[Unchanged]

## Singapore Technology

# Drivers intact; Beneficiaries of advanced packaging

### Chance to accumulate on dips

We remain POSITIVE on the Singapore Tech sector, and believe the recent retracement is an attractive opportunity to accumulate as our theses are unchanged. We note over a longer horizon, share prices correlate highly to consensus EPS revisions, and have little correlation to 10Y UST yields. As we see upside drivers to UMS and Frencken, we now value them at 15x/14.5x FY21E P/E respectively, as our previous ROE-g/COE-g method does not capture these. Hence our UMS/Frencken TP are up 17%/25% to SGD1.57/1.74 respectively. Sector favourites are UMS, Frencken, Venture and AEM.

### Theses unchanged

Observations of our coverage universe and their customers support our theses. We see UMS as the best candidate to ride out chip shortages, as it is a beneficiary of foundry spending. Meanwhile, Venture's and Frencken's end-markets are improving, and they are expecting several customers to launch new products in FY21. While we are concerned about HDMT TH (high density modular test test handlers) high-base effects for AEM in FY21E, we see upside drivers from: i) accretive M&A; and ii) stronger-than-expected cloud/ 5G spending in 2H21.

### Higher TP for UMS and FRKN due to upside drivers

For UMS, we believe potential upside drivers include: i) positive surprise of current business momentum in 2021 amid Applied Materials' (AMAT) robust outlook; ii) new business opportunities (e.g. Lam Research building supply chain in Penang/ UMS courting potential new customer). For Frencken, we and consensus' net margins are 7-8% for FY21-23E, but we believe Frencken has scope to outperform these from levers such as: i) greater value-add with customers in coming years; and ii) continual cost control.

### AEM and UMS: beneficiaries of advanced packaging

Performance, power, area-cost and time to market demands from inflections like Big Data, IoT and AI are putting limits on traditional Moore's law scaling. As such, chipmakers expect to increasingly rely on advance packaging technologies to drive performance improvement. Intel is a key advocate of this, and we see AEM as a beneficiary of current known-good-die issues surrounding heterogeneous packaging. As deposition and etch technologies are also crucial in enabling advanced packaging, and this is a high growth area for AMAT, we believe UMS is a beneficiary of this trend too. Key risks in our sector include: i) chip shortages/ slower-than-expected recoveries curtailing volumes; and ii) excessively weak USD.

Stock	Bloomberg	Mkt cap	Rating	Price	ТР	Upside	P/E	(x)	P/B	(x)	Div y	ld (%)
	code	(USD'm)		(LC)	(LC)	(%)	21E	22E	21E	22E	21E	22E
Venture	VMS SP	4,149	Buy	19.16	22.00	19	16.1	14.1	2.0	1.9	3.9	3.9
AEM Holdings	AEM SP	795	Buy	3.86	5.05	33	10.7	10.0	3.7	2.9	2.3	2.5
UMS Holdings	UMSH SP	463	Buy	1.16	1.57	38	11.1	9.6	2.1	1.8	2.6	2.6
Frencken Group	FRKN SP	440	Buy	1.39	1.74	28	11.6	10.4	1.6	1.4	2.6	2.9
Valuetronics	VALUE SP	202	Hold	0.63	0.58	(3)	9.9	12.0	1.2	1.1	4.2	3.3

### Analyst

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POSITIVE

### Advanced packaging and beneficiaries

According to AEM, referencing data from AMD and ASML, 42% of chip improvements over the next decade are expected to come from packaging technologies. A primary driver of this is because traditional Moore's law scaling is facing limitations amid increasing demands on performance, power, area-cost, and time-to-market factors as megatrends like IoT, Big Data and AI take off.

Heterogeneous design and advanced packaging allows functional system blocks that do not demand leading-edge nodes to be fabricated on trailing-nodes. This reduces silicon cost, shorten design time, and accelerate time to yield and market. In turn, these are key benefits to establish leadership in new markets.

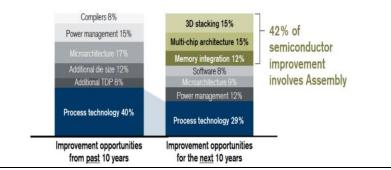
Intel are among the key advocates of advanced packaging. In today's datacentric world, a lot needs to be done to move, store, and process data. Workloads are also increasingly varied and specialized. Varied workloads require different processing architectures. For instance, scalar workloads run well on CPUs, vector workloads work well on GPUs, matrix workloads (e.g. AI and machine learning) run well on ASICs, while spatial workloads work well on FPGAs. Bringing CPUs, GPUs, FPGAs and specialised accelerators to together mix, match and integrate silicon allows Intel to help its customers solve problems intelligently and efficiently.

We see AEM as a beneficiary of Intel's focus in advanced packaging as system level test is able to overcome current difficulties in ensuring known-good-die (KGD) for chiplets (see "<u>Buy the dip</u>", 11-Sep-20; "<u>System level test - at an inflection point</u>", 18-Jun-19).

We also see Applied Materials, and by extension UMS, as a beneficiary of this trend. Applied Materials' products enable the foundational building blocks of heterogeneous integration, such as advanced bump and microbump (1D), fine-line redistribution layer (RDL-2D), through-silicon via (TSV-3D) and hybrid bonding interconnect (HBI-3D). In turn, enabling these are the strengths of AMAT's equipment catering for PVD, CVD, etch, ECD and so on. In fact, AMAT said one of their fastest growth areas are in advanced packaging.

We see UMS as a beneficiary of this trend because it manufactures the: i) wafer transfer modules for the Endura platform, which is AMAT's flagship deposition platform (according to AMAT, Endura caters for PVD and CVD); and ii) components that go into other AMAT platforms.

