

Frencken Group Ltd (FRKN SP)

Accumulate for FY24E

Maintain BUY with a higher TP of SGD1.27

With key customers ASML and AMAT raising their revenue forecasts, we believe Frencken's Singapore and Malaysia factory utilisation should benefit from a recovery of orders in FY24E, especially when ASML is also shifting some of its production from Europe to Malaysia. We think Frencken's performance likely bottomed in 1Q23 in line with management guiding for higher semi-con revenue in 2H23, signalling the worst is possibly over. We are now more confident of a stronger FY24E, and maintain BUY with a higher TP of SGD1.27 (+31%), based on 11x from 9x FY24E PE. We also raise FY24E PATMI by 8.5% on better margins due to higher operating leverage and better utilisation across SEA factories.

Semi-con bottomed for Frencken

Management concurs that the worst is likely over and it expects higher semi-con revenue for 2H23E than 1H23E. This is vital as semi-con contribution is crucial to its financial performance. We believe its key customers have seen their inventory levels dwindle at a faster rate than expected, leading them to raise their orders. In addition, its key customer in Europe with a 1.5-2.0 year lead time for its lithography machines is also trying to move some production to Malaysia which we believe will likely benefit Frencken as it is already assisting the customer shift of some production to Malaysia. We believe FRKN will likely win more market share from its European competitors.

Poised for FY24E recovery

With its top 2 largest semi-con customers raising forecasts, we believe Frencken is likely to benefit from an increase in orders which should lead to a ramp-up in utilisation, especially at its Southeast Asia factories. This would allow it to enjoy the operating leverage it had in FY21-22, increasing its operating margin.

Top Pick across our SG tech sector

Frencken should continue to gradually improve in subsequent quarters but we believe semi-con has already bottomed for Frencken. Trading at just 9.3x FY24x P/E, we see attractive upside, especially if the semi-con recovery materialises as expected. FRKN is our Top Pick in the tech sector.

FYE Dec (SGD m)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	767	786	723	832	956
EBITDA	95	94	62	93	107
Core net profit	59	52	25	49	59
Core FDEPS (cts)	13.7	12.1	5.9	11.6	13.8
Core FDEPS growth(%)	19.8	(11.8)	(51.6)	97.0	19.4
Net DPS (cts)	4.1	3.6	1.8	3.5	4.1
Core FD P/E (x)	14.3	7.8	17.7	9.0	7.5
P/BV (x)	2.2	1.0	1.1	1.0	0.9
Net dividend yield (%)	2.1	3.9	1.7	3.3	4.0
ROAE (%)	16.5	13.5	6.3	11.6	12.7
ROAA (%)	9.4	7.3	3.4	6.4	7.1
EV/EBITDA (x)	7.9	3.7	4.0	4.2	2.5
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	25	38	46
MIBG vs. Consensus (%)	-	-	0.0	28.8	28.6

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BUY

Share Price	SGD 1.04
12m Price Target	SGD 1.27 (+26%)
Previous Price Target	SGD 0.97

Company Description

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

Statistics

52w high/low (SGD)	1.21/0.78
3m avg turnover (USDm)	3.2
Free float (%)	59.8
Issued shares (m)	426
Market capitalisation	SGD443.1M
	USD325M

Major shareholders:

Micro Compact Sdn. Bhd.	6.2%
Precico Holdings Sdn. Bhd.	6.1%
GOOI FAMILY	5.8%

Price Performance



	-1M	-3M	-12M
Absolute (%)	26	11	(11)
Relative to index (%)	29	10	(9)

Source: FactSet

Details of other listed stocks in this note:

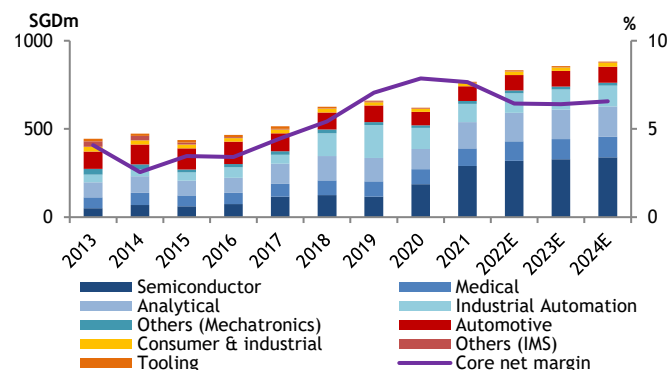
ASML (Nasdaq, CP US\$619, not rated)
AMAT (Nasdaq, CP US\$144, not rated)

