

Frencken Group Ltd (FRKN SP)

Time for a breather

D/G to HOLD as short-term risk reward turns neutral

3Q21 PATMI of SGD14.8m (+10.7% YoY) was in line. 9M21 PATMI accounted for 74% of our/consensus' FY21E. We cut FY21-23E EPS by 1-6% to factor i) slower 4Q21 business momentum than we previously expected; and ii) higher cost environment. Our TP falls to SGD2.50 (15.5x FY22E P/E), and we downgrade to Hold as we believe risk-reward is now balanced. Prefer AEM and UMS for exposure for Singapore tech.

3Q21 summary

3Q21 revenue rose 18.7% YoY, driven by semicon (+42.7%), medical (+21.8%), analytical (+29%), and consumer electronics (+18.1%). These were offset by industrial automation (-17%) and automotive (-5.6%). Gross margin fell 0.5ppt YoY to 17.1% due to higher material and freight cost.

2H21 revenue stable HoH

Frencken now expects 2H21 revenue to be stable HoH, from a "moderate increase" previously. In particular, the automotive segment is now expected to soften HoH from "stable". Guidance for most other segments are unchanged, i.e. semiconductor (stable HoH), medical and analytical (higher HoH) and industrial automation (lower HoH). Frencken's medical customer have recently blamed "chips and ships" for lowering guidance recently, and we suspect Frencken's sales potential may have been capped there as well.

Still positive for the longer run

Our forecast reflects assumptions where i) some of 4Q21 sales is pushed out into 2022 amid supply side bottlenecks; and ii) lowered gross margins on account of higher input costs. While we are neutral in the short term, we remain optimistic about Frencken's long term potential with a breadth of new products with stronger value add translating to revenue and margin expansion in coming years. The demand outlook from most customers, such as in semicon, medical and analytical remain encouraging too. Key risk to our view is if supply chain disruptions persist for longer than expected, and or if costs pass through is not as high as we anticipated.

| FYE Dec (SGD m) | FY19A | FY20A | FY21E | FY22E | FY23E |
|------------------------------|----------|----------|----------|----------|----------|
| Revenue | 659 | 621 | 750 | 850 | 904 |
| EBITDA | 80 | 80 | 95 | 109 | 123 |
| Core net profit | 47 | 49 | 59 | 69 | 77 |
| Core FDEPS (cts) | 11.0 | 11.5 | 13.7 | 16.1 | 18.1 |
| Core FDEPS growth(%) | 36.2 | 4.8 | 19.4 | 17.7 | 12.1 |
| Net DPS (cts) | 3.0 | 3.4 | 4.1 | 4.8 | 5.4 |
| Core FD P/E (x) | 8.4 | 11.5 | 17.2 | 14.6 | 13.1 |
| P/BV (x) | 1.3 | 1.7 | 2.7 | 2.4 | 2.1 |
| Net dividend yield (%) | 3.2 | 2.6 | 1.7 | 2.1 | 2.3 |
| ROAE (%) | 15.1 | 13.6 | 16.5 | 17.3 | 17.2 |
| ROAA (%) | 9.6 | 9.2 | 9.8 | 10.4 | 10.6 |
| EV/EBITDA (x) | 4.0 | 5.7 | 9.5 | 8.1 | 7.1 |
| Net gearing (%) (incl perps) | net cash | net cash | net cash | net cash | net cash |
| Consensus net profit | - | - | 60 | 71 | 78 |
| MKE vs. Consensus (%) | - | - | (2.9) | (3.0) | (0.7) |

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HOLD

[Prior:BUY]

Share Price SGD 2.36
12m Price Target SGD 2.50 (+8%)
Previous Price Target SGD 2.63

Company Description

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

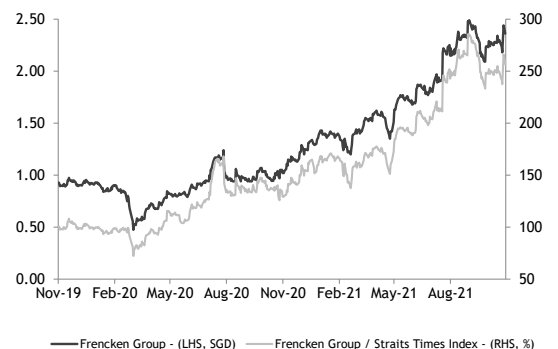
Statistics

| | |
|------------------------|--------------------|
| 52w high/low (SGD) | 2.49/1.02 |
| 3m avg turnover (USDm) | 5.3 |
| Free float (%) | 59.8 |
| Issued shares (m) | 427 |
| Market capitalisation | SGD1.0B USD746M |