## Fig 1: Assembly technologies are expected to drive 42% of chip performance improvement over the next decade

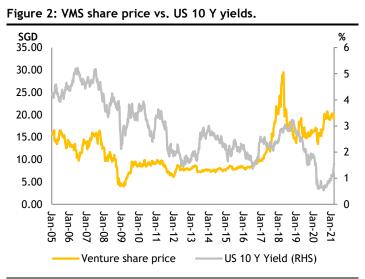


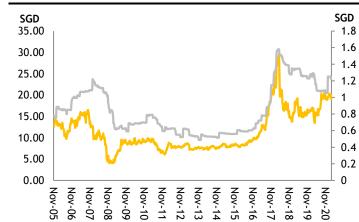
Source: AEM, AMD, ASML

### Opportunity to buy the dip

We believe the recent sell-off in the Singapore Technology sector provides an opportunity to accumulate on dips. Our theses for our picks are unchanged, and we observe that over a longer horizon, share prices move in tandem with consensus EPS revisions more so than other variables (e.g. rising US 10-year yields). We believe this in turn is largely due to company specific earnings drivers that have little correlation with cross-asset class factors. Furthermore, we think valuations for our sector coverage (10-16x FY21E P/E) are reasonable, and most companies have favourable or improving end-market outlook. To illustrate, we plot the relationship of share prices vs. 10Y UST yields, share price vs consensus EPS for our favourite picks Venture, AEM, Frencken and UMS.

### Venture





CY EPS (RHS)

Figure 3: VMS vs consensus current year EPS

Source: Bloomberg, Maybank Kim Eng

### AEM

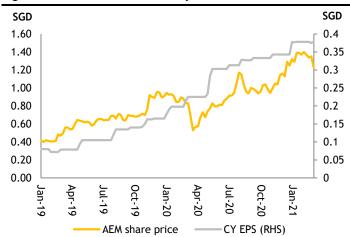


Figure 4: AEM share price vs. US 10 Y yields.

Fig 5: AEM vs consensus current year EPS

Source: Bloomberg, Maybank Kim Eng

Venture share price

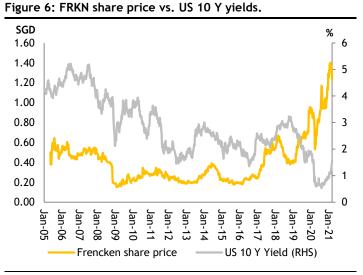


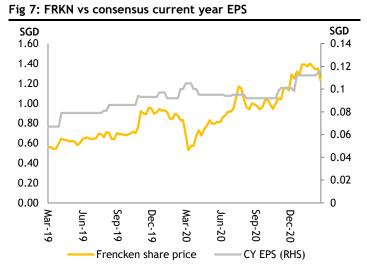
Source: Bloomberg, Maybank Kim Eng

March 14, 2021

Source: Bloomberg, Maybank Kim Eng

## Frencken





Source: Bloomberg, Maybank Kim Eng

### UMS

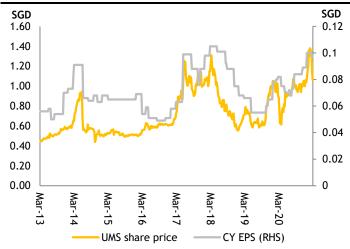
Figure 8: UMS share price vs. US 10 Y yields.



Source: Bloomberg, Maybank Kim Eng

Source: Bloomberg, Maybank Kim Eng

Fig 9: UMS vs consensus current year EPS



Source: Bloomberg, Maybank Kim Eng

## UMS Holdings (UMSH SP)

## Several upside drivers

### Raising TP to capture upside potential; BUY

We see several factors that may translate to upside for UMS. These include: i) potentially underappreciated FY21E revenue momentum; ii) room for increased volumes as Lam sets up shop in Penang; and iii) potential for new customer win that could drive long-term growth. As such, we now value UMS at 15x FY21E P/E (1.5SD above 5-year mean), from ROE-g/COE-g derived 2.5x FY21E P/B, as our previous approach does not capture these upside drivers that are hard to quantify. BUY with higher TP of SGD1.57.

### Strength in current cycle

Consensus expects AMAT revenue to grow 26% YoY in FY21. Within this, the semi systems segment is expected to grow 35% YOY. AMAT also expects PVD (of which Endura caters to, and UMS is a supplier for the Endura platform) to grow 40% YoY. We see consensus revenue growth for UMS of 16% YoY for FY21 as undemanding against AMAT's strong backdrop, and see possibility for upward revisions as the year progresses. AMAT expects the current strength to last into 2022.

### Other upside drivers

Much of UMS' volume production takes place in Penang, Malaysia. Lam Research (AMAT's closest competitor), recently topped out its new USD225m manufacturing facility in Penang. As Lam would likely have to build up its supply chain, and AMAT has several suppliers in Penang, we do not rule out UMS can be a beneficiary of increased volumes in a scenario where a rising tide lifts all boats. UMS cut 4Q20 DPS to SGD1cts (4Q19: SGD2.5cts). We believe this signals efforts to court new business opportunities are ongoing and UMS would need to expand capacity if this materialises.

### Reduced cyclicality may infer higher valuations

AMAT believes it is in the early-innings of a decade-plus investment cycle amid inflections like Big Data, AI and 5G. Its equipment is also crucial in enabling increasingly mainstream technologies like advanced packaging as traditional Moore's law hits limitations. We believe these could translate to shallower cycles for UMS, in turn providing room for its stock to enjoy higher multiples. Key risk is if we have overestimated margins or underestimated effective tax rate.

FYE Dec (SGD m)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	132	164	196	214	204
EBITDA	40	47	70	78	71
Core net profit	34	46	56	65	58
Core EPS (cts)	6.3	8.6	10.5	12.1	10.8
Core EPS growth (%)	(22.1)	37.9	21.2	15.9	(10.7)
Net DPS (cts)	4.0	4.0	3.0	3.0	3.0
Core P/E (x)	16.5	12.5	11.1	9.6	10.7
P/BV (x)	2.3	2.3	2.1	1.8	1.6
Net dividend yield (%)	3.9	3.7	2.6	2.6	2.6
ROAE (%)	13.8	14.7	20.6	20.5	16.0
ROAA (%)	11.9	15.4	16.9	17.2	13.8
EV/EBITDA (x)	13.2	11.6	8.1	6.6	6.6
Net gearing (%) (incl perps)	net cash				
Consensus net profit	-	-	50	56	57
MKE vs. Consensus (%)	-	-	11.3	14.7	1.6
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## BUY

Share Price	SGD 1.16
12m Price Target	SGD 1.57 (+38%)
Previous Price Target	SGD 1.34

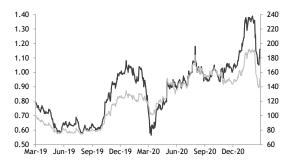
#### **Company Description**

UMS manufactures high precision components and modules found in front-end semiconductor equipment

