

Singapore Company Update

Frencken Group Limited

Bloomberg: FRKN SP | Reuters: FREN.SI

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DBS Group Research . Equity

19 May 2022

HOLD (Downgrade from BUY)

Last Traded Price (18 May 2022): S\$1.26 (STI : 3,225.35)

Price Target 12-mth: S\$1.36 (8% upside) (Prev S\$2.09)

Analyst

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What's New

- 1Q22 slightly below expectations on weaker margins
- Expect higher costs to persist in the interim stage
- Guided for moderate increase in 1H22 revenue vs. 2H21; expectations toned down for some segments
- Cut earnings by c.20%; downgrade to HOLD with lower TP of S\$1.36

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2020A	2021A	2022F	2023F
Revenue	621	767	834	898
EBITDA	80.6	95.2	107	119
Pre-tax Profit	51.9	70.5	63.8	72.7
Net Profit	42.6	58.7	53.1	60.6
Net Pft (Pre Ex.)	48.8	58.7	53.1	60.6
Net Pft Gth (Pre-ex) (%)	4.9	20.4	(9.6)	14.1
EPS (S cts)	10.0	13.8	12.4	14.2
EPS Pre Ex. (S cts)	11.5	13.8	12.4	14.2
EPS Gth Pre Ex (%)	5	20	(10)	14
Diluted EPS (S cts)	10.0	13.8	12.4	14.2
Net DPS (S cts)	3.00	3.00	3.73	4.26
BV Per Share (S cts)	78.7	88.1	96.8	107
PE (X)	12.6	9.2	10.1	8.9
PE Pre Ex. (X)	11.0	9.2	10.1	8.9
P/Cash Flow (X)	6.7	13.3	4.7	5.8
EV/EBITDA (X)	5.3	4.7	3.4	2.6
Net Div Yield (%)	2.4	2.4	3.0	3.4
P/Book Value (X)	1.6	1.4	1.3	1.2
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	12.7	15.6	12.8	13.3
Earnings Rev (%):			(20)	(19)
Consensus EPS (S cts):			14.6	16.8
Other Broker Recs:		B: 5	S: 0	H: 0

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Unrelenting margin pressure

Investment Thesis

Cut to HOLD with lower TP of S\$1.36 on weak margins. Gross margin declined to 15.4% in 1Q22 (from 17.3% in 1Q21), while net margin eased to 6.5% (from 8.1% in 1Q21), similar to 4Q21. This was due to continued supply chain disruptions, inflationary pressure, and investment for growth. We expect margin pressure to persist, at least in the near term. Hence, we cut our earnings projection for FY22F/23F by c.20%. With limited upside to our revised TP of S\$1.36, we downgrade the stock to HOLD.

Expect higher costs in interim stage as the group continues to invest for growth; working on NPIs in semiconductor space. Costs are expected to remain high as the group continues to create new pillars for growth with the recent acquisitions of Avimac and Penchem, expansion of facilities in Europe, Malaysia, and Singapore with large format machining and cleanroom assembly space, and the expansion of its workforce, paving the way for future growth. Meanwhile, Frencken is also working on new product initiatives (NPIs) in the semiconductor space, which could enable the group to penetrate a new segment of the semiconductor value chain.

Valuation:

Downgrade to HOLD with lower TP of S\$1.36. We cut earnings by 20%/19% for FY22F/23F. TP is lowered to S\$1.36 (previously S\$2.09), pegged to a lower peers' average of 11x (from the previous 13.5x, on further de-rating of tech stocks globally). Downgrade to HOLD.

Where we differ:

We are cautious on the margins front on the back of the still challenging supply chain environment and inflationary pressure.

Key Risks to Our View:

Dependence on global market conditions. Frencken has exposure to customers in the US, the EU, and Asia, so a global economic slowdown could impact demand and earnings.

