



Frencken Group Limited

(FRKN SP/FREN.SI)

Sustained momentum; good value compared to peers

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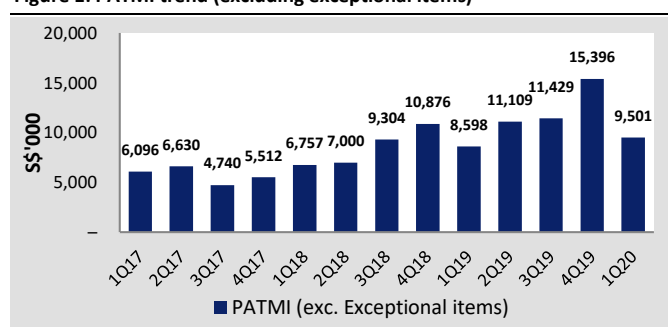
- Within expectations; supply chain disruption a concern.**
 FRKN reported a 11% YoY increase in 1Q20 profits to S\$9.5mn. The company switched to semi-annual reporting and only gave a business update for 1Q20, which fortunately, still contained key metrics such as the sales of each business segment.
- Semiconductor division clear outperformer.** FRKN's 1Q20 semiconductor sales surged 58% YoY to S\$42mn as client demand remained strong, and the group expects 2Q20 semiconductor sales to increase further. Its industrial automation segment is facing a slow period in the short-term, but we expect semiconductor and medical segment sales to offset the weakness.
- Maintain Outperform.** Despite FRKN's shares having rallied 67% from its 52-week lows of 47.5 cents on 19 March 2020, we still think FRKN presents value based on its undemanding valuations. At its current price, FRKN trades at only 7.9x FY2020F P/E and 1.0x FY2020F P/B, an attractive discount to local and regional peers.

Financials & Key Operating Statistics					
YE Dec (\$\$m)	2018	2019	2020F	2021F	2022F
Revenue	625.8	659.2	685.5	712.9	741.5
PATMI	30.0	42.4	42.7	44.7	45.7
Core PATMI	33.9	46.5	42.7	44.7	45.7
Core EPS	8.1	11.0	10.1	10.6	10.8
Core EPS grth (%)	44.1	36.1	-8.2	4.7	2.2
Core P/E (x)	9.8	7.2	7.9	7.5	7.4
DPS (\$Gcents)	2.1	3.0	3.0	3.0	3.0
Div Yield (%)	2.7	3.8	3.8	3.8	3.8
Net Margin (%)	4.8	6.4	6.2	6.3	6.2
Gearing (%)	0.6	Net Cash	Net Cash	Net Cash	Net Cash
Price / Book (x)	1.3	1.1	1.0	0.9	0.8
ROE (%)	11.2	14.2	12.2	11.7	11.0

Source: Company Data, KGI Research

Financial review. FRKN reported a commendable set of 1Q20 results on 14 May 2020, as net profit rose 11% YoY to S\$9.5mn, despite a 5% YoY drop in revenue. COVID-19 will have an impact in 2Q20 and possibly going into 3Q20 depending on the supply chain situation, which remains fluid. On a more important note, FRKN's balance sheet remains in a net cash position of S\$93mn as at end-1Q2, putting the group in a strong position to weather the challenges and gain market share.

Figure 1: PATMI trend (excluding exceptional items)



Source: Company data, KGI Research

OUTPERFORM - Maintain			
Price as of 22 May 20 (SGD)	0.80	Performance (Absolute)	
12M TP (\$)	1.01	1 Month (%)	17.8
Previous TP (\$)	1.01	3 Month (%)	-9.7
Upside (%)	17.4	12 Month (%)	29.3
Trading data		Perf. vs STI Index (Red)	
Mkt Cap (\$mn)	338		
Issued Shares (mn)	425		
Vol - 3M Daily avg (mn)	1.9		
Val - 3M Daily avg (\$mn)	1.4		
Free Float (%)	62.0%		
Major Shareholders		Previous Recommendations	
Gooi Soon Chai	23.4%	28-Feb-20	OP \$1.01
		18-Nov-19	N \$0.93
		7-Nov-19	OP \$0.93