#### Statistics

52w high/low (SGD)	1.39/0.57
3m avg turnover (USDm)	7.0
Free float (%)	69.2
Issued shares (m)	536
Market capitalisation	SGD622.3M
	USD463M
Major shareholders:	
LUONG ANDY	20.7%
UMS Holdings Bhd.	6.8%
Dimensional Fund Advisors LP	0.7%

#### Price Performance



UMS Holdings - (LHS, SGD) UMS Holdings / Straits Times Index - (RHS, %)

	-1M	-3M	-12M
Absolute (%)	(15)	16	50
Relative to index (%)	(19)	6	30
Source: FactSet			

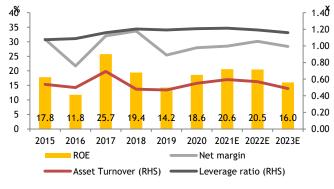


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### **Value Proposition**

- Precision metals engineering firm specialises in assembling modules and precision engineering for components for front-end semiconductor equipment.
- Has entrenched relationship with key customer Applied Materials, which in turn has an estimated 19% of WFE market share in 2018.
- Through associate JEP, UMS is expanding precision metals engineering to non-semiconductor sectors such as aerospace, which sees tailwinds from outsourcing trends.

### UMS Du Pont ROE



Source: Company, Maybank Kim Eng

### **Financial Metrics**

- PATMI growth of 21% in FY21E, driven by sustained investments from logic and foundry end-customers, and recovery from memory end-customers.
- UMS has a strong track record of maintaining a net cash balance sheet to tide through cycles.
- We forecast capex to be near depreciation levels. FCF and balance sheet are expected to support dividends over forecast period.



### EPS, FCF per share and DPS

### **Price Drivers**

### Historical share price trend



#### Source: Company, Maybank Kim Eng

- 1. Endura contract renewed for three years (2020 expiry)
- 2. Insider purchases from CEO Andy Luong and financial controller Stanley Loh.
- 3. 1Q18 revenue fell 11% YoY following six consecutive quarters of YoY increases.
- 4. AMAT spots optimistic tone for FY20 while UMS affirms it is seeing stable order volumes from AMAT.
- 5. AMAT, alongside peers, reaffirm positive FY20 expectations; UMS highlights semiconductor market has bottomed.

### **Swing Factors**

### Upside

- Earlier-than-expected recovery in investments from memory semiconductor players.
- Better-than-expected contributions from Kalf Engineering, Starke and JEP.
- Better-than-expected cost control, which in turn supports margins.

### Downside

- Further deterioration in US-China trade relations resulting in delayed semiconductor equipment spending.
- Weaker-than-expected margins due to negative operating leverage if volume falls.
- Lower-than-expected dividends may spook yield investors. UMS has a quarterly dividend policy and a track record of strong cash flow generation.

Source: Company, Maybank Kim Eng

## ESG

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### **Business Model & Industry Issues**

- Based on stakeholders' feedback, governance, economic performance, product compliance and customer privacy and satisfaction are the most important factors to both UMS and stakeholders. Waste management, water conservation and energy efficiency are among factors that are less material.
- Risks exposure include: i) socioeconomic: employees' wellbeing and equal opportunities; ii) governance: conflicts of interest; and iii) environmental: fines for non-compliance of environmental laws and regulations.
- In 2019, UMS did not incur any significant fines related to environmental laws, and there were no reported incidences of discrimination, whistleblowing, bribery or corruption.
- Human capital is a key input in driving UMS' capabilities vs. competitors. UMS believes in talent management to nurture employees, provide equal opportunities, and recognise and reward achievements to boost retention.

### Material E issues

- UMS' environmental exposure is through energy, water and inputs. In 2019, UMS did not incur any significant fines for non-compliance with environmental laws and regulations.
- For its manufacturing process, UMS' target for energy intensity is ≤0.13 KWH/revenue. In 2019, UMS' performance was 0.178.
- UMS has taken steps to control water flow in its special process lines, and have switched to NEWater from PUB water. It has a water intensity target of ≤0.0012 m3/revenue. In 2019, UMS' performance was 0.0014.
- Hazardous waste largely consists of chemicals and oily water removed from production processes. These are disposed of in compliance with regulations. Where possible, all retrieved metal chip and scraps, as well as packaging are recycled.
- Most delivery trucks are incompliance with EURO V standard.

### Material S issues

- UMS' workforce is 522 strong across Singapore and Malaysia as at end-2019. UMS is an equal-opportunity employer and values talent retention. Outstanding employees are rewarded for achievements.
- UMS adopts a localisation strategy for overseas operations to ensure on-the-ground teams have a good grasp of local socio-political and cultural sensitivities. In 2019, locals accounted for 44% of employees based in Malaysia and 90% of managerial positions. 26% of managerial employees are female.
- In 2019, there were no reports of discrimination or exploitative labour practices.

### Key G metrics and issues

- The board has five directors, of which one is the founder, executive chairman and CEO (Andy Luong), and three are independent, non-executive (60%). One is an executive director who is also UMS' financial controller (Stanley Loh).
- The audit, nominating, and remuneration committees are chaired by independent directors.
- Workshops on business ethics, anti-bribery compliance and enterprise risk management are held to educate employees on good corporate governance. Guidance is also provided for common ethical issues such as conflicts of interest and confidential information.
- In 2019, UMS did not receive any whistleblowing report regarding the company, and there were no cases of bribery or corruption.
- In 2019, key management personnel accounted for nearly a-third of employee benefits expense.
- In 2012, UMS adopted a policy to declare dividends every quarter. The form and frequency depends on UMS' economic performance and financial position, as well as current and future needs.
- In 2019, there were related-party transactions involving Sure Achieve Consultant, of which the wife of Mr Luong is a director. There were also transactions with Kalf Engineering in which Mr Luong and Mr Loh have an interest. All transactions were based on normal commercial terms and are not prejudicial to UMS and minority shareholders.