At A Glance

Issued Capital (m shrs)	427
Mkt. Cap (S\$m/US\$m)	538 / 388
Major Shareholders (%)	
Micro Compact Sdn. Bhd	6.2
Precico Singapore Pte Ltd	6.1
Free Float (%)	82.9
3m Avg. Daily Val (US\$m)	4.7
GIC Industry : Industrials / Capital Goods	



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WHAT'S NEW

1Q22 slightly below expectations on weaker margins

Revenue for most segments higher y-o-y except for **automotive**. Frencken reported a 9.3% y-o-y (+2% q-o-q) growth in revenue to S\$198.4m. Higher sales for the semiconductor, analytical & life sciences, and industrial automation segments in 1Q22 were partially offset by softer sales for the automotive segment. The automotive division was affected by constrained customer demand as a result of semiconductor chip supply chain challenges and disruptions arising from the military conflict in Ukraine. Net profit eased 12.6% y-o-y (+1.7% q-o-q) to S\$12.8m, accounting for 19% of ours and consensus forecasts, slightly below expectations.

Key segmental revenue breakdown

Segment	% contribution	S\$m	Y-o-Y (%)
Semiconductor	38.4	76.1	+15.5
Medical	11.6	23.0	-
Analytical & Life Science	19.6	38.9	+16.7
Industrial Automation	15.7	31.2	+8.7
Automotive	9.7	19.3	-10.7
Consumer & Industrial Electronics	2.4	4.8	+3.5
TOTAL	100	198.4	+9.3

Source: Company; DBS Bank

Weaker margins. Gross profit margin declined 1.9 percentage points (ppt) to 15.4% in 1Q22 (from 17.3% in 1Q21), mainly owing to rising raw material prices amid supply chain disruptions and increased production overhead costs. The higher production overhead costs were mainly due to increases in depreciation expenses and electricity costs, as well as rent, repair, and maintenance costs. Net margins eased to 6.5% from 8.1% in 1Q21, similar to 4Q21.

Potentially easing of supply chain disruption from 2H22.

The group envisages that this pressure would show signs of potential easing from 2H22 onwards, as it continues to work on mitigating cost inflation through operational initiatives. In the past few years, Frencken has demonstrated its ability to improve net margins from the various operational initiatives in place, including rationalisation exercise and improvement in productivity. Net margin improved from <5% to >6% from FY19.

Expect moderate increase in 1H22 revenue vs 2H21; **toned down expectations for some segments.** Overall, Frencken expects to register higher revenue in 1H22 as compared to 2H21. In terms of segmental performance, except for semiconductor and analytical & life sciences, guidance for the rest of the segments was lowered.

For the medical segment, though the order is intact and Frencken has the capacity to deliver, its customer was unable to take delivery for all the products due to the supply chain disruptions. The group continues to engage its customer in the industrial automation segment, and its performance generally tracks the capex of this customer.

The recent lockdown in China has affected the group's customers in the automotive segment. With the gradual easing of the lockdown, Frencken expects to see a marginal improvement going forward.

The semiconductor segment continues to be strong. The group is working on a new product related to wafer fabrication equipment, which requires a larger format, as compared to manufacturing smaller components, and more complex assembly. A successful launch of this product would enable Frencken to penetrate a new segment of the semiconductor value chain.

Guidance for 1H22 revenue vs 2H21

Segment	Current Guidance	Previous Guidance
Semiconductor	Higher	Higher
Medical	Lower	Stable
Analytical & life sciences	Higher	Stable
Industrial Automation	Stable	Higher
Automotive	Marginal improvement	Higher

Source: Company; DBS Bank

Higher costs to persist in the near term, trimmed margins. As the group continues to create new pillars for growth with the recent acquisitions of Avimac and Penchem, expansion of facilities in Europe, Malaysia, and Singapore with large format machining and cleanroom assembly space, and also expanding its workforce, costs in the near term are likely to continue to be high in the interim set-up phase.

Frencken Group Limited

Furthermore, the group is also working on NPIs that generally yield lower efficiency during the initial phases before the ramp-up in production. Hence, we have trimmed our gross margin to 15.5%/16% for FY22F/23F (from 17%/17.5% previously) while net margin is reduced to 6.4%/6.7% from 7.8%/8.1%.

