51
P/B (x)	0.9	0.9	0.9	0.8	0.8
P/CF (x)	7.98	9.05	4.39	7.08	6.73
Dividend Yield (%)	3.6	4.9	4.4	4.4	4.4
EV/EBITDA (x)	2.74	3.16	3.68	3.30	2.90
Return on average equity (%)	16.5	13.5	8.3	8.4	8.5
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

Target Price (Return):	SGD0.80 (-4%)
Price (Market Cap):	SGD0.84 (USD265m)
ESG score:	3.00 (out of 4)
Avg Daily Turnover (SGD/USD)	3.85m/2.87m

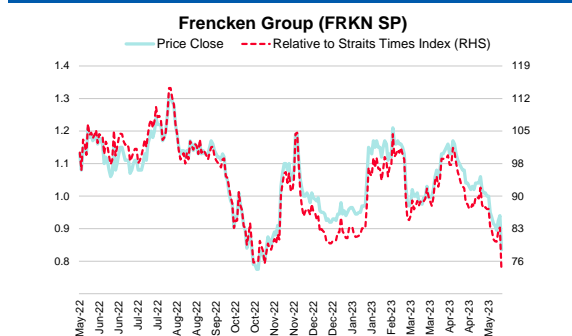
Analyst

Alfie Yeo
+65 6320 0810
alfie.yeo@rhbgroup.com



Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(11.7)	(19.7)	(28.0)	(20.5)	(29.2)
Relative	(10.5)	(16.4)	(25.3)	(19.0)	(28.3)
52-wk Price low/high (SGD)	0.78 – 1.31				



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-Physical Vapour Deposition (PVD) technology, which is an environmentally-friendly surface coating process compared to conventional methods.

S: GOOD

FRKN 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 COVID-19 pandemic, the company worked to secure more than 30,000 masks that 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:

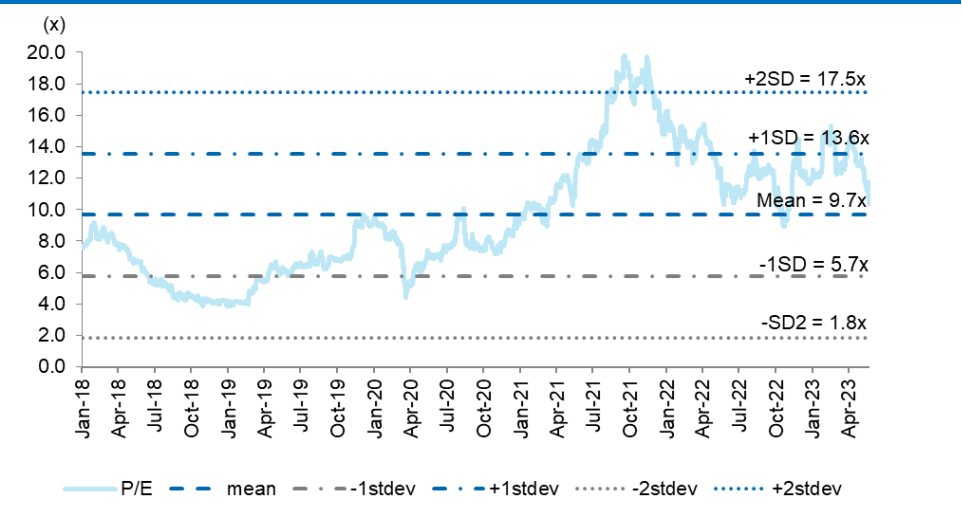
Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

