



# Frencken Group Limited

(FRKN SP/FREN.SI)

## Highest quarterly profit but valuations not a bargain anymore

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- 2Q19 PATMI rose 59% YoY to S\$11.1mn, once again driven by its Industrial Automation (IA) segment. Its IA revenues surged 129% YoY and 10% QoQ to S\$45mn, offsetting weakness in its Semiconductor business, which declined 23% YoY and 8% QoQ to S\$24mn.
- We downgrade our recommendation on Frencken to NEUTRAL as valuations are no longer a bargain following the 70% year-to-date rally in its share price. Although still cheaper relative to peers, discount has narrowed to only around 10%.
- A key upside catalyst, in our view, is that Frencken is an attractive takeover target for a larger company given its diverse client and product base.

Financials & Key Operating Statistics					
YE Dec (\$m)	2017	2018	2019F	2020F	2021F
Revenue	515.1	625.8	657.1	683.4	710.7
PATMI	33.1	30.0	33.5	33.0	35.3
Core PATMI	23.0	33.9	33.5	33.0	35.3
Core EPS	5.6	8.3	8.2	8.1	8.6
Core EPS grth (%)	44.5	47.7	-1.2	-1.5	6.9
Core P/E (x)	13.0	8.8	8.9	9.1	8.5
DPS (\$Gcents)	2.4	2.1	2.6	2.6	2.6
Div Yield (%)	3.3	2.9	3.6	3.6	3.6
Net Margin (%)	6.4	4.8	5.1	4.8	5.0
Gearing (%)	-1.8	0.6	-15.4	-21.7	-28.0
Price / Book (x)	1.2	1.1	1.0	0.9	0.8
ROE (%)	13.3	11.2	10.6	9.8	9.7

Source: Company Data, KGI Research

**Results summary.** It was a good start to the first half of the year for Frencken. 2Q19 PATMI rose 59% YoY to a record quarterly high of S\$11.1mn, with 1H19 PATMI already making up 72% of our 2019 full-year forecasts. Given the better-than-expected results, we raise our 2019F and 2020F PATMI by 22% and 9% respectively.

**Diversified sales mix.** Sales for Frencken's high-margin Mechatronics business rose 17% YoY, led mainly by a 129% YoY surge in its IA segment. Weakness in its Semiconductor segment was in line with management's earlier guidance of a YoY decline.

Figure 1: Revenue breakdown (YoY and QoQ comparison)

Sales (\$S'000)	2Q 19	2Q 18	YoY (%)	1Q19	QoQ (%)
Semiconductor	24,262	31,396	(22.7%)	26,380	(8.0%)
Medical	22,754	21,187	7.4%	19,460	16.9%
Analytical	35,541	33,862	5.0%	36,023	(1.3%)
Industrial Automation	46,111	20,162	128.7%	41,961	9.9%
Others	4,342	7,396	(41.3%)	4,174	4.0%
<b>Mechatronics Total</b>	<b>133,010</b>	<b>114,003</b>	<b>16.7%</b>	<b>127,998</b>	<b>3.9%</b>
Automotive	24,992	24,960	0.1%	24,296	2.9%
Consumer & Industrial Elect.	4,686	5,672	(17.4%)	4,697	(0.2%)
Others	1,150	690	66.7%	1,179	(2.5%)
Tooling	855	2,028	(57.8%)	1,318	(35.1%)
<b>IMS Total</b>	<b>31,683</b>	<b>33,350</b>	<b>(5.0%)</b>	<b>31,490</b>	<b>0.6%</b>

Source: Company data, KGI Research

**Downside risks as more business segments slow down.** IA has been the biggest revenue driver, contributing to 28% of 2Q19 sales, compared to just 14% in 2Q18. Management has guided for this segment to post YoY growth in 3Q19 but for a

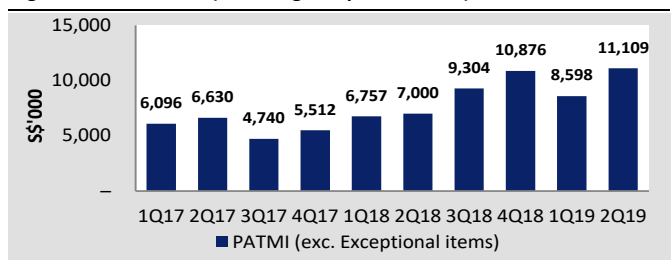
### Neutral - Downgrade

Price as of 21 Aug 19 (SGD)	0.73	<b>Performance (Absolute)</b>	
12M TP (\$)	0.81	1 Month (%)	14.1
Previous TP (\$)	0.67	3 Month (%)	19.7
Upside (%)	10.4	12 Month (%)	88.7
<b>Trading data</b>		<b>Perf. vs STI Index (Red)</b>	
Mkt Cap (\$mn)	309		
Issued Shares (mn)	424		
Vol - 3M Daily avg (mn)	1.9		
Val - 3M Daily avg (\$mn)	1.2		
Free Float (%)	62.0%		
<b>Major Shareholders</b>		<b>Previous Recommendations</b>	
Gooi Soon Chai	23.4%	13-May-19	OP \$0.67
		12-Mar-19	OP \$0.67
		7-Mar-18	OP \$0.72

QoQ decline, which implies a range of between S\$41mn and S\$46mn in revenues. In summary, we estimate 3Q19 overall sales to be flat QoQ, with downside risks from its automotive and analytical segments.