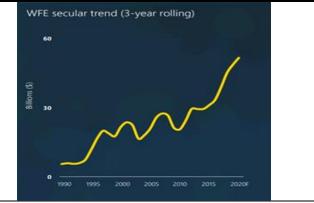
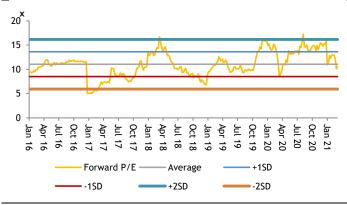


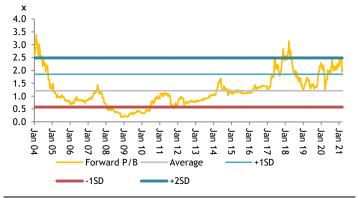
Figure 10: Recent cyclicality has been less pronounced, due to increasingly structural growth drivers

Source: Lam Research









Source: Bloomberg, FactSet, Maybank Kim Eng, Company

Source: Bloomberg, FactSet, Maybank Kim Eng, Company

### Figure 13: Peer comparisons

Company	BBG	MKE	MKE TP	Price	FYE	Мсар		P/E	: (x)		EV /EBITDA (x)	PBR (x)	Div yield (%)
	Code	Rec	(LC)	(LC)	mm	USDm	Act	FY1	FY2	FY3	FY1	FY1	FY1
UMS	UMSH SP	Buy	1.57	1.16	12	315	12.8	11.1	9.6	10.7	8.1	2.1	2.6
Singapore-listed semiconductor equipment makers/ suppliers													
AEM	AEM SP	Buy	5.05	3.88	12	363	11.0	10.9	10.1	10.0	6.0	2.1	2.3
Micro-Mechanics	MMH SP	NR	-	3.09	06	320	29.3	23.1	20.9	22.6	12.1	7.4	4.5
Average							17.4	14.7	13.2	14.1	7.8	3.8	3.2
Globally listed AMAT suppliers													
Ultra Clean Holdings	UCTT US	NR	-	50.85	12	2,065	18.2	14.6	13.3	-	-	3.3	-
MKS Instruments Advanced Energy	MKSI US	NR	-	169.66	12	9,369	22.8	19.1	17.8	17.4	12.4	3.4	0.5
Industries	AEIS US	NR	-	108.70	12	4,163	20.8	19.1	17.1	-	-	4.1	0.0
Brooks Automation	BRKS US	NR	-	85.83	09	6,370	68.1	42.9	37.3	30.6	21.2	5.3	0.9
Ichor Holdings	ICHR US	NR	-	46.10	12	1,294	18.4	14.9	12.2	11.5	7.5	2.7	0.0
Flex	FLEX US	NR	-	18.28	03	9,125	14.9	12.7	11.8	11.1	6.8	2.7	0.0
Celestica	CLS US	NR	-	8.68	12	954	8.9	9.0	7.9	-	-	-	0.0
Average							28.2	21.2	19.0	18.1	12.4	3.6	0.6
Globally listed front-end semicon equipment makers													
Applied Materials	AMAT US	NR	-	117.19	10	107,541	28.1	19.5	18.1	17.1	14.0	7.6	0.8
Lam Research	LRCX US	NR	-	535.39	06	76,512	33.6	21.4	20.3	17.9	14.7	13.0	0.9
ASML	ASML NA	NR	-	456.90	12	229,245	53.8	43.9	36.2	31.2	25.0	12.7	0.7
KLA Corp	KLAC US	NR	-	296.36	06	45,662	28.6	22.0	20.7	19.3	15.1	13.5	1.2
Tokyo Electron	8035 JP	NR	-	40,410	03	58,557	34.5	27.3	22.2	19.7	13.6	6.5	1.8
							41.1	31.7	27.1	24.0	19.1	11.0	0.9

Source: Bloomberg, FactSet, Maybank Kim Eng

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Metrics					
P/E (reported) (x)	11.6	13.7	11.1	9.6	10.7
Core P/E (x)	16.5	12.5	11.1	9.6	10.7
P/BV (x)	2.3	2.3	2.1	1.8	1.6
P/NTA (x)	2.3	2.3	2.1	1.8	1.6
Net dividend yield (%)	3.9	3.7	2.6	2.6	2.6
FCF yield (%)	8.8	7.8	5.8	10.2	10.5
EV/EBITDA (x)	13.2	11.6	8.1	6.6	6.6
EV/EBIT (x)	15.9	13.9	9.2	7.4	7.6
INCOME STATEMENT (SGD m)					
Revenue	131.9	164.4	195.6	214.2	203.5
EBITDA	40.4	46.9	69.6	78.2	70.8
Depreciation	(6.9)	(7.7)	(8.2)	(8.4)	(8.6
Amortisation	0.0	0.0	0.0	0.0	(0.0
EBIT	33.5	39.2	61.5	69.8	62.1
Net interest income / (exp)	(0.6)	(0.4)	(0.2)	(0.2)	(0.2
Associates & JV	2.6	0.1	0.5	2.0	2.0
Exceptionals	(1.0)	9.5	0.0	0.0	0.
Other pretax income	0.0	0.0	0.0	0.0	0.
Pretax profit	34.5	48.4	61.8	71.6	63.
Income tax	(2.2)	(2.6)	(6.2)	(7.2)	(6.4
Minorities	0.3	0.2	0.2	0.2	0.
Discontinued operations	0.0	0.0	0.0	0.0	0.
Reported net profit	32.6	36.5	55.8	64.6	57.
Core net profit	33.6	46.0	55.8	64.6	57.
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	34.4	53.8	73.4	120.7	166.
Accounts receivable	22.1	23.5	28.0	34.2	27.
Inventory	51.7	53.9	71.8	73.4	68.
Property, Plant & Equip (net)	52.3	56.3	53.1	49.8	46.
Intangible assets	81.2	80.1	80.1	80.1	80.
Investment in Associates & JVs	39.4	35.4	35.9	37.9	39.
Other assets	6.1	6.6	6.6	6.6	6.
Total assets	287.2	309.5	348.8	402.6	433.9
ST interest bearing debt	9.3	15.7	15.7	15.7	15.
Accounts payable	18.8	25.4	26.9	32.2	25.
	3.6	3.8	3.4	3.4	23.
LT interest bearing debt					
Other liabilities	11.0	12.0	10.0	10.0	10.
Total Liabilities	42.3	56.6	56.3	61.6	51.4
Shareholders Equity	243.3	251.3	291.1	339.7	381.
Minority Interest	1.6	1.7	1.5	1.3	1.
Total shareholder equity	244.9	252.9	292.5	341.0	382.
Total liabilities and equity	287.2	309.5	348.8	402.6	433.9
CASH FLOW (SGD m)				_	
Pretax profit	34.5	48.4	61.8	71.6	63.
Depreciation & amortisation	6.9	7.7	8.2	8.4	8.
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.
Change in working capital	18.1	3.0	(22.2)	(2.5)	5.
Cash taxes paid	(2.3)	(2.1)	(6.2)	(7.2)	(6.4
Other operating cash flow	0.0	0.0	0.0	0.0	0.
Cash flow from operations	54.5	56.9	41.1	68.3	69.
Capex	(5.8)	(11.7)	(5.0)	(5.0)	(5.0
Free cash flow	48.7	45.2	36.1	63.3	64.
Dividends paid	(18.8)	(26.7)	(16.0)	(16.0)	(16.0
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.
Change in Debt	(12.2)	6.6	(0.4)	0.0	(3.4
Other invest/financing cash flow	(3.3)	4.0	0.0	0.0	(3.4
Effect of exch rate changes	(0.0)	(9.7)	0.0	0.0	0.
	(0.0)	(7.7)	0.0	0.0	0.