Financial Exhibits

Asia	Financial summary (SGD)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Singapore	Recurring EPS	0.14	0.12	0.08	0.08	0.09
Technology	DPS	0.03	0.04	0.04	0.04	0.04
Frencken Group	BVPS	0.88	0.92	0.96	1.00	1.06
FRKN SP	Return on average equity (%)	16.5	13.5	8.3	8.4	8.5
Neutral						
	Valuation metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Valuation basis	Recurring P/E (x)	6.07	6.87	10.67	10.07	9.51
Blended 10x FY23-24F P/E	P/B (x)	0.9	0.9	0.9	0.8	0.8
	FCF Yield (%)	7.6	(0.9)	17.2	8.5	9.3
Key drivers	Dividend Yield (%)	3.6	4.9	4.4	4.4	4.4
Increasing demand for customers' products	EV/EBITDA (x)	2.74	3.16	3.68	3.30	2.90
	EV/EBIT (x)	3.63	4.50	5.81	5.20	4.58
Key risks	Income statement (SGDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
i. Worsening trade war affecting consumer sentiment;	Total turnover	767	786	706	743	782
ii. Economic slowdown;	Gross profit	129	119	95	100	106
iii. Weaker demand for customers' products;	EBITDA	95	95	69	72	76
iv. FX fluctuation risk.	Depreciation and amortisation	(23)	(28)	(25)	(27)	(28)
	Operating profit	72	67	44	46	48
	Net interest	(1)	(4)	(4)	(3)	(3)
	Pre-tax profit	71	63	40	42	45
	Taxation	(11)	(11)	(7)	(7)	(8)
	Reported net profit	59	52	33	35	37
	Recurring net profit	59	52	33	35	37
Company Profile	Cash flow (SGDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
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	(34)	(43)	23	(11)	(12)
	Cash flow from operations	45	39	81	50	53
	Capex	(17)	(43)	(20)	(20)	(20)
	Cash flow from investing activities	(29)	(41)	(19)	(19)	(19)
	Dividends paid	(13)	(18)	(16)	(16)	(16)
	Cash flow from financing activities	21	(19)	(16)	(16)	(16)
	Cash at beginning of period	174	193	167	213	228
	Net change in cash	36	(20)	46	16	18
	Ending balance cash	210	167	213	228	246
	Balance sheet (SGDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Total cash and equivalents	193	167	213	228	245
	Tangible fixed assets	111	128	123	116	109
	Total investments	3	3	3	3	3
	Total assets	688	725	734	759	786
	Short-term debt	96	108	108	108	108
	Total long-term debt	2	1	1	1	1
	Total liabilities	309	329	320	325	330
	Total equity	379	396	414	434	456
	Total liabilities & equity	688	725	734	759	786
	Key metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Revenue growth (%)	23.4	2.5	(10.2)	5.2	5.3
	Recurrent EPS growth (%)	22.6	(11.7)	(35.6)	6.0	5.8
	Gross margin (%)	16.8	15.1	13.5	13.5	13.5
	Operating EBITDA margin (%)	12.4	12.1	9.8	9.8	9.8
	Net profit margin (%)	7.7	6.6	4.7	4.8	4.8
	Dividend payout ratio (%)	21.8	34.0	46.5	43.9	41.5
	Capex/sales (%)	2.3	5.4	2.8	2.7	2.6
	Interest cover (x)	30.4	16.0	10.5	11.0	11.6

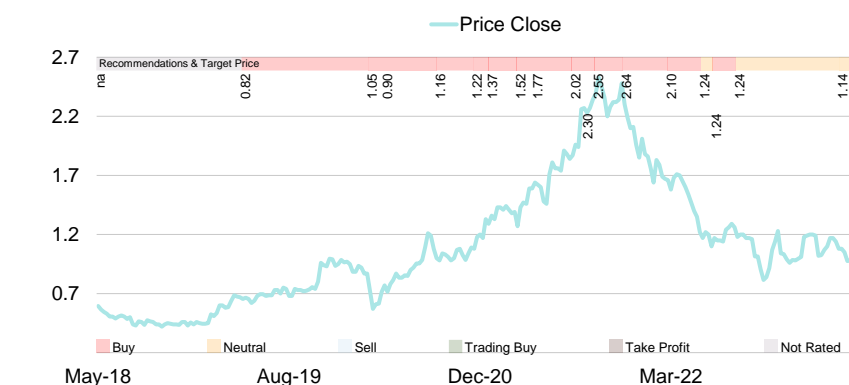
Source: Company data, RHB

Figure 1: FRKN's historical P/E trend



Source: Bloomberg

Recommendation Chart

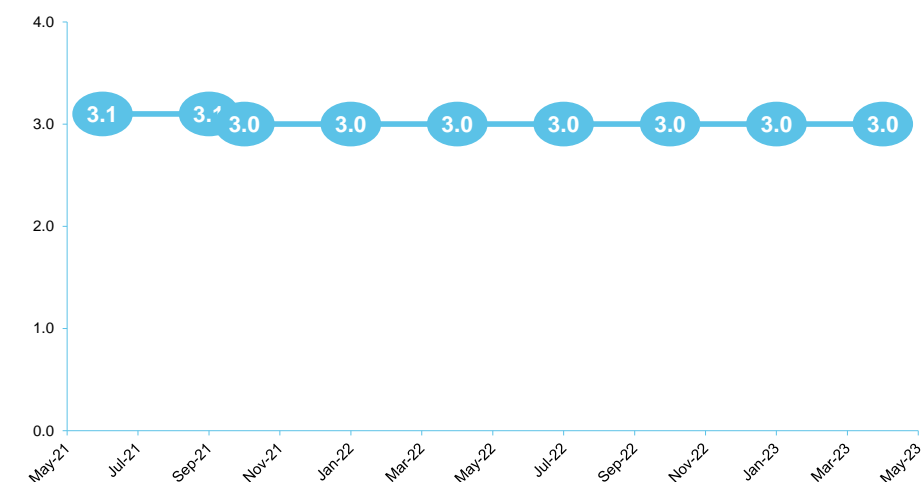


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2020-12-23	Buy	1.37	1.24
2020-11-16	Buy	1.22	1.05
2020-08-19	Buy	1.16	0.98

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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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

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

SINGAPORE

RHB Bank Berhad (Singapore branch)
90 Cecil Street
#04-00 RHB Bank Building
Singapore 069531
Fax: +65 6509 0470