

16 August 2022

Technology | Software & Services

Frencken Group (FRKN SP)

Neutral (from Buy)

A Muted Outlook; Downgrade To NEUTRAL

- **Downgrade to NEUTRAL from Buy, SGD1.24 TP, 4% upside with c.3% FY22F yield.** Frencken's 1H22 revenue ticked up by 3.6% YoY to SGD388.9m, but its PATMI declined by 16.6% YoY to SGD26.1m – this accounts for 50% of our forecasts, ie in line. Going forward, we should see some margin recovery as old contracts and open purchase orders (POs) are extended, and higher prices are imputed into the new contracts. However, its performance in FY22 may worsen YoY, so we cut our call on the stock to NEUTRAL, for now.
- **Margins will likely improve, albeit gradually.** Management thinks that margins likely bottomed in 1H22, and will likely strengthen in the subsequent quarters, as new contracts and POs with higher prices replace the existing, lower-margin ones. However, Frencken has started preparations on its non-new sites and production facilities in Europe, Malaysia and Singapore to cater for future business growth. This will increase costs. That said, revenue from the increased capacity will likely only flow in from FY23F onwards. As a result, we expect net margins to still remain muted in FY22.
- **Revenue growth will be muted till FY23F.** Management continues to see growth in the semiconductor, medical and life science as well as automotive segments – the latter will likely undergo a rebound after a weak 1H22. However, we expect revenue growth to be muted this year, as many of the new projects will likely only ramp up after the new facilities are ready and qualified.
- **Downgrade to NEUTRAL for now.** Our downgrade is premised on the fact that the stock's closing price is now close to our TP, and the company's outlook is somewhat lacklustre. There should be more clarity on its expansion plan by end-3Q or in 4Q – and, in the meantime, investors can focus on other stocks in the same sector to yield more returns. That said, we remain confident in management's ability to enable Frencken to perform better once its expansion plans are completed, and FY22F should just be a temporary blip in its long-term outlook.
- **Key risks** include a rise in material and overhead costs, and a downturn in semiconductor 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% premium to our intrinsic value to derive our TP.

Target Price (Return): SGD1.24 (+4%)
Price (Market Cap): SGD1.19 (USD371m)
ESG score: 3.00 (out of 4)
Avg Daily Turnover (SGD/USD) 3.88m/2.79m

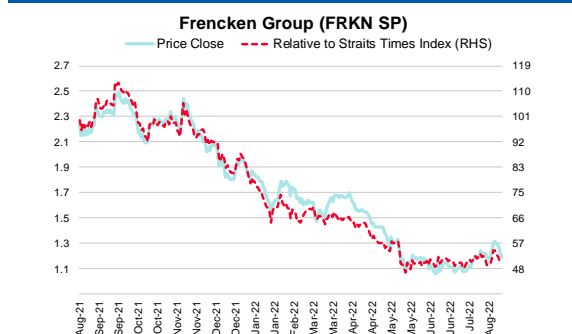
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(39.6)	8.2	(9.2)	(31.6)	(46.6)
Relative	(44.3)	2.7	(11.6)	(27.1)	(49.9)
52-wk Price low/high (SGD)				1.06 – 2.49	



Source: Bloomberg

Overall ESG Score: 3.00 (out of 4)

E: GOOD

Frencken is working on expanding the market share of its proprietary and niche eco-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 then donated to frontliners 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 capitalization of less than USD0.5bn.

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)	10.45	8.54	9.61	9.23	8.84
P/B (x)	1.5	1.3	1.2	1.1	1.0
P/CF (x)	5.84	12.42	13.64	6.68	6.46
Dividend Yield (%)	2.5	2.5	3.1	3.3	3.4
EV/EBITDA (x)	4.87	4.26	4.97	4.36	3.76
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

Financial Exhibits

Asia	Financial summary (SGD)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Singapore	Recurring EPS	0.11	0.14	0.12	0.13	0.13
Technology	DPS	0.03	0.03	0.04	0.04	0.04
Frencken Group	BVPS	0.79	0.89	0.98	1.07	1.16
FRKN SP	Return on average equity (%)	13.6	16.5	13.2	12.6	12.0
Neutral						
	Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Recurring P/E (x)	10.45	8.54	9.61	9.23	8.84
	P/B (x)	1.5	1.3	1.2	1.1	1.0
	FCF Yield (%)	12.4	4.6	3.3	11.0	11.5
	Dividend Yield (%)	2.5	2.5	3.1	3.3	3.4
	EV/EBITDA (x)	4.87	4.26	4.97	4.36	3.76
	EV/EBIT (x)	6.65	5.64	6.34	5.53	4.75
Valuation basis						
10x FY22F P/E						
Key drivers						
Increase in demand for its customers' products						
Key risks						
i. Worsening trade war affecting consumer sentiment;						
ii. Economic slowdown;						
iii. Weaker demand for its customers' products;						
iv. FX fluctuation risks.						
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.						
	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

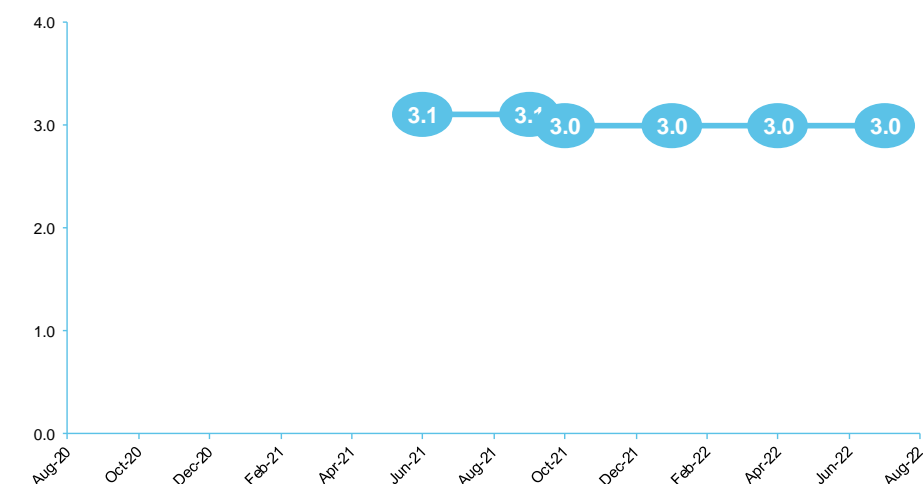


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-06-20	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
2020-04-14	Buy	0.90	0.71
2020-03-08	Buy	1.05	0.83

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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