

Frencken Group Ltd (FRKN SP)

Expecting sequential strength

2H21 missed street slightly; still a favourite LT pick

2H21 PATMI of SGD27.6m (+15.6% YoY) met our estimate but fell slightly short of the street. We trim our TP by 1% to SGD2.47 (15.5x FY22E P/E), and lower FY22E PATMI by 1.3% to factor in higher costs. With improving supply-side dynamics and a robust demand outlook, management expects stronger 1H22 revenue HoH. We contend Frencken's revenue and geographical diversity provides earnings resilience through economic cycles. BUY. Frencken remains one of our favourite long-term picks.

Semi, analytical and medical drove 2H21 growth

2H21 revenue grew 19.4% YoY to SGD391.8m, driven by strength in semiconductor (+51.5%) amid an upswing in global capex spending, medical (+26.4%) and analytical (+25.3%), offset by weakness in industrial automation (IA) and automotive (-15.9% respectively). Gross margin fell 2.1ppt to 16.2% on lower automotive contribution. 2H21 net margin was 7.0% (-2.1 ppt YoY, -1.3ppt HoH) on higher costs (e.g. materials, logistics). Management aims to improve FY22 margins as supply side disruptions ease.

Sequentially stronger 1H22

In 1H22, semicon and automotive are expected to be higher HoH. We attribute this to easing in supply side issues. IA is expected to be stronger HoH, and medical and analytical stable HoH. Frencken secured its first radar antenna program using its proprietary plastic metallisation process, and expects the automotive segment to benefit from more programs in the future, driven by V2X trends (vehicle-to-everything) trends.

Risks

We continue to favour Frencken for its growth prospects as it adds value to existing blue-chip customers - which should lead to margin expansion. Currently, Frencken has not seen material impact from the Russia-Ukraine conflict but it might impact prices (e.g. aluminium) or create further supply chain bottlenecks (e.g. in automotive, where palladium is used to make catalytic converters) if it persists.

| FYE Dec (SGD m) | FY20A | FY21A | FY22E | FY23E | FY24E |
|------------------------------|----------|----------|----------|----------|----------|
| Revenue | 621 | 767 | 873 | 918 | 977 |
| EBITDA | 80 | 95 | 109 | 123 | 133 |
| Core net profit | 49 | 59 | 69 | 78 | 85 |
| Core FDEPS (cts) | 11.5 | 13.7 | 16.2 | 18.2 | 19.8 |
| Core FDEPS growth(%) | 4.8 | 19.8 | 17.7 | 12.2 | 9.2 |
| Net DPS (cts) | 3.4 | 4.1 | 4.9 | 5.5 | 6.0 |
| Core FD P/E (x) | 11.5 | 14.3 | 10.0 | 8.9 | 8.2 |
| P/BV (x) | 1.7 | 2.2 | 1.6 | 1.4 | 1.3 |
| Net dividend yield (%) | 2.6 | 2.1 | 3.0 | 3.4 | 3.7 |
| ROAE (%) | 13.6 | 16.5 | 17.3 | 17.2 | 16.7 |
| ROAA (%) | 9.2 | 9.4 | 9.8 | 10.1 | 10.1 |
| EV/EBITDA (x) | 5.7 | 7.9 | 5.2 | 4.4 | 4.0 |
| Net gearing (%) (incl perps) | net cash | net cash | net cash | net cash | net cash |
| Consensus net profit | - | - | 68 | 75 | na |
| MKE vs. Consensus (%) | - | - | 2.0 | 3.4 | na |

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BUY

| | |
|-----------------------|-----------------|
| Share Price | SGD 1.62 |
| 12m Price Target | SGD 2.47 (+55%) |
| Previous Price Target | SGD 2.50 |

Company Description

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

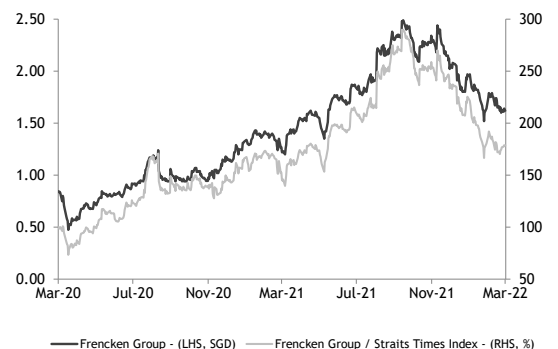
Statistics

| | |
|------------------------|----------------------|
| 52w high/low (SGD) | 2.49/1.20 |
| 3m avg turnover (USDm) | 4.8 |
| Free float (%) | 59.8 |
| Issued shares (m) | 426 |
| Market capitalisation | SGD690.3M USD508M |