Major shareholders:

| | |
|----------------------------|------|
| Micro Compact Sdn. Bhd. | 6.2% |
| Precico Holdings Sdn. Bhd. | 6.1% |
| GOOI FAMILY | 5.7% |

Price Performance



| | | | |
|-----------------------|-----|-----|------|
| | -1M | -3M | -12M |
| Absolute (%) | 5 | 6 | 125 |
| Relative to index (%) | 4 | 4 | 89 |

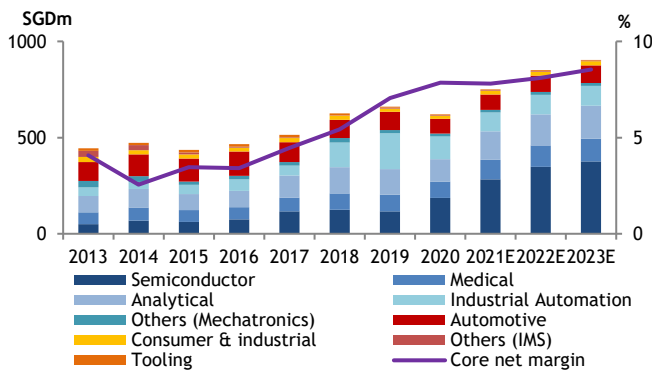
Source: FactSet

ESG@MKE
Tear Sheet Insert

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

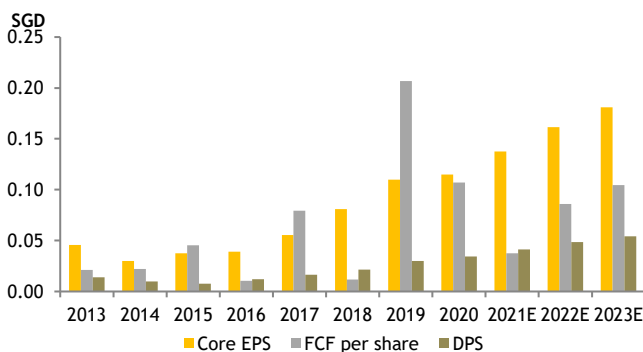


Source: Company

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.

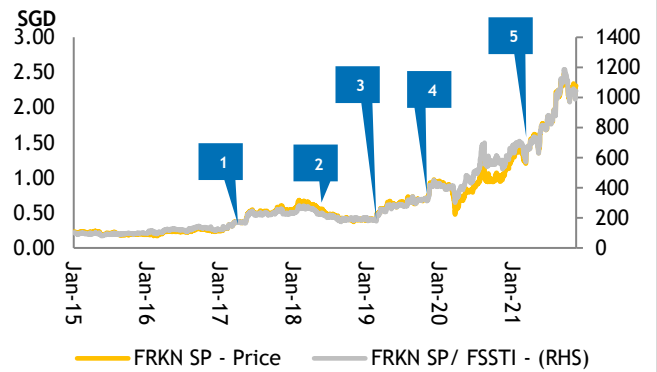
EPS, FCF per share and DPS



Source: Company, Maybank Kim Eng

Price Drivers

Historical share price trend



Source: Company, Maybank Kim Eng

1. 1Q17 core net profit doubled to SGD6.1m, driven by strength in semiconductor and analytical subdivisions.
2. General derating of the Singapore tech sector amid initial US-China tensions.
3. Reported FY18 core net profit of SGD34m (+47% YoY) on strength from industrial automation.
4. 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.
5. Frencken's semiconductor segment is beneficiary of chip shortages

Swing Factors

Upside

- Stronger-than-expected semiconductor and industrial automation contributions.
- 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.



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| | |
|--|-----------|
| Risk Rating & Score¹ | Not Rated |
| Score Momentum² | na |
| Last Updated | na |
| Controversy Score³ | na |

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 2020.
- 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 2020, 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 long-term 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.
- Employee safety remains of paramount importance for Frencken with proper mitigation measures implemented.
- In 2020, Frencken’s injury rate was 0.15%. (2019: 0.078%).
- Employees underwent an average of 1.5-14 hours of training in 2020 across technical, occupational health and safety and strategic topics.
- Male employees account for 34.2% 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, non-independent 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 3.8%/1.3% of total employee compensation in 2020. (2019: 3.6%/ 1.2%).
- Related-party transactions were immaterial (<1% of profit).
- 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.

¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company’s exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company’s enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company’s score since the last update - a **negative** integer indicates a company’s improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Fig 1: Forecast changes

| | FY21E | | | FY22E | | | FY23E | | |
|------------------------|-------|-------|-----------|-------|-------|-----------|-------|-------|-----------|
| | New | Old | Chg (%) | New | Old | Chg (%) | New | Old | Chg (%) |
| Revenue (SGDm) | 750.3 | 767.4 | -2.2 | 850.0 | 839.4 | 1.3 | 904.5 | 892.5 | 1.3 |
| Gross profit (SGDm) | 131.1 | 135.3 | -3.2 | 150.9 | 152.1 | -0.8 | 163.9 | 163.2 | 0.4 |
| EBIT (SGDm) | 72.6 | 76.4 | -5.1 | 85.2 | 89.1 | -4.4 | 96.6 | 96.8 | -0.2 |
| EBITDA (SGDm) | 95.3 | 99.2 | -3.9 | 109.4 | 113.3 | -3.4 | 122.6 | 122.8 | -0.2 |
| Core net profit (SGDm) | 58.5 | 62.1 | -5.8 | 68.9 | 72.5 | -5.0 | 77.2 | 77.8 | -0.8 |
| EPS (SGD) | 0.14 | 0.15 | -5.8 | 0.16 | 0.17 | -5.0 | 0.18 | 0.18 | -0.8 |
| | | | Chg (ppt) | | | Chg (ppt) | | | Chg (ppt) |
| Gross material margin | 17.5% | 17.6% | -0.2 | 17.8% | 18.1% | -0.4 | 18.1% | 18.3% | -0.2 |
| SGA as % of sales | 8.2% | 8.2% | 0.0 | 8.2% | 8.1% | 0.1 | 8.2% | 8.2% | 0.0 |

Source: Maybank Kim Eng

Fig 2: 3Q21 performance summary

| FYE Dec | 3Q21 | 3Q20 | 2Q21 | YoY Chg | QoQ Chg | FYE | 9M21 vs FYE |
|--------------|-------|-------|-------|--------------|---------|-------|-------------|
| | SGDm | SGDm | SGDm | (%) | (%) | SGDm | (%) |
| Revenue | 196.5 | 165.5 | 193.8 | 18.7 | 1.4 | 767.4 | 74.5 |
| Gross profit | 33.5 | 29.2 | 34.1 | 14.7 | -1.7 | 135.3 | 73.1 |
| PATMI | 14.8 | 13.3 | 16.6 | 10.7 | -11.2 | 62.1 | 74.2 |
| Core PATMI | 14.8 | 13.3 | 16.6 | 10.7 | -11.2 | 62.1 | 74.2 |
| | | | | Change (ppt) | | | |
| Gross margin | 17.3% | 17.6% | 17.6% | -0.3 | -0.3 | | |
| Net margin | 7.5% | 8.1% | 8.6% | -0.5 | -1.1 | | |