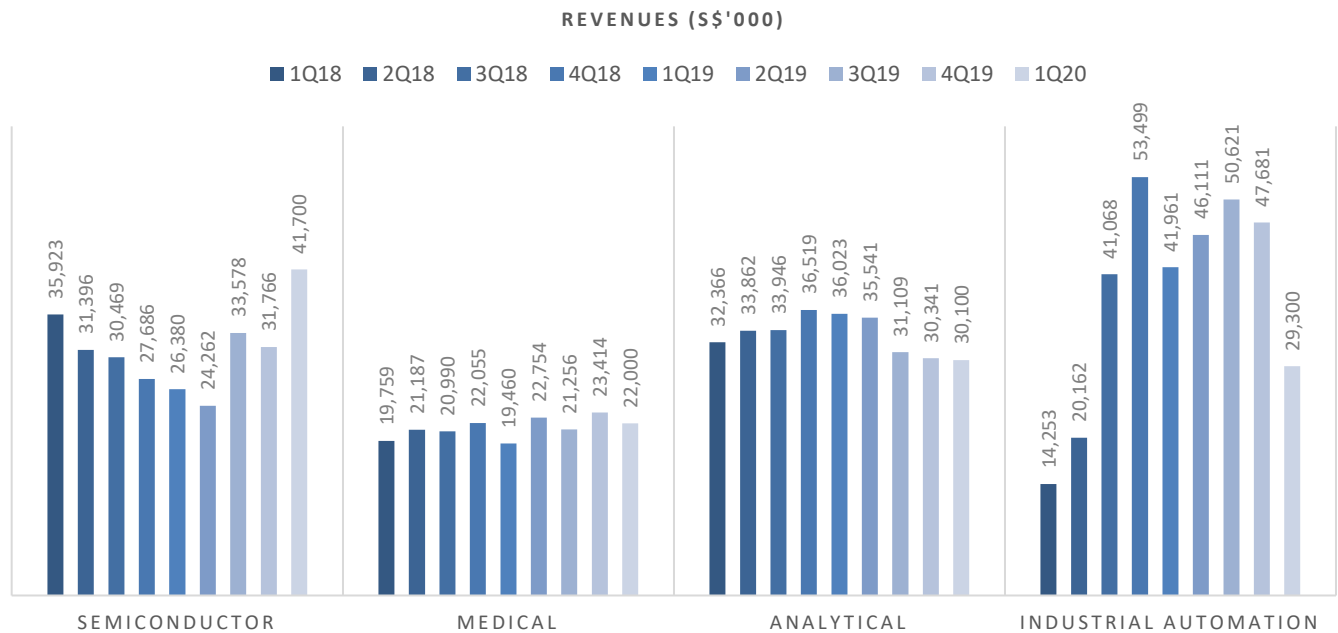
2Q20 outlook. Management has guided that its semiconductor and medical segments are expected to be higher QoQ in 2Q20 but guided for continued weakness in its Industrial Automation (mainly lower orders from a major hard disk manufacturer) and automotive segments. All its facilities have resumed operations with the exception of its factory in India, as of 14 May 2020. However, we do note that clients even in the relatively resilient semiconductor and healthcare segment (e.g., Siemens) have withdrawn their 2020 outlook due to the COVID-19 pandemic, indicating that the biggest risk is still on supply-side disruptions.

Semiconductor momentum. ASML's CEO guided that its 2Q20 sales would be 50% higher QoQ if not for the disruption caused by COVID-19. While ASML said demand for its products remained strong, the company stopped short of giving a 2Q20 and full-year guidance due to the uncertainties in the market. We think the near-term weakness due to supply-chain disruptions are already priced in by the markets as ASML's share price made new highs this week.

Valuation & Action: We maintain our Outperform recommendation on FRKN, with an unchanged fair value of S\$1.01 based on a conservative 10x FY20F earnings and a 20-30% discount to peers' P/E and P/B valuations. FRKN trades at only 4.0/3.7/3.5x FY20/21/22F EV/EBITDA, making it an attractive takeover target for Asian-based companies looking to diversify to Europe and the US.