Major shareholders:

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

Price Performance



| | -1M | -3M | -12M |
|-----------------------|-----|------|------|
| Absolute (%) | (7) | (21) | 33 |
| Relative to index (%) | (5) | (25) | 23 |

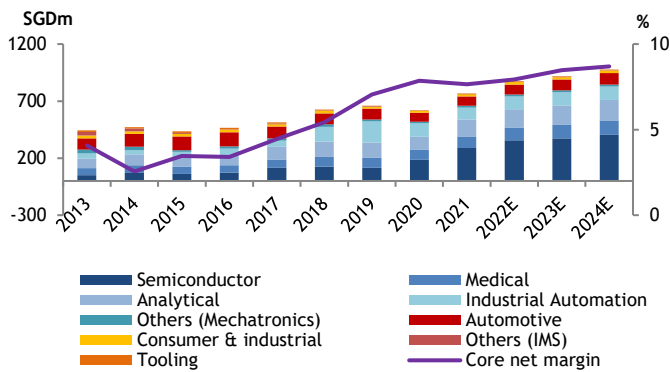
Source: FactSet

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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

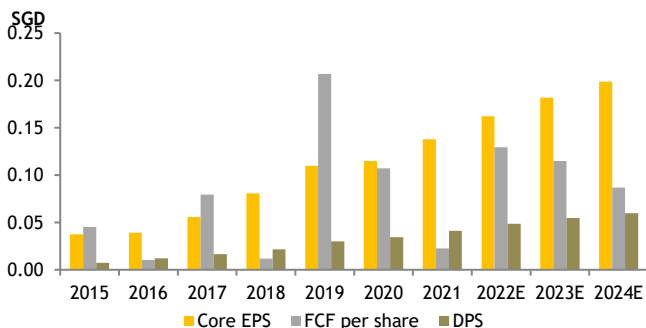


Source: Company

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.

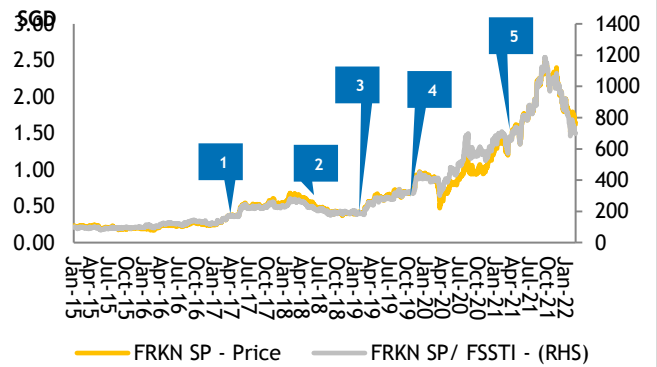
EPS, FCF per share and DPS



Source: Company, Maybank IBG Research

Price Drivers

Historical share price trend



Source: Company, Maybank IBG Research

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 & Score ¹ | Not Rated |
| 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 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

| | FY22E | | | FY23E | | |
|------------------------|-------|-------|-----------|-------|-------|-----------|
| | New | Old | Chg (%) | New | Old | Chg (%) |
| Revenue (SGDm) | 873.0 | 850.0 | 2.7 | 918.0 | 904.5 | 1.5 |
| Gross profit (SGDm) | 150.4 | 150.9 | -0.3 | 164.9 | 163.9 | 0.6 |
| EBIT (SGDm) | 82.8 | 85.2 | -2.8 | 96.5 | 96.6 | -0.1 |
| EBITDA (SGDm) | 107.0 | 109.4 | -2.2 | 122.5 | 122.6 | -0.1 |
| Core net profit (SGDm) | 68.0 | 68.9 | -1.3 | 77.7 | 77.2 | 0.6 |
| EPS (SGD) | 0.16 | 0.16 | -1.3 | 0.18 | 0.18 | 0.6 |
| | | | Chg (ppt) | | | Chg (ppt) |
| Gross material margin | 17.2% | 17.8% | -0.5 | 18.0% | 18.1% | -0.2 |
| SGA as % of sales | 8.2% | 8.2% | 0.0 | 7.9% | 8.2% | -0.3 |