ESG@MAYBANK IBG
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

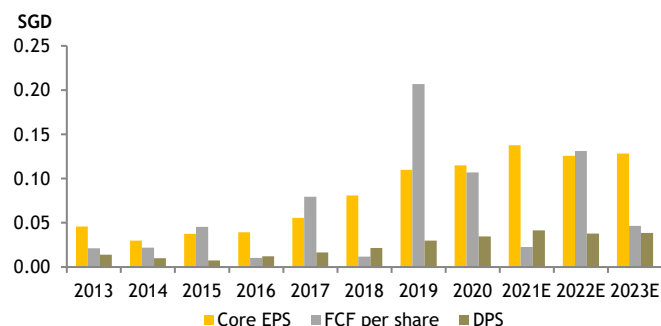


Source: Company

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 uncertainty.
- Historically pays out 30% of earnings as dividends. We expect this trend to continue.

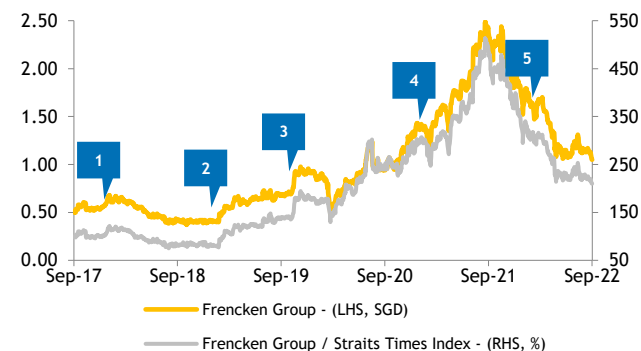
EPS, FCF per share and DPS



Source: Company

Price Drivers

Historical share price trend



Source: Company, Maybank IBG Research

1. General de-rating of the Singapore tech sector amid initial US-China tensions.
2. Reported FY18 core net profit of SGD34m (+47% YoY) on strength from industrial automation.
3. 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.
4. Frencken's semiconductor segment is a beneficiary of chip shortages.
5. Tech sector derating drove share price lower; 1Q22 net profit fell 12.6% YoY on margin pressures amid inflation and other supply chain challenges.

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 re-rate towards peers' valuations.

Downside

- Drop in demand.
- Supply chain disruptions that impede Frencken's production ability and revenue recognition.
- Lower-than-expected dividend pay-out.

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Risk Rating & Score ¹	na
Score Momentum ²	na
Last Updated	na
Controversy Score ³	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 2021.
- 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 2021, 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 2021, Frencken’s injury rate was 0%. (2019: 0.15%). Employees underwent an average of 1.2-17 hours of training in 2021 across technical, occupational health and safety and strategic topics.
- Male employees account for 66% 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

- The 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 3.4%/1.4% of total employee compensation in 2021. (2019: 3.8%/ 1.3%).
- 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).

Quantitative Parameters (Score: 21)						
	Particulars	Unit	2019	2020	2021	Venture SG (2021)
E	Scope 1 GHG emissions	tCO2e	NA	NA	NA	68061
	Scope 2 GHG emissions	tCO2e	NA	NA	NA	NA
	Total	tCO2e	NA	NA	NA	68061
	Scope 3 GHG emissions	tCO2e	NA	NA	NA	NA
	Total	tCO2e	NA	NA	NA	68061
	GHG intensity (Scope 1 and 2)	KgCO2e/emp kWh/unit of sales	NA	NA	NA	28.4
	Energy consumption	M3/unit of sales	NA	6.6	4.4	47.7
	Water consumption	Metric tonnes	NA	0.10	0.11	0.26
	Recycled waste generated	tonnes	NA	NA	17	NA
S	% of women in workforce	%	35.5	65.8	34	55.1
	Economic value generated and distributed	SGD'000	59353	58929	71924	312322
	Average training hours by gender (women)	Number	14	14	6.3	51.1
	New employees hired by gender (women)	%	NA	NA	NA	54
	Total training hours	%	4000	4800	11499	437922
	Key operations assessed for risks related to corruption	%	100	100	100	100
G	MD/CEO salary as % of reported net profit	%	4.72	6.44	2.98	2.41
	Board salary as % of reported net profit	%	2.29	2.25	1.70	0.27
	Independent directors on the Board	%	67	67	60	75
	Female directors on the Board	%	0	0	0	38

