

21 June 2022

Technology | Software & Services

Frencken Group (FRKN SP)

Buy (from Neutral)

Valuations Look Attractive; U/G To BUY

- **Upgrade to BUY, from Neutral, with an unchanged TP of SGD1.24, 16% upside and c.4% yield.** Previously we had downgraded to Neutral and lowered our pegged P/E to 10x (from 14x) as considered NPAT growth would have been hampered due to higher costs, along with the devaluation of the global tech stocks. Over the past month, Frencken has corrected c.20% and is now trading at just 8.5x FY22F P/E, an attractive valuation, which we consider represents a good entry for a long term investment.
- **Muted margins likely to last for 1-2 quarters.** Gross profit margins remain around 15.4% vs 17.3% a year ago, mainly due to higher prices of materials, freight and energy, and increased production overhead costs. Depreciation also surged due to significant capital investments of c.SGD28.6m during FY21. These investments were done in relation to upgrading and expanding programs for the group's global manufacturing facilities and the acquisition of Avimac 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 its customers which could help improve margins. However, we expect these price increases to only flow in mostly during 3Q22 and expect margins in the near term to remain muted at 15.3-16.0% which would impact profitability.
- **Semiconductor and analytical segments are still going strong while automotive declines.** Semiconductor segment increased 15.5% YoY to SGD76.1m, while analytical and life sciences segment is 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 volume ordered by the customer. We understand that the customer is trying to mitigate this issue and expects orders to gradually recover in the next quarters.
- **Headwinds ahead but likely priced-in.** Frencken has corrected close to 60% from its peak and is now trading at 8.5x FY22F P/E which we do think it has factored in the negative facts regarding muted margins and a weaker automotive outlook. As a result of the low price level and valuation, we upgrade to BUY, from Neutral, with an unchanged TP of SGD1.24, pegged to a 10x FY22F P/E.
- **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 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)	9.40	7.68	8.65	8.30	7.95
P/B (x)	1.4	1.2	1.1	1.0	0.9
P/CF (x)	5.25	11.17	12.26	6.01	5.81
Dividend Yield (%)	2.8	2.8	3.5	3.6	3.8
EV/EBITDA (x)	4.24	3.73	4.35	3.76	3.18
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

Target Price (Return):	SGD1.24 (15.9%)
Price (Market Cap):	SGD1.07 (USD329m)
ESG score:	3.00 (out of 4)
Avg Daily Turnover (SGD/USD)	5.15m/3.79m

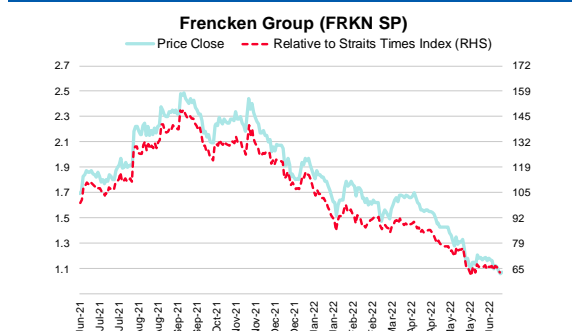
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(45.7)	(9.3)	(34.8)	(41.2)	(37.1)
Relative	(44.9)	(4.9)	(27.8)	(42.0)	(35.6)
52-wk Price low/high (SGD)				1.06 – 2.49	



Source: Bloomberg

Overall ESG Score: 3.00 (out of 4)

E: GOOD

The company is working on expanding the market share of their 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.

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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
Buy						
	Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Recurring P/E (x)	9.40	7.68	8.65	8.30	7.95
	P/B (x)	1.4	1.2	1.1	1.0	0.9
	FCF Yield (%)	13.8	5.1	3.7	12.2	12.8
	Dividend Yield (%)	2.8	2.8	3.5	3.6	3.8
	EV/EBITDA (x)	4.24	3.73	4.35	3.76	3.18
	EV/EBIT (x)	5.80	4.94	5.55	4.77	4.02
Valuation basis						
10x FY22F P/E						
Key drivers						
i. 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.						
	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

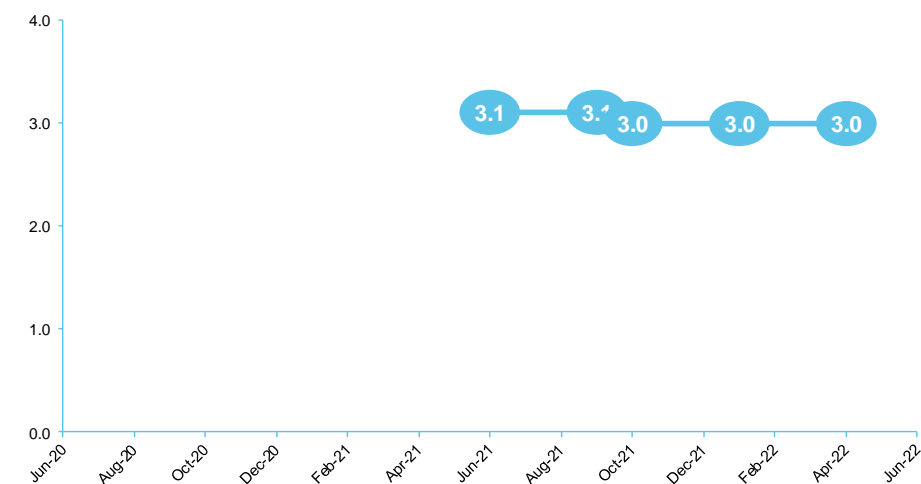


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-05-22	Neutral	1.24	1.18
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
2019-11-11	Buy	0.82	0.76

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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