Source: Maybank IBG Research

Fig 2: 2H21 summary

| FYE Dec | 2H21 | 2H20 | 1H21 | YoY Chg | HoH Chg | FYE | FYA vs. FYE |
|-----------------------|---------|---------|---------|---------|--------------|---------|-------------|
| | (SGD m) | (SGD m) | (SGD m) | (%) | (%) | SGDm | |
| Revenue | 391.8 | 328.1 | 375.3 | 19.4 | 4.4 | 750.3 | 102.2 |
| COGS | (328.2) | (268.1) | (309.9) | 22.4 | 5.9 | (619.2) | 103.1 |
| Gross profit | 63.5 | 60.0 | 65.4 | 5.9 | -2.9 | 131.1 | 98.3 |
| Total SGA | (32.4) | (26.9) | (28.4) | 20.4 | 13.9 | (61.5) | 98.8 |
| Other op. income | 3.7 | 4.1 | 4.0 | -10.9 | -7.2 | 7.0 | 108.8 |
| Other op. exp | (2.0) | (2.4) | (1.8) | -15.0 | 15.3 | (4.0) | 94.9 |
| EBIT | 32.8 | 34.8 | 39.1 | -5.9 | -16.3 | 72.6 | 99.1 |
| EBITDA | 45.0 | 45.9 | 49.9 | -1.8 | -9.7 | 95.3 | 99.6 |
| Interest inc | 0.5 | 0.6 | 0.5 | -17.6 | -3.7 | 1.5 | 64.4 |
| Interest exp | (1.3) | (1.1) | (1.0) | 16.4 | 27.1 | (2.4) | 98.3 |
| Associates | 0.0 | 0.0 | 0.0 | nm | nm | 0.0 | nm |
| Exceptionals | 0.0 | (6.2) | 0.0 | -100.0 | nm | 0.0 | nm |
| Pretax profit | 31.9 | 28.1 | 38.6 | 13.8 | -17.3 | 71.6 | 98.4 |
| Taxation | (4.4) | (3.7) | (7.0) | 21.7 | -36.1 | (12.9) | 88.5 |
| Net profit | 27.5 | 24.4 | 31.6 | 12.6 | -13.1 | 58.7 | 100.6 |
| Minority interest | (0.1) | 0.6 | 0.3 | nm | -128.0 | 0.2 | 192.0 |
| PATMI | 27.6 | 23.8 | 31.3 | 15.6 | -12.0 | 58.5 | 100.3 |
| Core PATMI | 27.6 | 30.1 | 31.3 | -8.3 | -12.0 | 58.5 | 100.3 |
| | | | | | Change (ppt) | | |
| Gross material margin | 16.2% | 18.3% | 17.4% | -2.1 | -1.2 | | |
| EBIT margin | 8.4% | 10.6% | 10.4% | -2.3 | -2.1 | | |
| Core net margin | 7.0% | 9.2% | 8.3% | -2.1 | -1.3 | | |

Source: Maybank IBG Research

| FYE 31 Dec | FY20A | FY21A | FY22E | FY23E | FY24E |
|------------------------|-------|-------|-------|-------|-------|
| Key Metrics | | | | | |
| P/E (reported) (x) | 9.1 | 13.2 | 10.0 | 8.9 | 8.1 |
| Core P/E (x) | 11.4 | 14.3 | 10.0 | 8.9 | 8.1 |
| Core FD P/E (x) | 11.5 | 14.3 | 10.0 | 8.9 | 8.2 |
| P/BV (x) | 1.7 | 2.2 | 1.6 | 1.4 | 1.3 |
| P/NTA (x) | 1.7 | 2.2 | 1.6 | 1.4 | 1.3 |
| Net dividend yield (%) | 2.6 | 2.1 | 3.0 | 3.4 | 3.7 |
| FCF yield (%) | 8.1 | 1.0 | 8.0 | 7.1 | 5.4 |
| EV/EBITDA (x) | 5.7 | 7.9 | 5.2 | 4.4 | 4.0 |
| EV/EBIT (x) | 7.7 | 10.4 | 6.7 | 5.6 | 5.0 |

INCOME STATEMENT (SGD m)

| | | | | | |
|-----------------------------|--------|--------|--------|--------|--------|
| Revenue | 620.6 | 767.1 | 873.0 | 918.0 | 976.6 |
| EBITDA | 80.1 | 94.9 | 108.5 | 122.5 | 133.0 |
| Depreciation | (21.1) | (23.0) | (24.2) | (26.0) | (27.8) |
| Amortisation | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EBIT | 58.9 | 71.9 | 84.3 | 96.5 | 105.1 |
| Net interest income / (exp) | (0.8) | (1.4) | (1.4) | (1.4) | (1.4) |
| Associates & JV | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Exceptionals | (6.2) | 0.0 | 0.0 | 0.0 | 0.0 |
| Other pretax income | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Pretax profit | 51.9 | 70.5 | 82.9 | 95.1 | 103.7 |
| Income tax | (8.8) | (11.4) | (13.4) | (16.2) | (17.6) |
| Minorities | (0.2) | (0.4) | (0.2) | (1.2) | (1.2) |
| Discontinued operations | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported net profit | 42.8 | 58.7 | 69.3 | 77.7 | 84.9 |
| Core net profit | 49.1 | 58.7 | 69.3 | 77.7 | 84.9 |