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Ratios					
Growth ratios (%)					
Revenue growth	3.1	24.7	19.0	9.5	(5.0)
EBITDA growth	(20.9)	16.1	48.5	12.3	(9.5)
EBIT growth	(26.2)	17.0	56.8	13.5	(11.0)
Pretax growth	(24.3)	40.5	27.6	15.9	(10.7)
Reported net profit growth	(24.4)	12.0	52.9	15.9	(10.7)
Core net profit growth	(22.1)	37.1	21.2	15.9	(10.7)
Profitability ratios (%)					
EBITDA margin	30.6	28.5	35.6	36.5	34.8
EBIT margin	25.4	23.8	31.4	32.6	30.5
Pretax profit margin	26.1	29.4	31.6	33.4	31.4
Payout ratio	65.9	58.5	28.7	24.8	27.7
DuPont analysis					
Net profit margin (%)	24.7	22.2	28.5	30.2	28.4
Revenue/Assets (x)	0.5	0.5	0.6	0.5	0.5
Assets/Equity (x)	1.2	1.2	1.2	1.2	1.1
ROAE (%)	13.8	14.7	20.6	20.5	16.0
ROAA (%)	11.9	15.4	16.9	17.2	13.8
Liquidity & Efficiency					
Cash conversion cycle	309.7	194.1	194.3	210.1	212.1
Days receivable outstanding	50.8	49.9	47.3	52.3	54.2
Days inventory outstanding	354.3	247.5	251.5	266.3	266.3
Days payables outstanding	95.3	103.3	104.5	108.5	108.5
Dividend cover (x)	1.5	1.7	3.5	4.0	3.6
Current ratio (x)	3.3	2.8	3.7	4.4	5.8
Leverage & Expense Analysis					
Asset/Liability (x)	6.8	5.5	6.2	6.5	8.4
Net gearing (%) (incl perps)	net cash				
Net gearing (%) (excl. perps)	net cash				
Net interest cover (x)	52.9	98.7	nm	nm	nm
Debt/EBITDA (x)	0.3	0.4	0.3	0.2	0.2
Capex/revenue (%)	4.4	7.1	2.6	2.3	2.5
Net debt/ (net cash)	(21.4)	(34.2)	(54.3)	(101.6)	(150.3)

Source: Company; Maybank

## Frencken Group Ltd (FRKN SP)

## Thesis playing out

## Favourable prospects, cyclically and structurally; BUY

Frencken's cyclical and structural prospects remain attractive. As it executes on delivering a breadth of new products with greater value-add in coming years, we see upside potential to net margins. Alongside, institutional interest have been rising as the investment thesis plays out. We raise our TP to SGD1.74, now based on 14.5x FY21E P/E (2SD above 10-year mean), from ROE-g/COE-g-derived 1.6x FY21E P/B previously, to account for longer-term potential of better than expected margins.

### Drivers of cyclical dynamics

Frencken expects new product introductions in medical and analytical segments in FY21E, of which in some Frencken have increased value-add materially. As elective surgeries return, Frencken expects orders deferred from last year to be realised this year. Semiconductor visibility also appears strong through the entire year. Of the SGD23.7m spent on capex in FY20, around 80% was purposed for semiconductor requirements.

### Margin upside in medium term

Our/consensus' net margin assumption are 7-8% for FY21-23E. As Frencken increases its value-add with customers over the next few years through a breadth of new products, we see upside potential. IMS segment margins were 5%/8% in FY19-20, a large improvement from 1% in FY17-18, largely driven by continued cost improvements. We believe as Frencken's proprietary eco-PVD and filters in the automotive subsegment grow in future years, these could be a further driver of IMS margins.

### Momentum in execution underpins rising interest

We believe valuation at +2SD above 10-year mean is not onerous. Frencken's historical multiples may not be fully indicative of future potential, as since 2015, current management have turned around the company, and have set the foundation to drive growth from a breadth of new products with greater value add. Yet, our 14.5x FY21E P/E is still a discount to what consensus is inferring for Venture (18x), which we see is warranted as VMS is larger and more diversified. Key risks are: i) our overestimation of industrial automation growth in FY21E, and/ or ii) weaker-than-expected volumes, due to either still difficult business conditions/ risks of shortages in the supply chains.

