

24 December 2020

Technology | Software & Services

## Frencken Group (FRKN SP)

**Buy** (Maintained)

**One-Off Does Not Impact a Positive Outlook; Keep BUY**

Target Price (Return): SGD1.37 (10.5%)  
 Price: SGD1.24  
 Market Cap: USD397m  
 Avg Daily Turnover (SGD/USD) 4.36m/3.20m

- **Maintain BUY with a higher DCF-derived SGD1.37 TP from SGD1.22, 11% upside and c.3% yield.** Frencken announced that it would take an impairment loss of SGD6.2m associated with the development of a product in the healthcare industry due to a strategic direction change by its customer to not launch the product. Management revealed that the incident does not impact the future outlook of its medical segment as it did not project any revenue from this product and the impairment is a non-cash item.

- **Just a one-off non-cash impairment.** Management expects this impairment to be one-off and will not impact the cash balance of the company. Management did not include any projections from the product in the 2021-2022 projections of its medical segment. Despite the development costs being impaired, Frencken still owns the design patents associated with this product and could still benefit from it, should the customer decide to launch the product in the future.

- **Recovery in the automotive sector.** Revenue from the automotive segment is likely to be better in 2H20 vs 1H20, as the automotive sales have picked up after the end of the global lockdown caused by COVID-19. We think revenue from this segment will continue to pick up in 2021 as well.

- **Growth in industrial automation will likely come in 2021.** Frencken's key customer in the industrial automation segment has delayed its new product launch due to supply chain issues. As a result, we now estimate the launch will likely happen in 2021, expect this segment to continue taking a hit, and only see a recovery next year, in 2021. Management also guided that the industrial automation segment would remain stable in 2H20 after seeing a 35-40% drop YoY in 1H20.

- **Twin growth drivers for 2021.** Due to the delay in Frencken's industrial automation segment, we believe 2021 will be a strong year for the group, where both its semiconductor and industrial segments should drive profits upwards. We lowered our 2020 forecasts to reflect the impairment of SGD6.2m but have included higher growth expectations from the automotive and semiconductor sector for 2021F. As a result, we expect a 38.5% growth in EPS for 2021. We also retain our BUY call and a higher DCF-backed SGD1.37 TP, implying 12x 2021F P/E. We believe there is also room for further re-rating, as peers are trading at higher valuations. We remain positive on Frencken's long-term prospects and its management team and retain our BUY recommendation.

- **Key risks** include an economic slowdown and customers delaying orders.

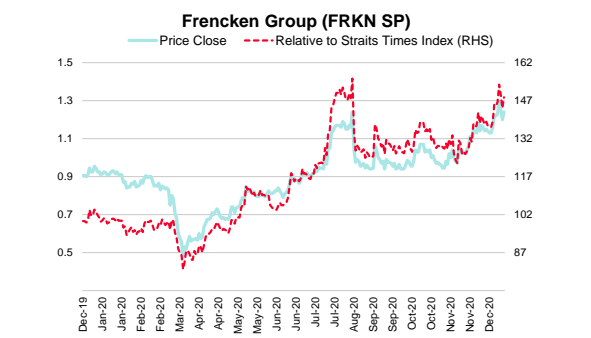
### Analyst

Jarick Seet  
 +65 6320 0810  
[jarick.seet@rhbgroup.com](mailto:jarick.seet@rhbgroup.com)



### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	34.1	17.0	28.5	37.8	37.0
Relative	46.2	17.5	14.3	30.3	48.9
52-wk Price low/high (SGD)	0.48 – 1.29				



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (SGDm)	626	659	617	708	744
Recurring net profit (SGDm)	33	46	35	48	51
Recurring net profit growth (%)	33.6	38.4	(23.5)	38.5	5.9
Recurring P/E (x)	15.79	11.45	14.97	10.81	10.21
P/B (x)	2.0	1.8	1.6	1.5	1.3
P/CF (x)	17.97	5.28	19.07	7.74	7.26
Dividend Yield (%)	1.7	2.4	2.0	2.8	3.0
EV/EBITDA (x)	8.46	5.61	7.41	5.40	4.75
Return on average equity (%)	11.7	15.1	11.3	14.4	13.8
Net debt to equity (%)	0.6	net cash	net cash	net cash	net cash

Source: Company data, RHB

### Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD1bn.