BALANCE SHEET (SGD m)

| | | | | | |
|-------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Cash & Short Term Investments | 174.5 | 192.6 | 227.1 | 252.8 | 264.4 |
| Accounts receivable | 98.7 | 123.3 | 130.2 | 171.6 | 149.5 |
| Inventory | 143.2 | 203.1 | 211.8 | 200.8 | 237.2 |
| Property, Plant & Equip (net) | 99.8 | 110.8 | 102.6 | 127.6 | 152.6 |
| Intangible assets | 11.7 | 19.5 | 19.5 | 19.5 | 19.5 |
| Investment in Associates & JVs | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other assets | 36.0 | 38.9 | 38.9 | 38.9 | 38.9 |
| Total assets | 563.8 | 688.1 | 730.1 | 811.2 | 862.1 |
| ST interest bearing debt | 67.3 | 95.6 | 95.6 | 95.6 | 95.6 |
| Accounts payable | 80.1 | 121.9 | 115.2 | 140.6 | 130.9 |
| LT interest bearing debt | 0.0 | 1.6 | 1.6 | 1.6 | 1.6 |
| Other liabilities | 80.0 | 90.0 | 90.0 | 90.0 | 90.0 |
| Total Liabilities | 227.5 | 309.1 | 302.4 | 327.9 | 318.2 |
| Shareholders Equity | 334.0 | 376.2 | 424.6 | 479.0 | 538.5 |
| Minority Interest | 2.3 | 2.9 | 3.1 | 4.3 | 5.5 |
| Total shareholder equity | 336.3 | 379.0 | 427.7 | 483.3 | 543.9 |
| Total liabilities and equity | 563.8 | 688.1 | 730.1 | 811.2 | 862.1 |

CASH FLOW (SGD m)

| | | | | | |
|----------------------------------|--------|--------|--------|--------|--------|
| Pretax profit | 51.9 | 70.5 | 82.9 | 95.1 | 103.7 |
| Depreciation & amortisation | 21.1 | 23.0 | 24.2 | 26.0 | 27.8 |
| Adj net interest (income)/exp | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Change in working capital | 1.1 | (34.7) | (22.3) | (4.9) | (24.0) |
| Cash taxes paid | (5.9) | (16.2) | (13.4) | (16.2) | (17.6) |
| Other operating cash flow | 6.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| Cash flow from operations | 74.4 | 42.6 | 71.3 | 100.0 | 89.9 |
| Capex | (28.9) | (33.9) | (16.1) | (51.0) | (52.8) |
| Free cash flow | 45.5 | 8.7 | 55.3 | 49.0 | 37.1 |
| Dividends paid | (12.8) | (17.6) | (20.8) | (23.3) | (25.5) |
| Equity raised / (purchased) | 0.8 | 0.1 | 0.0 | 0.0 | 0.0 |
| Change in Debt | 14.1 | 29.9 | 0.0 | 0.0 | 0.0 |
| Other invest/financing cash flow | 5.9 | (3.5) | 0.0 | 0.0 | 0.0 |
| Effect of exch rate changes | (0.3) | 0.0 | 0.0 | 0.0 | 0.0 |
| Net cash flow | 53.3 | 17.6 | 34.5 | 25.7 | 11.6 |

