

15 October 2020

Technology | Software & Services

Frencken Group (FRKN SP)

Twin Drivers To Boost EPS; Stay BUY

Buy (Maintained)

Target Price (Return): SGD1.16 (+8%)
Price: SGD1.07
Market Cap: USD336m
Avg Daily Turnover (SGD/USD) 6.22m/4.54m

- **BUY, DCF-based TP of SGD1.16, 8% upside with c.3% FY20F yield.** 2020 should be a muted year for Frencken due to the drop in its industrial automation business, as the group's key customer is likely to launch a new product in FY21. However, we expect this segment to recover in FY21, while the group should enjoy strong growth in its semiconductor division. FY21F should be a better year, and we expect Frencken to record decent EPS growth of 12.3% YoY then.

- **Riding on the semiconductor uplift.** Frencken's semiconductor segment is likely to see strong double-digit growth this year, as it should benefit from the uplift in the chip industry. Management has also guided for higher revenue in 2H20F, due to a pick-up in orders from customers in Asia and Europe. Based on our channel checks and the performance of companies in the supply chain of the semiconductor sector, we believe this segment will continue to be a key positive catalyst for Frencken's EPS growth in 2020F.

- **Factories globally have resumed production.** At present, all of the group's manufacturing sites in Asia, Europe and the US have resumed normal operations. In addition, the initial supply chain disruptions caused by the COVID-19 lockdown measures have largely been resolved.

- **Growth in industrial automation will likely come in FY21.** Frencken's key customer in industrial automation has delayed its new product launch, due to supply chain issues. As such, we believe the launch will likely only happen in FY21. As a result, we expect this segment to continue to take a hit, and only see recovery in FY21. Management also guided that the industrial automation segment will remain stable in 2H20, after seeing a 35-40% drop YoY in business, in 1H20.

- **Twin growth drivers for FY21F.** Due to the delay in its industrial automation segment, we believe FY21 will be a strong year for Frencken – as both its semiconductor and industrial automation units should drive profits upwards. As such, we project a 12% YoY growth in EPS for FY21, and maintain our DCF-backed TP of SGD1.16. Our TP implies an FY21F P/E of just 10.8x. The stock has recovered since about two months ago, but its valuation remains undemanding. Also, there is room for a further re-rating, as its peers are trading at higher valuations. We are also confident of the group's long-term prospects, and in its management team. Premised on this, we make no change to our BUY recommendation.

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

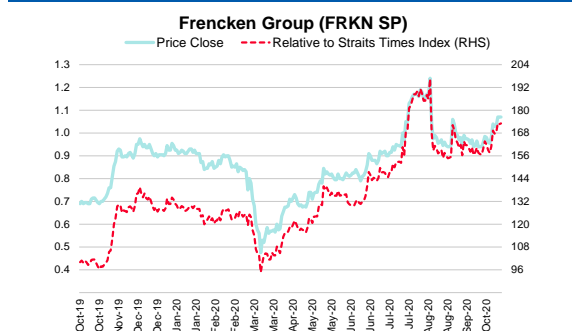
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	15.7	9.7	15.7	50.7	55.1
Relative	36.4	6.8	18.2	53.7	73.3
52-wk Price low/high (SGD)				0.48 – 1.24	



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (SGDm)	626	659	617	691	725
Recurring net profit (SGDm)	33	46	40	45	47
Recurring net profit growth (%)	33.6	38.4	(12.7)	12.3	5.8
Recurring P/E (x)	13.62	9.88	11.31	10.07	9.51
P/B (x)	1.7	1.5	1.4	1.3	1.2
P/CF (x)	15.51	4.55	13.92	7.06	6.61
Dividend Yield (%)	2.0	2.8	2.7	3.0	3.2
EV/EBITDA (x)	7.30	4.72	5.64	4.76	4.16
Return on average equity (%)	11.7	15.1	12.9	13.2	12.8
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 capitalization 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	0.09	0.11	0.11
Technology	DPS	0.02	0.03	0.03	0.03	0.03
Frencken Group	BVPS	0.63	0.70	0.77	0.84	0.92
FRKN SP	Return on average equity (%)	11.7	15.1	12.9	13.2	12.8
Buy						
	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Valuation basis	Recurring P/E (x)	13.62	9.88	11.31	10.07	9.51
DCF	P/B (x)	1.7	1.5	1.4	1.3	1.2
	FCF Yield (%)	1.0	18.6	1.6	8.6	9.6
Key drivers	Dividend Yield (%)	2.0	2.8	2.7	3.0	3.2
Demand for customers' products;	EV/EBITDA (x)	7.30	4.72	5.64	4.76	4.16
	EV/EBIT (x)	9.95	6.40	7.55	6.31	5.54
Key risks						
i. Worsening trade war affecting consumer sentiment;	Income statement (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
ii. Economic slowdown;	Total turnover	626	659	617	691	725
iii. Weaker demand for customer's products;	Gross profit	102	111	96	114	123
iv. FX fluctuation risk.	EBITDA	61	80	68	76	80
	Depreciation and amortisation	(16)	(21)	(17)	(19)	(20)
	Operating profit	45	59	51	57	60
	Net interest	(1)	(1)	(1)	(1)	(1)
	Pre-tax profit	40	54	50	56	59
	Taxation	(10)	(11)	(10)	(11)	(12)
	Reported net profit	30	42	40	45	47
	Recurring net profit	33	46	40	45	47
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.	Cash flow (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Change in working capital	(26.8)	26.0	(26.3)	(1.2)	(0.6)
	Cash flow from operations	29.0	99.0	32.4	63.9	68.2
	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)	(12.0)	(13.5)	(14.3)
	Cash flow from financing activities	(1.8)	(19.1)	(12.0)	(13.5)	(14.3)
	Cash at beginning of period	68.2	67.1	122.4	116.5	140.4
	Net change in cash	4.0	68.2	(4.6)	25.4	28.9
	Ending balance cash	67.1	122.4	118.6	142.4	170.2
	Balance sheet (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	67	122	116	140	168
	Tangible fixed assets	97	92	100	107	113
	Total investments	5	5	5	5	5
	Total assets	464	506	525	568	608
	Short-term debt	67	53	53	53	53
	Total long-term debt	1	0	0	0	0
	Total liabilities	196	208	198	211	217
	Total equity	268	298	326	358	391
	Total liabilities & equity	464	506	525	568	608
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	21.5	5.3	(6.3)	11.9	5.0
	Recurrent EPS growth (%)	31.5	37.9	(12.7)	12.3	5.8
	Gross margin (%)	16.3	16.9	15.5	16.5	16.9
	Operating EBITDA margin (%)	9.8	12.2	11.1	11.0	11.1
	Net profit margin (%)	4.8	6.4	6.5	6.5	6.5
	Capex/sales (%)	3.9	2.3	4.0	3.6	3.4
	Interest cover (x)	17.7	20.4	17.6	19.7	20.8

Source: Company data, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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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