Source: Company, Maybank Kim Eng

| FYE 31 Dec | FY19A | FY20A | FY21E | FY22E | FY23E |
|-------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Key Metrics | | | | | |
| P/E (reported) (x) | 6.4 | 9.1 | 17.2 | 14.6 | 13.0 |
| Core P/E (x) | 8.4 | 11.4 | 17.2 | 14.6 | 13.0 |
| Core FD P/E (x) | 8.4 | 11.5 | 17.2 | 14.6 | 13.1 |
| P/BV (x) | 1.3 | 1.7 | 2.7 | 2.4 | 2.1 |
| P/NTA (x) | 1.3 | 1.7 | 2.7 | 2.4 | 2.1 |
| Net dividend yield (%) | 3.2 | 2.6 | 1.7 | 2.1 | 2.3 |
| FCF yield (%) | 22.4 | 8.1 | 1.6 | 3.6 | 4.4 |
| EV/EBITDA (x) | 4.0 | 5.7 | 9.5 | 8.1 | 7.1 |
| EV/EBIT (x) | 5.5 | 7.7 | 12.4 | 10.4 | 9.0 |
| INCOME STATEMENT (SGD m) | | | | | |
| Revenue | 659.2 | 620.6 | 750.3 | 850.0 | 904.5 |
| EBITDA | 80.5 | 80.1 | 95.3 | 109.4 | 122.6 |
| Depreciation | (21.1) | (21.1) | (22.7) | (24.2) | (26.0) |
| Amortisation | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EBIT | 59.4 | 58.9 | 72.6 | 85.2 | 96.6 |
| Net interest income / (exp) | (1.3) | (0.8) | (0.9) | (0.9) | (0.9) |
| Associates & JV | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Exceptionals | (4.2) | (6.2) | 0.0 | 0.0 | 0.0 |
| Other pretax income | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Pretax profit | 53.9 | 51.9 | 71.6 | 84.3 | 95.7 |
| Income tax | (11.3) | (8.8) | (12.9) | (15.2) | (17.2) |
| Minorities | (0.2) | (0.2) | (0.2) | (0.2) | (1.2) |
| Discontinued operations | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported net profit | 42.4 | 42.8 | 58.5 | 68.9 | 77.2 |
| Core net profit | 46.5 | 49.1 | 58.5 | 68.9 | 77.2 |
| BALANCE SHEET (SGD m) | | | | | |
| Cash & Short Term Investments | 122.4 | 174.5 | 172.9 | 189.0 | 210.4 |
| Accounts receivable | 97.6 | 98.7 | 139.8 | 158.3 | 163.8 |
| Inventory | 140.7 | 143.2 | 168.9 | 195.0 | 210.8 |
| Property, Plant & Equip (net) | 92.1 | 99.8 | 102.1 | 102.9 | 127.9 |
| Intangible assets | 17.5 | 11.7 | 11.7 | 11.7 | 11.7 |
| Investment in Associates & JVs | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other assets | 35.9 | 36.0 | 36.0 | 36.0 | 36.0 |
| Total assets | 506.2 | 563.8 | 631.4 | 692.8 | 760.6 |
| ST interest bearing debt | 53.1 | 67.3 | 67.3 | 67.3 | 67.3 |
| Accounts payable | 87.8 | 80.1 | 106.5 | 119.5 | 132.1 |
| LT interest bearing debt | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other liabilities | 67.0 | 80.0 | 80.0 | 80.0 | 80.0 |
| Total Liabilities | 208.0 | 227.5 | 253.9 | 266.9 | 279.5 |
| Shareholders Equity | 295.4 | 334.0 | 374.9 | 423.1 | 477.2 |
| Minority Interest | 2.8 | 2.3 | 2.5 | 2.7 | 3.9 |
| Total shareholder equity | 298.2 | 336.3 | 377.4 | 425.9 | 481.1 |
| Total liabilities and equity | 506.2 | 563.8 | 631.4 | 692.8 | 760.6 |
| CASH FLOW (SGD m) | | | | | |
| Pretax profit | 53.9 | 51.9 | 71.6 | 84.3 | 95.7 |
| Depreciation & amortisation | 21.1 | 21.1 | 22.7 | 24.2 | 26.0 |
| Adj net interest (income)/exp | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Change in working capital | 33.6 | 1.1 | (40.5) | (31.6) | (8.8) |
| Cash taxes paid | (9.4) | (5.9) | (12.9) | (15.2) | (17.2) |
| Other operating cash flow | 4.2 | 6.2 | 0.0 | 0.0 | 0.0 |
| Cash flow from operations | 103.4 | 74.4 | 41.0 | 61.8 | 95.7 |
| Capex | (15.8) | (28.9) | (25.0) | (25.0) | (51.0) |
| Free cash flow | 87.5 | 45.5 | 16.0 | 36.8 | 44.6 |
| Dividends paid | (9.1) | (12.8) | (17.6) | (20.7) | (23.2) |
| Equity raised / (purchased) | 0.6 | 0.8 | 0.0 | 0.0 | 0.0 |
| Change in Debt | (15.5) | 14.1 | 0.0 | 0.0 | 0.0 |
| Other invest/financing cash flow | 6.4 | 5.9 | 0.0 | 0.0 | 0.0 |
| Effect of exch rate changes | 0.0 | (0.3) | 0.0 | 0.0 | 0.0 |
| Net cash flow | 69.9 | 53.3 | (1.6) | 16.1 | 21.5 |