| FYE 31 Dec | FY20A | FY21A | FY22E | FY23E | FY24E |
|--|----------|----------|----------|----------|----------|
| Key Ratios | | | | | |
| Growth ratios (%) | | | | | |
| Revenue growth | (5.8) | 23.6 | 13.8 | 5.1 | 6.4 |
| EBITDA growth | (0.5) | 18.5 | 14.3 | 12.9 | 8.5 |
| EBIT growth | (0.7) | 22.1 | 17.2 | 14.5 | 9.0 |
| Pretax growth | (3.8) | 36.0 | 17.5 | 14.7 | 9.1 |
| Reported net profit growth | 1.1 | 37.1 | 17.9 | 12.2 | 9.2 |
| Core net profit growth | 5.4 | 19.7 | 17.9 | 12.2 | 9.2 |
| Profitability ratios (%) | | | | | |
| EBITDA margin | 12.9 | 12.4 | 12.4 | 13.3 | 13.6 |
| EBIT margin | 9.5 | 9.4 | 9.7 | 10.5 | 10.8 |
| Pretax profit margin | 8.4 | 9.2 | 9.5 | 10.4 | 10.6 |
| Payout ratio | 34.2 | 30.0 | 30.0 | 30.0 | 30.0 |
| DuPont analysis | | | | | |
| Net profit margin (%) | 6.9 | 7.7 | 7.9 | 8.5 | 8.7 |
| Revenue/Assets (x) | 1.1 | 1.1 | 1.2 | 1.1 | 1.1 |
| Assets/Equity (x) | 1.7 | 1.8 | 1.7 | 1.7 | 1.6 |
| ROAE (%) | 13.6 | 16.5 | 17.3 | 17.2 | 16.7 |
| ROAA (%) | 9.2 | 9.4 | 9.8 | 10.1 | 10.1 |
| Liquidity & Efficiency | | | | | |
| Cash conversion cycle | 97.5 | 92.8 | 96.7 | 96.7 | 96.7 |
| Days receivable outstanding | 56.9 | 52.1 | 52.3 | 59.2 | 59.2 |
| Days inventory outstanding | 99.2 | 97.7 | 103.6 | 98.6 | 98.6 |
| Days payables outstanding | 58.7 | 57.0 | 59.2 | 61.2 | 61.2 |
| Dividend cover (x) | 2.9 | 3.3 | 3.3 | 3.3 | 3.3 |
| Current ratio (x) | 2.0 | 1.9 | 2.1 | 2.1 | 2.2 |
| Leverage & Expense Analysis | | | | | |
| Asset/Liability (x) | 2.5 | 2.2 | 2.4 | 2.5 | 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) | 70.3 | 51.3 | 60.1 | 68.8 | 74.9 |
| Debt/EBITDA (x) | 0.8 | 1.0 | 0.9 | 0.8 | 0.7 |
| Capex/revenue (%) | 4.7 | 4.4 | 1.8 | 5.6 | 5.4 |
| Net debt/ (net cash) | (107.1) | (95.4) | (129.9) | (155.6) | (167.2) |

Source: Company; Maybank

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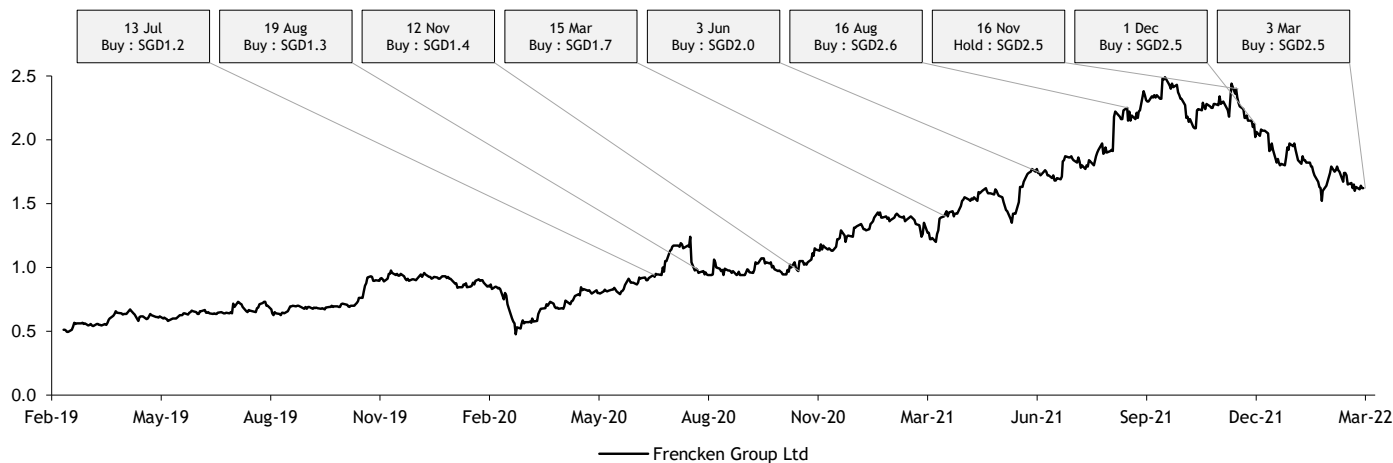
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