## Financial Exhibits

Asia	Financial summary (SGD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Singapore	Recurring EPS	0.08	0.11	0.08	0.11	0.12
Technology	DPS	0.02	0.03	0.02	0.03	0.04
<b>Frencken Group</b>	BVPS	0.63	0.70	0.76	0.84	0.92
FRKN SP	Return on average equity (%)	11.7	15.1	11.3	14.4	13.8
Buy						
	<b>Valuation metrics</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
<b>Valuation basis</b>	Recurring P/E (x)	15.79	11.45	14.97	10.81	10.21
DCF-backed TP of SGD1.37.	P/B (x)	2.0	1.8	1.6	1.5	1.3
	FCF Yield (%)	0.9	16.0	0.5	8.1	9.0
<b>Key drivers</b>	Dividend Yield (%)	1.7	2.4	2.0	2.8	3.0
i. Demand for customers' products;	EV/EBITDA (x)	8.46	5.61	7.41	5.40	4.75
	EV/EBIT (x)	11.54	7.61	10.26	7.03	6.21
<b>Key risks</b>						
i. Worsening trade war affecting consumer sentiment;	<b>Income statement (SGDm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
ii. Economic slowdown;	Total turnover	626	659	617	708	744
iii. Weaker demand for customer's products;	Gross profit	102	111	96	117	126
iv. FX fluctuation risk.	EBITDA	61	80	62	81	85
	Depreciation and amortisation	(16)	(21)	(17)	(19)	(20)
	Operating profit	45	59	45	62	65
	Net interest	(1)	(1)	(1)	(1)	(1)
	Pre-tax profit	40	54	44	60	64
	Taxation	(10)	(11)	(9)	(12)	(13)
	Reported net profit	30	42	35	48	51
	Recurring net profit	33	46	35	48	51
	<b>Cash flow (SGDm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
	Change in working capital	(26.8)	26.0	(26.3)	(1.2)	(0.6)
	Cash flow from operations	29.0	99.0	27.4	67.5	72.0
	Capex	(24.3)	(15.2)	(25.0)	(25.0)	(25.0)
	Cash flow from investing activities	(23.2)	(11.7)	(25.0)	(25.0)	(25.0)
	Dividends paid	(10.1)	(9.1)	(10.5)	(14.6)	(15.4)
	Cash flow from financing activities	(1.8)	(19.1)	(10.5)	(14.6)	(15.4)
	Cash at beginning of period	68.2	67.1	122.4	113.0	139.5
	Net change in cash	4.0	68.2	(8.1)	28.0	31.6
	Ending balance cash	67.1	122.4	115.1	141.5	172.0
	<b>Balance sheet (SGDm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
	Total cash and equivalents	67	122	113	139	170
	Tangible fixed assets	97	92	100	107	113
	Total investments	5	5	5	5	5
	Total assets	464	506	521	571	613
	Short-term debt	67	53	53	53	53
	Total long-term debt	1	0	0	0	0
	Total liabilities	196	208	198	214	220
	Total equity	268	298	323	357	393
	Total liabilities & equity	464	506	521	571	613
	<b>Key metrics</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
	Revenue growth (%)	21.5	5.3	(6.3)	14.7	5.0
	Recurrent EPS growth (%)	31.5	37.9	(23.5)	38.5	5.9
	Gross margin (%)	16.3	16.9	15.5	16.5	16.9
	Operating EBITDA margin (%)	9.8	12.2	10.1	11.4	11.4
	Net profit margin (%)	4.8	6.4	5.7	6.8	6.9
	Capex/sales (%)	3.9	2.3	4.0	3.5	3.4
	Interest cover (x)	17.7	20.4	15.5	21.3	22.4

Source: Company data, RHB

## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2019-05-09	Buy	0.82	0.62

Source: RHB, Bloomberg

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##### **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