FYE Dec (SGD m)	FY19A	FY20A	FY21E	FY22E	FY23E	
Revenue	659	621	688	710	750	
EBITDA	80	80	88	97	103	
Core net profit	47	49	51	57	59	
Core FDEPS (cts)	11.0	11.5	11.9	13.3	13.8	
Core FDEPS growth(%)	36.2	4.8	4.0	11.7	3.8	
Net DPS (cts)	3.0	3.4	3.6	4.0	4.2	
Core FD P/E (x)	8.4	11.5	11.6	10.4	10.0	
P/BV (x)	1.3	1.7	1.6	1.4	1.3	
Net dividend yield (%)	3.2	2.6	2.6	2.9	3.0	
ROAE (%)	15.1	13.6	14.5	14.6	13.7	
ROAA (%)	9.6	9.2	8.7	9.1	8.8	
EV/EBITDA (x)	4.0	5.7	5.3	4.5	4.1	
Net gearing (%) (incl perps)	net cash					
Consensus net profit	-	-	50	54	56	
MKE vs. Consensus (%)	-	-	2.1	5.3	5.5	
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THIS REPORT HAS BEEN PREPARED BY MAYBANK KIM ENG RESEARCH SEE PAGE 20 FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS



## BUY

Share Price	SGD 1.39
12m Price Target	SGD 1.74 (+28%)
Previous Price Target	SGD 1.39

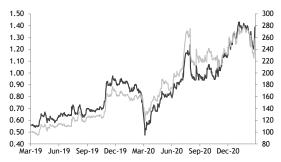
### **Company Description**

Frencken manufactures components and modules for various industries including semiconductor, life sciences, automotive and industrial automation.

### Statistics

52w high/low (SGD)	1.43/0.48
3m avg turnover (USDm)	3.6
Free float (%)	59.8
Issued shares (m)	426
Market capitalisation	SGD592.3M
	USD440M
Major shareholders:	
GOOI FAMILY	9.4%
Micro Compact Sdn. Bhd.	6.2%
Precico Holdings Sdn. Bhd.	6.1%

### Price Performance



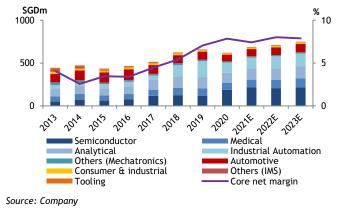
	-1M	-3M	-12M
Absolute (%)	1	23	96
Relative to index (%)	(4)	12	69
Source: FactSet			



### Value Proposition

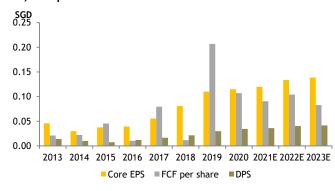
- Technology hardware manufacturer that specialises in complex components.
- High-mix, low-volume, high complexity for mechatronics segment.
- Customers are sticky, given: i) decades-long working relationships; ii) complementary competencies; and iii) mutual dependency (sole-source for some critical products).
- We expect Frencken to leverage its relationships with customers to introduce products with greater value-add, in turn driving margins further.

### Diverse end markets with room for margin expansion



### **Financial Metrics**

- Over the medium term, we expect earnings to be driven by revenue growth and margin optimisation through new products and improving efficiencies.
- Net cash balance sheet and strong cash flow should provide resilience amid economic uncertainties.
- Historically pays out 30% of earnings as dividends. We expect this trend to continue.

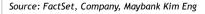


### EPS, FCF per share and DPS

### Price Drivers

### Historical share price trend





- 6. 1Q17 core net profit doubled to SGD6.1m, driven by strength in semiconductor and analytical subdivisions.
- 7. General derating of the Singapore tech sector amid initial US-China tensions.
- 8. Reported FY18 core net profit of SGD34m (+47% YoY) on strength from industrial automation.
- Reported 3Q19 core net profit of SGD31m (+35%) on strength from industrial automation and semiconductor. General tech sector rerating amid initial signs of global semiconductor recovery.

### **Swing Factors**

### Upside

- Stronger-than-expected semiconductor and industrial automation contributions in FY20-21E.
- Robust margin accretion from new products and improving efficiencies.
- Improving institutional interest, which could help the stock rerate towards peers' valuations.

### Downside

- Erosion in revenue resilience due to on-going economic weakness.
- Supply chain disruptions that impede Frencken's production ability and revenue recognition.
- Lower-than-expected dividend pay-out.

Source: Company, Maybank Kim Eng

### Maybank Kim Eng

## ESG

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### Business Model & Industry Issues

- The nature of Frencken's business in the electronics and automotive manufacturing supply chains exposes it to risks including environmental, workplace safety, and conflict of interest. Frencken has not faced any fines or non-monetary sanctions pertaining environmental nor socioeconomic laws and regulations in 2019.
- From an environment perspective, Frencken's Eco-PVD offering can be seen as a more environmentally friendly approach for automotive coating. While Frencken does not use recycled materials currently, it may do so in the future subject to customers' requirements.
- From a governance and socioeconomic perspective, Frencken is adopting industry best practices, including those set by customers, as these facilitate smooth business.

### Material E issues

- Environmental risks Frencken's production process involves non-renewable materials and waste generation. Non-compliance of rules and laws may severely impact the environment of local communities.
- In 2019, Frencken had zero fines and non-monetary sanctions for non-compliance with environmental laws and/or regulations.
- Areas for potential improvement include i) increased use of recycled materials, contingent on customer approval;
  ii) increased efficiency of water and electric usage.
- Opportunities Frencken's proprietary eco-PVD coating technology is more environmentally friendly than traditional PVD methods. Frencken is optimistic of longterm prospects for this offering.

### **Material S issues**

- Employee health and safety risks. Frencken benchmarks its occupational safety and health practices against industry best practices. E.g. the Bangi (Malaysia) plant is in compliance with Agilent Supplier Environmental, Health and Safety and Social Responsibility guidelines.
- No Covid-19 cases as at May-20. Employee safety remains of paramount importance for Frencken with proper mitigation measures implemented.
- In 2019, Frencken's injury rate was 0.078%.
- Employees underwent an average of 8.9 hours of training in 2019 across topics such as environmental management, health and safety, HR, and quality management.
- Male employees account for 70.9% of the workforce. Socioeconomic risks. To ensure smooth business operations, Frencken i) adheres to all applicable laws and regulations and ii) upholds strong ethical standards. This safeguards trust with stakeholders and avoids liability due to non-compliance.