Qualitative Parameters (Score: 67)	
a)	Is there an ESG policy in place and is there a standalone ESG committee or is it part of a risk committee? <i>Yes, Frencken added Ethical Sustainable Profitable Growth to the tag line, signalling the start of its sustainability journey called "Frencken*Sustain*Life" (FSL). FSL is its Environment Social Governance programme, managed by its board and key management team, which will prioritize returns to stakeholders.</i>
b)	Is the senior management salary linked to fulfilling ESG targets? <i>Yes. The BSC KPI's are accessed on an annual basis during management review meetings</i>
c)	Does the company follow the task force of climate related disclosures (TCFD) framework for ESG reporting? <i>Yes</i>
d)	Does the company have a mechanism to capture Scope 3 emissions - which parameters are captured? <i>No</i>
e)	What are the 2-3 key carbon mitigation/water/waste management strategies adopted by the company? <i>For new shipments, Frencken reuses cartons and plastic pallets returned by customers. In this way, it aligns with customers' efforts in reducing plastic and paper waste to landfills. To reduce its carbon footprint and build greater business sustainability, solar energy panels have been installed at its factories in Chuzhou (China), Selangor (Malaysia) and Thailand.</i>
f)	Does carbon offset form part of the net zero/carbon neutrality target of the company? <i>No</i>

Target (Score: 66.7)		
Particulars	Target	Achieved
Less than 0.20% of water consumption per sale value	0.20%	0.11%
Less than 7% of electricity consumption per sale value	7.00%	4.38%
Briefings to present quarterly and FY results	100%	100%
Carbon neutrality/net zero	NA	NA
Impact		
NA		
Overall Score: 44		
As per our ESG matrix, Frencken Group (FRKN SP) has an overall score of 44.		

ESG score	Weights	Scores	Final Score
Quantitative	50%	21	11
Qualitative	25%	67	17
Target	25%	67	17
Total			44

As per our ESG assessment, FRKN has an established framework, internal policies, and tangible mid/long-term targets but needs to make headway in improving its quantitative "E" metrics, especially on GHG emissions. FRKN's overall ESG score is 44, which makes its ESG rating below average in our view (average ESG rating = 50)

Fig 1: Changes in our FY23-25 forecasts

	FY23E			FY24E			FY25E		
	New	Old	Chg (%)	New	Old	Chg (%)	New	Old	Chg (%)
Revenue (SGDm)	723.2	723.2	0.0	831.7	832.0	0.0	956.5	956.5	0.0
Gross profit (SGDm)	86.2	86.2	0.0	124.0	112.0	10.7	145.3	145.3	0.0
EBIT (SGDm)	34.1	34.1	0.0	63.4	59.3	7.0	75.0	75.0	0.0
EBITDA (SGDm)	62.2	62.2	0.0	93.3	89.0	4.8	106.6	106.6	0.0
Core net profit (SGDm)	25.1	25.1	0.0	49.5	45.6	8.5	59.0	59.0	0.0
EPS (SGD)	0.06	0.06	0.0	0.12	0.11	8.5	0.14	0.14	0.0
			Chg (ppt)			Chg (ppt)			Chg (ppt)
Gross material margin	15.1%	15.6%	-0.4	14.9%	15.7%	-0.8	15.2%	15.7%	-0.6
SGA as % of sales	7.8%	8.2%	-0.4	7.9%	7.9%	0.0	8.0%	8.2%	-0.2