| FYE 31 Dec | FY19A | FY20A | FY21E | FY22E | FY23E |
|--|----------|----------|----------|----------|----------|
| Key Ratios | | | | | |
| Growth ratios (%) | | | | | |
| Revenue growth | 5.3 | (5.8) | 20.9 | 13.3 | 6.4 |
| EBITDA growth | 12.6 | (0.5) | 19.0 | 14.8 | 12.0 |
| EBIT growth | 31.7 | (0.7) | 23.1 | 17.4 | 13.4 |
| Pretax growth | 34.2 | (3.8) | 38.1 | 17.6 | 13.5 |
| Reported net profit growth | 41.1 | 1.1 | 36.6 | 17.7 | 12.1 |
| Core net profit growth | 37.1 | 5.4 | 19.3 | 17.7 | 12.1 |
| Profitability ratios (%) | | | | | |
| EBITDA margin | 12.2 | 12.9 | 12.7 | 12.9 | 13.6 |
| EBIT margin | 9.0 | 9.5 | 9.7 | 10.0 | 10.7 |
| Pretax profit margin | 8.2 | 8.4 | 9.5 | 9.9 | 10.6 |
| Payout ratio | 30.0 | 34.2 | 30.0 | 30.0 | 30.0 |
| DuPont analysis | | | | | |
| Net profit margin (%) | 6.4 | 6.9 | 7.8 | 8.1 | 8.5 |
| Revenue/Assets (x) | 1.3 | 1.1 | 1.2 | 1.2 | 1.2 |
| Assets/Equity (x) | 1.7 | 1.7 | 1.7 | 1.6 | 1.6 |
| ROAE (%) | 15.1 | 13.6 | 16.5 | 17.3 | 17.2 |
| ROAA (%) | 9.6 | 9.2 | 9.8 | 10.4 | 10.6 |
| Liquidity & Efficiency | | | | | |
| Cash conversion cycle | 97.2 | 97.5 | 93.7 | 98.6 | 101.6 |
| Days receivable outstanding | 58.3 | 56.9 | 57.2 | 63.1 | 64.1 |
| Days inventory outstanding | 93.8 | 99.2 | 90.7 | 93.7 | 98.6 |
| Days payables outstanding | 54.9 | 58.7 | 54.2 | 58.2 | 61.2 |
| Dividend cover (x) | 3.3 | 2.9 | 3.3 | 3.3 | 3.3 |
| Current ratio (x) | 2.0 | 2.0 | 2.1 | 2.2 | 2.3 |
| Leverage & Expense Analysis | | | | | |
| Asset/Liability (x) | 2.4 | 2.5 | 2.5 | 2.6 | 2.7 |
| Net gearing (%) (incl perps) | net cash | net cash | net cash | net cash | net cash |
| Net gearing (%) (excl. perps) | net cash | net cash | net cash | net cash | net cash |
| Net interest cover (x) | 45.9 | 70.3 | 79.6 | 93.5 | 106.0 |
| Debt/EBITDA (x) | 0.7 | 0.8 | 0.7 | 0.6 | 0.5 |
| Capex/revenue (%) | 2.4 | 4.7 | 3.3 | 2.9 | 5.6 |
| Net debt/ (net cash) | (69.2) | (107.1) | (105.5) | (121.6) | (143.1) |

Source: Company; Maybank

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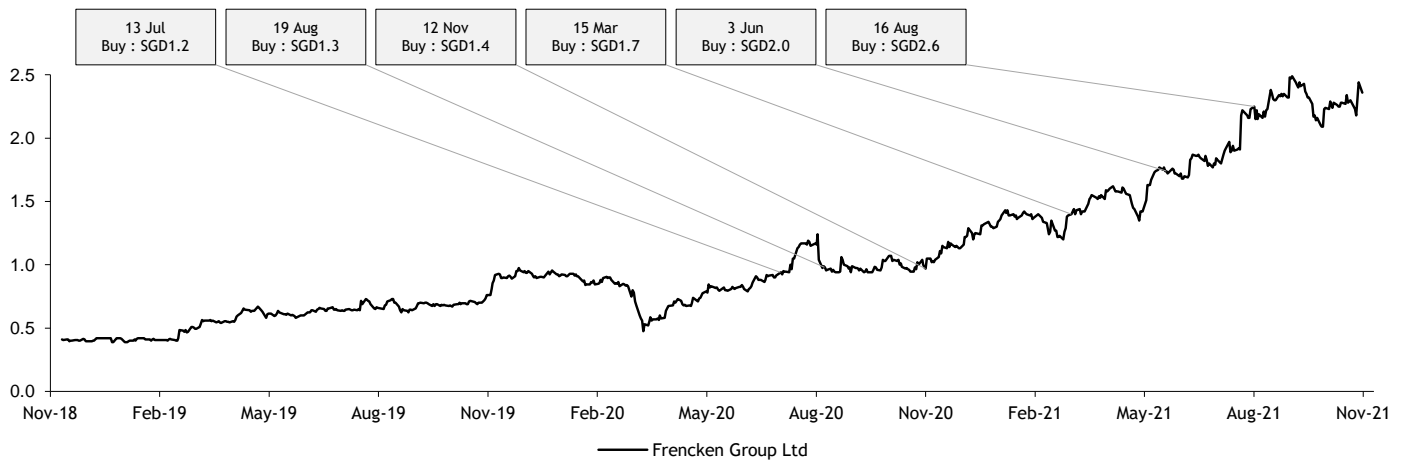
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