Risks: Frencken's main business segments are cyclical in nature. A spending slowdown in its key business segments, namely semiconductor, automotive and analytical machines may impact margins and new orders. However, its track record has shown revenue resilience due to the well-diversified mix of its business.

Revenue Trend by business segments

Figure 2: Revenue trend by business segments (Mechatronics Division)


Source: Company data, KGI Research

Diversified sales mix

Figure 3: Revenue breakdown (YoY and QoQ comparison)

Sales (S\$'000)	1Q 20	1Q 19	YoY (%)	4Q 19	QoQ (%)
Semiconductor	41,700	26,380	58.1%	31,766	31.3%
Medical	22,000	19,460	13.1%	23,414	(6.0%)
Analytical	30,100	36,023	(16.4%)	30,341	(0.8%)
Industrial Automation	29,300	41,961	(30.2%)	47,681	(38.5%)
Others	3,140	4,174	(24.8%)	4,296	(26.9%)
Mechatronics Total	126,240	127,998	(1.4%)	137,498	(8.2%)
Automotive	18,800	24,296	(22.6%)	22,208	(15.3%)
Consumer & Industrial Ele	4,570	4,697	(2.7%)	4,047	12.9%
Others	700	699	0.1%	1,084	(35.4%)
Tooling	1,045	1,318	(20.7%)	1,067	(2.1%)
IMS Total	25,115	31,010	(19.0%)	28,406	(11.6%)
Total	151,355	159,008	(4.8%)	165,904	(8.8%)

Source: Company data, KGI Research

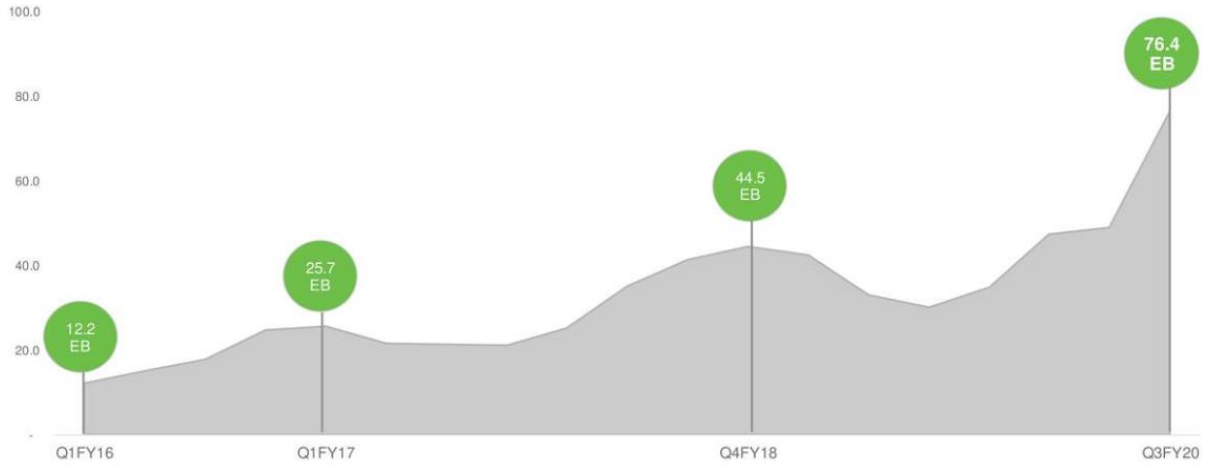
Riding on long-term trends in semiconductor and data storage.

1) Semiconductor momentum. In its 1Q20 earnings call, ASML remained upbeat on the outlook going all the way out into 2025, driven by higher acceptance of its Extreme Ultraviolet Lithography (EUV) systems. Demand for EUV has been stronger-than-expected, as management forecasts EUV sales growth of around 60% YoY in 2020, reflecting strong logic demand and confidence in the technology. This demand in turn is fuelled by end-market applications requiring high performance compute, specifically 5G and AI, as customers accelerate their 7-nanometre ramp up.