Cut earnings by c.20%, downgrade to HOLD with lower TP of S\$1.36. Overall, net earnings were cut by 20%/19% for FY22F/23F. TP was lowered to S\$1.36 (previously S\$2.09), pegged to a lower peers' average of 11x (from the previous 13.5x, on further de-rating of tech stocks globally) on FY22F earnings. Given the limited upside to our new TP, we downgrade the stock to HOLD.

Company Background

Frencken Group Limited (Frencken) provides end-to-end solutions across the entire customer value chain. It offers comprehensive original design, original equipment and diversified integrated manufacturing solutions for world-class multinational companies in the automotive, healthcare, industrial, life sciences, and semiconductor industries.

Historical PE and PB band



Source: Bloomberg Finance L.P., DBS Bank estimates



Source: Bloomberg Finance L.P., DBS Bank estimates

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Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Gross Margin %	16.9	17.1	16.8	15.5	16.0
% of SGA	8.83	9.19	8.42	8.60	8.60

Segmental Breakdown

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (\$m)					
Mechatronics	540	520	659	726	784
IMS	120	101	108	108	114
Total	659	621	767	834	898

Income Statement (\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	659	621	767	834	898
Cost of Goods Sold	(548)	(515)	(638)	(705)	(754)
Gross Profit	111	106	129	129	144
Other Opng (Exp)/Inc	(58.2)	(57.1)	(64.6)	(71.7)	(77.2)
Operating Profit	53.3	49.1	64.3	57.6	66.5
Other Non Opng (Exp)/Inc	6.08	10.6	7.62	7.62	7.62
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(1.3)	(0.8)	(1.4)	(1.4)	(1.4)
Exceptional Gain/(Loss)	(4.2)	(6.2)	0.0	0.0	0.0
Pre-tax Profit	53.9	51.9	70.5	63.8	72.7
Tax	(11.3)	(8.8)	(11.4)	(10.3)	(11.8)
Minority Interest	(0.2)	(0.5)	(0.4)	(0.4)	(0.4)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	42.4	42.6	58.7	53.1	60.6
Net Profit before Except.	46.5	48.8	58.7	53.1	60.6
EBITDA	80.5	80.6	95.2	107	119
Growth					
Revenue Gth (%)	5.3	(5.7)	23.4	8.8	7.7
EBITDA Gth (%)	31.0	0.1	18.2	12.6	11.3
Opg Profit Gth (%)	31.8	(7.8)	30.9	(10.4)	15.5
Net Profit Gth (Pre-ex) (%)	37.1	4.9	20.4	(9.6)	14.1
Margins & Ratio					
Gross Margins (%)	16.9	17.1	16.8	15.5	16.0
Opg Profit Margin (%)	8.1	7.9	8.4	6.9	7.4
Net Profit Margin (%)	6.4	6.9	7.7	6.4	6.7
ROAE (%)	14.3	12.7	15.6	12.8	13.3
ROA (%)	8.4	7.6	8.5	7.4	7.9
ROCE (%)	12.3	11.4	11.6	9.7	10.3
Div Payout Ratio (%)	30.0	29.9	21.8	30.0	30.0
Net Interest Cover (x)	41.2	58.6	45.8	41.1	47.4

Source: Company, DBS Bank

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Interim Income Statement (S\$m)

FY Dec	2H2019	1H2020	2H2020	1H2021	2H2021
Revenue	336	293	328	375	392
Cost of Goods Sold	(277)	(247)	(268)	(310)	(328)
Gross Profit	58.3	45.4	60.0	65.4	63.5
Other Oper. (Exp)/Inc	(29.2)	(21.4)	(31.4)	(26.2)	(30.7)
Operating Profit	29.1	24.1	28.6	39.1	32.8
Other Non Opp (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(0.5)	(0.3)	(0.6)	(0.6)	(0.9)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	28.6	23.8	28.1	38.6	31.9
Tax	(5.8)	(5.2)	(3.7)	(7.0)	(4.4)
Minority Interest	(0.1)	0.10	(0.6)	(0.3)	(0.1)
Net Profit	22.7	18.7	23.8	31.3	27.4
Net profit bef Except.	22.7	18.7	23.8	31.3	27.4
EBITDA	39.6	24.1	39.6	50.0	45.2