Source: Maybank IBG Research

FYE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Key Metrics					
P/E (reported) (x)	13.2	10.5	17.7	9.0	7.5
Core P/E (x)	14.3	7.8	17.7	9.0	7.5
Core FD P/E (x)	14.3	7.8	17.7	9.0	7.5
P/BV (x)	2.2	1.0	1.1	1.0	0.9
P/NTA (x)	2.2	1.0	1.1	1.0	0.9
Net dividend yield (%)	2.1	3.9	1.7	3.3	4.0
FCF yield (%)	1.0	nm	33.1	nm	31.1
EV/EBITDA (x)	7.9	3.7	4.0	4.2	2.5
EV/EBIT (x)	10.4	5.3	7.4	6.1	3.6

INCOME STATEMENT (SGD m)

Revenue	767.1	786.1	723.2	831.7	956.5
EBITDA	94.9	94.4	62.2	93.3	106.6
Depreciation	(23.0)	(27.8)	(28.1)	(29.9)	(31.7)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	71.9	66.6	34.1	63.4	75.0
Net interest income / (exp)	(1.4)	(3.6)	(3.6)	(3.6)	(3.6)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	70.5	63.0	30.5	59.8	71.4
Income tax	(11.4)	(11.4)	(5.2)	(10.2)	(12.1)
Minorities	(0.4)	0.2	(0.2)	(0.2)	(0.2)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	58.7	51.9	25.1	49.5	59.0
Core net profit	58.7	51.9	25.1	49.5	59.0

BALANCE SHEET (SGD m)

Cash & Short Term Investments	192.6	167.0	306.5	169.3	289.6
Accounts receivable	123.3	123.2	114.6	158.9	155.6
Inventory	203.1	228.8	120.2	267.6	176.9
Property, Plant & Equip (net)	110.8	127.5	120.9	112.4	137.4
Intangible assets	19.5	21.5	21.5	21.5	21.5
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	38.9	57.1	59.1	72.2	73.2
Total assets	688.1	725.2	742.8	801.8	854.3
ST interest bearing debt	95.6	107.7	107.7	107.7	107.7
Accounts payable	121.9	108.3	108.1	132.3	143.3
LT interest bearing debt	1.6	1.1	1.1	1.1	1.1
Other liabilities	90.0	112.0	112.0	112.0	112.0
Total Liabilities	309.1	328.8	328.6	352.8	363.7
Shareholders Equity	376.2	391.9	409.5	444.1	485.4
Minority Interest	2.9	4.5	4.7	4.9	5.1
Total shareholder equity	379.0	396.4	414.2	449.0	490.5
Total liabilities and equity	688.1	725.2	742.8	801.8	854.3

CASH FLOW (SGD m)

Pretax profit	70.5	63.0	30.5	59.8	71.4
Depreciation & amortisation	23.0	27.8	28.1	29.9	31.7
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.0
Change in working capital	(34.7)	(44.1)	115.1	(180.5)	103.8
Cash taxes paid	(16.2)	(8.8)	(5.2)	(10.2)	(12.1)
Other operating cash flow	0.0	(0.0)	0.0	0.0	0.0
Cash flow from operations	42.6	37.8	168.4	(101.0)	194.8
Capex	(33.9)	(41.4)	(21.4)	(21.4)	(56.7)
Free cash flow	8.7	(3.6)	147.0	(122.4)	138.1
Dividends paid	(17.6)	(17.6)	(7.5)	(14.8)	(17.7)
Equity raised / (purchased)	0.1	0.0	0.0	0.0	0.0
Change in Debt	29.9	(12.8)	0.0	0.0	0.0
Other invest/financing cash flow	(3.5)	(3.6)	0.0	0.0	0.0
Effect of exch rate changes	0.0	(56.7)	0.0	0.0	0.0
Net cash flow	17.6	(94.4)	139.5	(137.2)	120.4