In terms of DUV units, management was not able to give guidance but was generally optimistic that it was only a matter of when the memory market recovers this year.

2) Industrial Automation – slowing down capex in the short term. Seagate's current capex plans, which will be in the lower range of 6% of revenues (previously it guided 6-8% of revenues), will be to support its capacity expansion plan and prepare for the ramp up of its heat-assisted magnetic recording (HAMR) technology. Seagate is banking on HAMR to drive 20% CAGR growth in areal density over the next decade and expects 20 terabyte HAMR drives by 2020. As for overall data centre spend, Seagate sees 2020 to be a stronger YoY year on higher volume demand.

Figure 4: Seagate near-term demand trend – Exabytes (EB) shipped



Source: Seagate Presentation, KGI Research

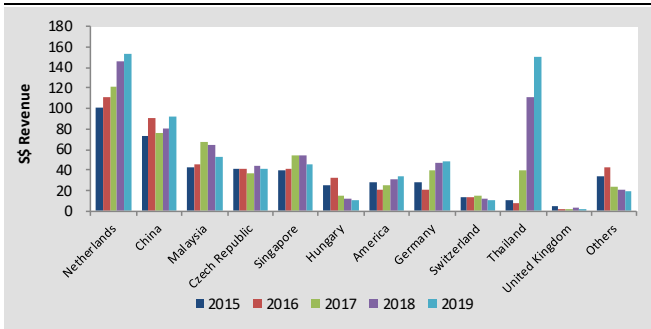
Figure 5: Company profile

Frencken Group Limited (Frencken) provides original equipment and integrated manufacturing solutions. The group has 17 operating sites across Asia, Europe and the USA and caters to multinational companies in the automotive, healthcare, industrial, life sciences and semiconductor industries. Revenue from Europe and Asia contributed to 42% and 53% of FY18 total sales, respectively.

Frencken was listed on the SGX in May 2005.

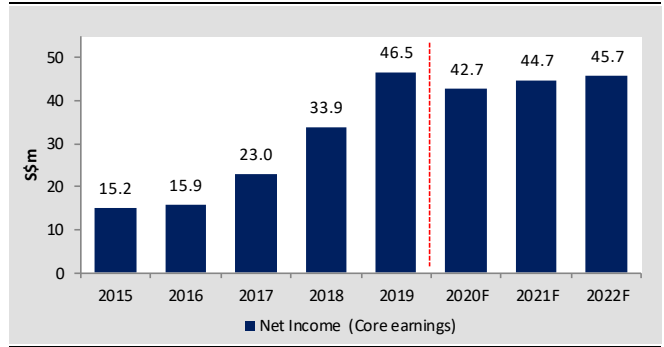
Source: KGI Research

Figure 7: Revenue breakdown by geography



Source: Company data, KGI Research

Figure 6: Core net earnings (excluding exceptional items)



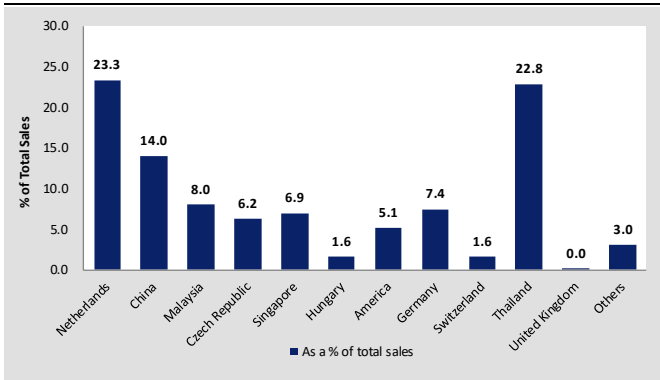
Source: Company data, KGI Research

Figure 8: Frencken's clients include many multinational companies



Source: Company data, KGI Research

Figure 9: Geographical contribution as a percentage of total sales



Source: Company data, KGI Research

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Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
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