Growth

Revenue Gth (%)	3.8	(12.9)	12.2	14.4	4.4
EBITDA Gth (%)	7.8	(39.2)	64.5	26.3	(9.7)
Opp Profit Gth (%)	11.5	(17.2)	18.8	36.8	(16.3)
Net Profit Gth (%)	15.0	(17.3)	27.2	31.5	(12.6)

Margins

Gross Margins (%)	17.4	15.5	18.3	17.4	16.2
Opp Profit Margins (%)	8.7	8.2	8.7	10.4	8.4
Net Profit Margins (%)	6.8	6.4	7.3	8.3	7.0

Balance Sheet (S\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	92.1	99.8	111	89.1	64.1
Invt in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other LT Assets	39.3	34.7	41.6	47.1	48.2
Cash & ST Invt	122	174	193	271	325
Inventory	141	143	203	155	165
Debtors	97.6	98.7	123	137	148
Other Current Assets	14.1	13.0	16.8	16.8	16.8
Total Assets	506	564	688	716	768
ST Debt	53.1	67.3	95.6	95.6	95.6
Creditor	87.8	80.1	122	106	114
Other Current Liab	49.5	64.2	70.8	76.6	78.1
LT Debt	0.17	0.0	1.58	1.58	1.58
Other LT Liabilities	17.5	15.8	19.2	19.2	19.2
Shareholder's Equity	295	334	376	413	456
Minority Interests	2.78	2.33	2.87	3.25	3.64
Total Cap. & Liab.	506	564	688	716	768
Non-Cash Wkg. Capital	115	110	150	126	138
Net Cash/(Debt)	69.2	107	95.4	174	228
Debtors Turn (avg days)	54.1	58.0	58.7	60.0	60.0
Creditors Turn (avg days)	60.9	59.2	72.4	58.5	58.5
Inventory Turn (avg days)	97.5	105.9	120.6	85.1	85.1
Asset Turnover (x)	1.3	1.1	1.1	1.2	1.2
Current Ratio (x)	2.0	2.0	1.9	2.1	2.3
Quick Ratio (x)	1.2	1.3	1.1	1.5	1.6
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	25.2	34.3	17.7	20.6	20.6

Source: Company, DBS Bank

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Cash Flow Statement (\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	53.9	51.9	70.5	63.8	72.7
Dep. & Amort.	21.1	21.7	23.3	42.0	45.2
Tax Paid	(11.3)	(8.8)	(11.4)	(10.3)	(11.8)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	26.0	8.08	(36.9)	19.1	(13.9)
Other Operating CF	5.10	6.84	(5.2)	0.0	0.0
Net Operating CF	94.9	79.6	40.4	115	92.3
Capital Exp.(net)	(13.4)	(23.1)	(17.2)	(20.0)	(20.0)
Other Invs.(net)	0.0	0.0	0.0	0.0	0.0
Invs in Assoc. & JV	0.0	(1.5)	(13.0)	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	1.66	1.82	1.42	0.0	0.0
Net Investing CF	(11.7)	(22.8)	(28.8)	(20.0)	(20.0)
Div Paid	(9.1)	(12.8)	(12.8)	(15.9)	(18.2)
Chg in Gross Debt	(10.6)	(3.0)	9.70	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	0.56	0.77	(6.1)	0.0	0.0
Net Financing CF	(19.1)	(15.0)	(9.2)	(15.9)	(18.2)
Currency Adjustments	0.53	(0.4)	(0.8)	0.0	0.0
Chg in Cash	64.5	41.5	1.48	78.7	54.1
Opg CFPS (S cts)	16.2	16.9	18.1	22.4	24.9
Free CFPS (S cts)	19.2	13.3	5.42	22.2	16.9

Source: Company, DBS Bank

Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	13 Aug 21	2.23	2.65	BUY
2:	25 Feb 22	1.63	2.09	BUY

Source: DBS Bank

Analyst: Lee Keng LING

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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