### Key G metrics and issues

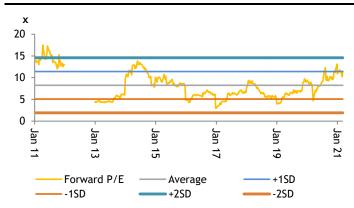
- Board consists of six directors, of whom one is an executive director (CEO), one is a non-executive, nonindependent chairman, and four are independent (67%). All directors are male.
- The nominating, audit and remuneration committees are chaired by independent directors.
- Chairman Mr. Gooi Soon Chai's deemed stake in the company is c.22%.
- Three independent directors have served more than nine years from date of appointments. Frencken states that their independence is not in any way affected by their length of service.
- Professional background of independent directors includes law, accounting, consultancy and electronics engineering.
- Key management/ directors' compensation accounted for 3.6%/1.2% of total employee compensation in 2019. (2018: 3.2%/ 1%)
- Related-party transactions were immaterial (<1% of profit).</li>
- Auditor is Deloitte & Touche LLP which was appointed in 2014.
- Former non-independent non-executive chairman Mr. Larry Low resigned in 2016 and pared his stake from 8.14% to 4.74% in 2018. Mr. Low is the father of fugitive Jho Low. However, this development has no impact to the governance nor operations of the company as current management and board are independent of Mr. Low.

#### Figure 14: Revenue forecasts

Segment revenue (SGDm)	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E	Comments
<u>Mechatronics</u>	373.3	496.8	539.6	520.5	579.9	594.3	627.0	
<u>YoY</u>	24%	33%	<b>9</b> %	-4%	11%	2%	5%	
Medical	72.0	84.0	86.9	85.1	89.3	95.6	101.3	Stable long-term demand from aging populatio
YoY	13%	17%	3%	-2%	5%	7%	<b>6</b> %	
Semiconductor	116.4	125.5	116.0	186.3	218.0	207.1	217.5	Factoring in capex upswing during FY20-21. While some industry reports and equipment makers are forecasting strength to sustain into 2022, our current base case is cyclical contraction in 2022.
YoY	57%	8%	-8%	61%	17%	-5%	5%	
Analytical	114.5	136.7	133.0	115.8	127.4	136.3	144.5	Stable long-term demand from increased healt and wellness awareness
YoY	34%	19%	-3%	-13%	10%	7%	6%	
Industrial automation	50.9	129.0	186.4	118.9	130.8	139.9	148.3	Typically lumpy in nature
YoY	-14%	153%	44%	-36%	10%	7%	6%	
Others	19.5	21.7	17.3	14.4	14.4	15.4	15.4	
YoY	2%	11%	-2 <b>0</b> %	-17%	0%	7%	0%	
IMS	141.6	128.7	121.0	100.9	108.6	116.1	123.7	
YoY	-14%	- <b>9</b> %	-6%	-17%	8%	7%	7%	
Automotive	102.8	96.3	93.7	77.0	84.7	90.7	97.0	Factoring in FY21E recovery following weak volumes in FY20 (which was in part due to shutdown of automotive supply chains as a result of Covid-19)
YoY	-19%	-6%	-3%	-18%	10%	7%	7%	
Consumer & industrial	21.3	21.1	18.3	16.5	16.5	17.7	18.6	
YoY	5%	- 1%	-14%	<b>-9</b> %	0%	7%	5%	
Tooling and others	17.5	11.3	9.0	7.4	7.4	7.8	0.0	
YoY	-3%	-35%	-20%	-18%	0%	6%	- 100%	

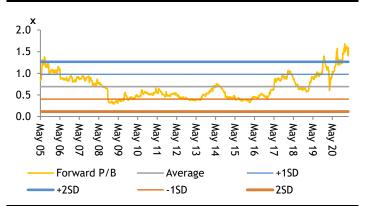
Source: Company data, Maybank Kim Eng

### Figure 15: Forward P/E band



Source: Bloomberg, FactSet, Maybank Kim Eng, Company

### Figure 16: Forward P/B band



Source: Bloomberg, FactSet, Maybank Kim Eng, Company

### Figure 17: Peer comparisons

<b>C</b>	550		MKE	Delas	EVE			D.(5	- ( . )		EV /EBITDA	PBR	Div yield
Company	BBG	MKE	TP	Price	FYE	Mcap			E (x)	EV/2	(X)	(X)	(%)
	Code	Rec	(LC)	(LC)	mm	USDm	Act	FY1	FY2	FY3	FY1	FY1	FY1
Frencken	FRKN SP	Buy	1.74	1.39	12	439	12.2	11.6	10.4	10.0	5.5	1.6	2.6
Singapore listed EMS and precision engineering peers													
Venture Corp	VMS SP	Buy	22.00	19.14	12	4,156	18.7	16.2	14.2	11.8	10.3	2.1	3.9
Valuetronics	VALUE SP	NR	0.58	0.63	03	205	8.5	10.0	12.2	11.4	2.7	1.2	4.1
Average							17.7	15.5	13.7	11.6	9.6	2.0	3.8
High mix low volume EMS peers													
Benchmark Elec	BHE US	NR	-	31.50	12	1,144	33.2	35.5	25.7	-	-	-	-
Plexus	PLXS US	NR	-	90.48	10	2,608	22.2	23.0	20.8	17.8	11.8	2.7	-
Average							25.5	26.8	22.3	17.8	11.8	2.7	0.0
Global EMS players													
Hon Hai	2317 TT	NR	-	117.00	12	57,445	14.1	15.8	12.9	11.6	8.1	1.2	3.4
Flex	FLEX US	NR	-	18.28	03	9,125	14.9	16.1	13.8	12.1	7.2	2.8	0.0
Jabil	JBL US	NR	-	47.71	08	7,179	16.5	18.4	13.5	12.1	5.3	4.2	0.7
Pegatron	2938 TT	NR	-	72.00	12	6,790	9.7	11.3	11.1	10.6	4.3	1.1	6.3
SKP Resources	SKP MK	NR	-	2.22	03	676	37.0	22.3	19.2	17.0	14.4	4.1	2.4
V.S. Industry	VSI MK	Hold	3.25	2.70	07	1,244	42.2	22.3	16.6	15.9	12.2	3.0	2.0
Sanmina	SANM	NR	-	39.40	10	2,558	12.9	14.3	13.2	13.3	-	-	0.0
FIH Mobile	2038 HK	NR	-	1.12	12	1,167	-	-	15.2	14.5		0.6	0.0
Celestica	CLS CN	NR	-	10.86	12	954	8.7	9.3	8.9	6.8	4.0	0.7	0.0
Fabrinet	FN US	NR	-	92.05	06	3,394	24.7	21.5	19.3	17.9	14.6	3.1	-
Average							14.9	16.0	13.3	12.0	7.8	1.7	3.4