FYE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Key Ratios					
Growth ratios (%)					
Revenue growth	23.6	2.5	(8.0)	15.0	15.0
EBITDA growth	18.5	(0.5)	(34.2)	50.1	14.3
EBIT growth	22.1	(7.3)	(48.9)	86.1	18.2
Pretax growth	36.0	(10.6)	(51.6)	96.2	19.3
Reported net profit growth	37.1	(11.7)	(51.6)	97.0	19.4
Core net profit growth	19.7	(11.7)	(51.6)	97.0	19.4
Profitability ratios (%)					
EBITDA margin	12.4	12.0	8.6	11.2	11.1
EBIT margin	9.4	8.5	4.7	7.6	7.8
Pretax profit margin	9.2	8.0	4.2	7.2	7.5
Payout ratio	30.0	30.0	30.0	30.0	30.0
DuPont analysis					
Net profit margin (%)	7.7	6.6	3.5	5.9	6.2
Revenue/Assets (x)	1.1	1.1	1.0	1.0	1.1
Assets/Equity (x)	1.8	1.9	1.8	1.8	1.8
ROAE (%)	16.5	13.5	6.3	11.6	12.7
ROAA (%)	9.4	7.3	3.4	6.4	7.1
Liquidity & Efficiency					
Cash conversion cycle	92.8	110.9	96.7	96.7	96.7
Days receivable outstanding	52.1	56.4	59.2	59.2	59.2
Days inventory outstanding	97.7	116.5	98.6	98.6	98.6
Days payables outstanding	57.0	62.1	61.2	61.2	61.2
Dividend cover (x)	3.3	3.3	3.3	3.3	3.3
Current ratio (x)	1.9	1.8	1.9	2.0	2.0
Leverage & Expense Analysis					
Asset/Liability (x)	2.2	2.2	2.3	2.3	2.3
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)	51.3	18.5	9.5	17.6	20.8
Debt/EBITDA (x)	1.0	1.2	1.8	1.2	1.0
Capex/revenue (%)	4.4	5.3	3.0	2.6	5.9
Net debt/ (net cash)	(95.4)	(58.2)	(197.7)	(60.5)	(180.8)

Source: Company; Maybank IBG Research

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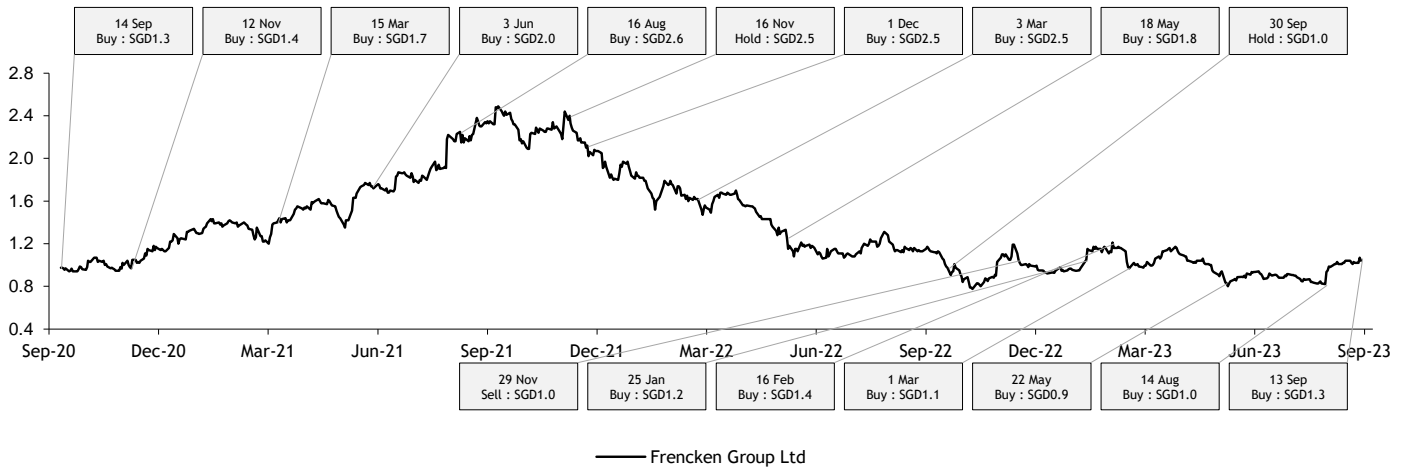
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