Source: Bloomberg, FactSet, Maybank Kim Eng

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23
Key Metrics					
P/E (reported) (x)	6.4	9.1	11.6	10.4	10.0
Core P/E (x)	8.4	11.4	11.6	10.4	10.0
Core FD P/E (x)	8.4	11.5	11.6	10.4	10.0
P/BV (x)	1.3	1.7	1.6	1.4	1.
P/NTA (x)	1.3	1.7	1.6	1.4	1.
Net dividend yield (%)	3.2	2.6	2.6	2.9	3.0
FCF yield (%)	22.4	8.1	6.5	7.5	5.9
EV/EBITDA (x)	4.0	5.7	5.3	4.5	4.1
EV/EBIT (x)	5.5	7.7	7.2	6.1	5.!
INCOME STATEMENT (SGD m)					
Revenue	659.2	620.6	687.6	709.5	749.
EBITDA	80.5	80.1	87.6	96.5	103.
Depreciation	(21.1)	(21.1)	(22.7)	(24.2)	(26.0
Amortisation	0.0	0.0	0.0	0.0	(20.0
	0.0 59.4				
		58.9	64.8	72.3	77.3
Net interest income /(exp)	(1.3)	(0.8)	(0.8)	(0.8)	(0.8
Associates & JV	0.0	0.0	0.0	0.0	0.
Exceptionals	(4.2)	(6.2)	0.0	0.0	0.
Other pretax income	0.0	0.0	0.0	0.0	0.
Pretax profit	53.9	51.9	64.0	71.5	76.
ncome tax	(11.3)	(8.8)	(12.8)	(14.3)	(16.0
Winorities	(0.2)	(0.2)	(0.2)	(0.2)	(1.2
Discontinued operations	0.0	0.0	0.0	0.0	0.
Reported net profit	42.4	42.8	51.0	57.0	59.
Core net profit	46.5	49.1	51.0	57.0	59.
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	122.4	174.5	197.8	225.1	242.
Accounts receivable	97.6	98.7	119.9	121.2	125.
nventory	140.7	143.2	143.5	150.6	160.
Property, Plant & Equip (net)	92.1	99.8	102.1	102.9	127.
Intangible assets	17.5	11.7	11.7	11.7	11.
nvestment in Associates & JVs	0.0	0.0	0.0	0.0	0.
Other assets	35.9	36.0	36.0	36.0	36.
Total assets	506.2	563.8	610.9	647.4	703.
ST interest bearing debt	53.1	67.3	67.3	67.3	67.
Accounts payable	87.8	80.1	91.3	87.7	101.
LT interest bearing debt	0.2	0.0	0.0	0.0	0.
Other liabilities	67.0	80.0	80.0	80.0	80.
Total Liabilities					
	208.0	227.5	238.7	235.1	249.
Shareholders Equity	295.4	334.0	369.6	409.5	450.
Winority Interest	2.8	2.3	2.5	2.7	3.
Total shareholder equity	298.2	336.3	372.2	412.3	454.8
Total liabilities and equity	506.2	563.8	610.9	647.4	703.8
CASH FLOW (SGD m)					
Pretax profit	53.9	51.9	64.0	71.5	76.
Depreciation & amortisation	21.1	21.1	22.7	24.2	26.
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.
Change in working capital	33.6	1.1	(10.3)	(12.0)	(0.0
Cash taxes paid	(9.4)	(5.9)	(12.8)	(14.3)	(16.0
Other operating cash flow	4.2	6.2	0.0	0.0	0.
Cash flow from operations	103.4	74.4	63.6	69.4	86.
Capex	(15.8)	(28.9)	(25.0)	(25.0)	(51.0
Free cash flow	87.5	45.5	38.6	44.4	35.
Dividends paid	(9.1)	(12.8)	(15.3)	(17.1)	(17.7
Equity raised / (purchased)	0.6	0.8	0.0	0.0	0.
Change in Debt	(15.5)	14.1	0.0	0.0	0.
Other invest/financing cash flow	64	59	0.0	0.0	
Other invest/financing cash flow Effect of exch rate changes	6.4 0.0	5.9 (0.3)	0.0 0.0	0.0 0.0	0. 0.

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Ratios					
Growth ratios (%)					
Revenue growth	5.3	(5.8)	10.8	3.2	5.7
EBITDA growth	12.6	(0.5)	9.4	10.2	6.9
EBIT growth	31.7	(0.7)	10.0	11.5	6.7
Pretax growth	34.2	(3.8)	23.4	11.7	6.8
Reported net profit growth	41.1	1.1	19.0	11.7	3.8
Core net profit growth	37.1	5.4	4.0	11.7	3.8
Profitability ratios (%)					
EBITDA margin	12.2	12.9	12.7	13.6	13.8
EBIT margin	9.0	9.5	9.4	10.2	10.3
Pretax profit margin	8.2	8.4	9.3	10.1	10.2
Payout ratio	30.0	34.2	30.0	30.0	30.0
DuPont analysis					
Net profit margin (%)	6.4	6.9	7.4	8.0	7.9
Revenue/Assets (x)	1.3	1.1	1.1	1.1	1.1
Assets/Equity (x)	1.7	1.7	1.7	1.6	1.6
ROAE (%)	15.1	13.6	14.5	14.6	13.7
ROAA (%)	9.6	9.2	8.7	9.1	8.8
Liquidity & Efficiency					
Cash conversion cycle	97.2	97.5	93.7	96.7	94.7
Days receivable outstanding	58.3	56.9	57.2	61.2	59.2
Days inventory outstanding	93.8	99.2	90.7	90.7	90.7
Days payables outstanding	54.9	58.7	54.2	55.2	55.2
Dividend cover (x)	3.3	2.9	3.3	3.3	3.3
Current ratio (x)	2.0	2.0	2.1	2.3	2.3
Leverage & Expense Analysis					
Asset/Liability (x)	2.4	2.5	2.6	2.8	2.8
Net gearing (%) (incl perps)	net cash				
Net gearing (%) (excl. perps)	net cash				
Net interest cover (x)	45.9	70.3	77.4	86.3	92.1
Debt/EBITDA (x)	0.7	0.8	0.8	0.7	0.7
Capex/revenue (%)	2.4	4.7	3.6	3.5	6.8
Net debt/ (net cash)	(69.2)	(107.1)	(130.4)	(157.8)	(175.3)

Source: Company; Maybank

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