Frencken's IMS division offered no surprises as 2Q19 revenues declined slightly by 5% YoY and flat QoQ at S\$32mn. Its IMS segment is expected to improve on better utilisation at its new manufacturing facility in Chuzhou, Anhui Province, China.

Figure 2: PATMI trend (excluding exceptional items)



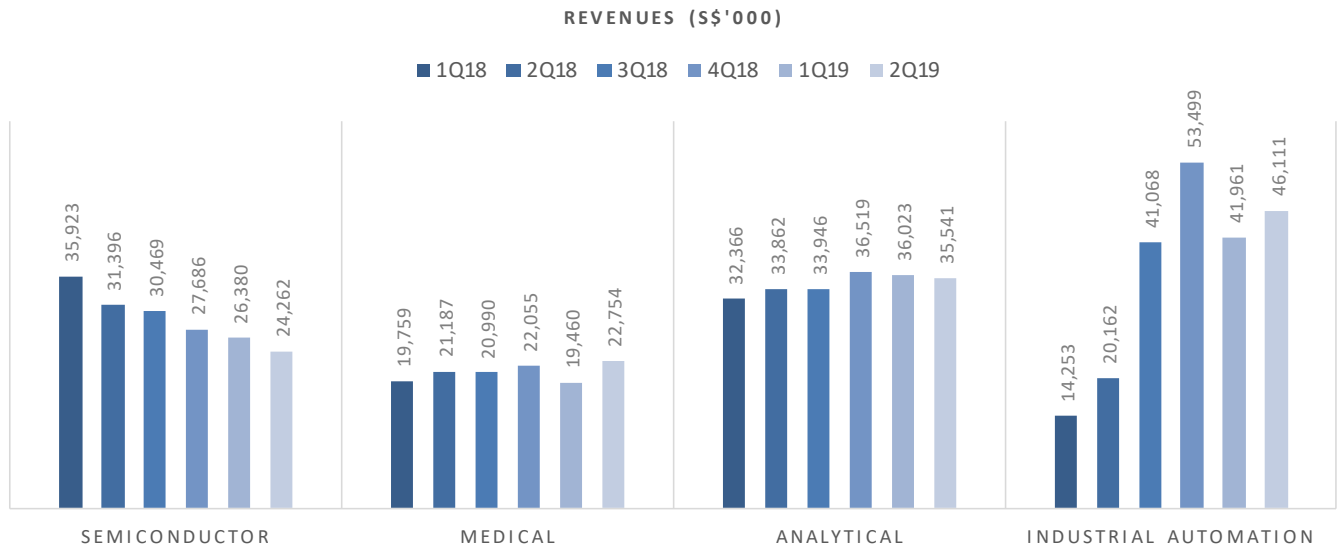
Source: Company data, KGI Research

**Valuation & Action: No longer a bargain.** We downgrade our recommendation to NEUTRAL and peg a fair value of S\$0.81, based on 10x FY20F earnings (in line with its peer average). Although we are of the view that Frencken is an attractive takeover target for a larger company given the group's diverse client and product base, we believe that the risk-to-reward dynamics are not as attractive following the >70% YTD rally in its share price.

**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 which may be due to the well-diversified mix of its business.

### Revenue Trend by business segments

Figure 3: Revenue trend by business segments (Mechatronics Division)



Source: Company data, KGI Research

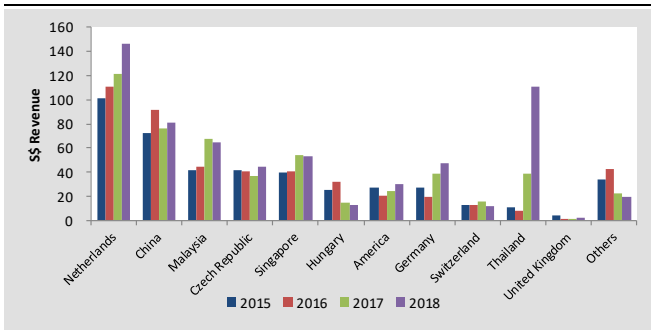
Figure 4: Company profile

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 6: Revenue breakdown by geography



Source: Company data, KGI Research

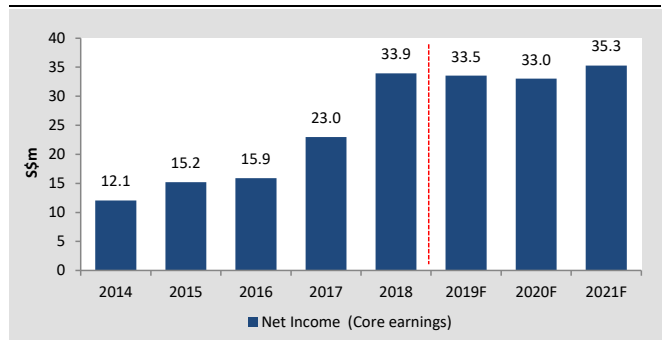
**Frencken – valuations have narrowed to peers after the 74% YTD share price rally.** Frencken’s PE and PB ratios have both narrowed to around 10% to its closest peers. Venture, Hi-P, UMS, AEM and Fu Yu are trading at 9-12x forward P/E.

Figure 8: Peer comparison

BBG TICKER	Company	PRICE (\$GD)	MKT CAP (\$GDm)	P/E (HIST)	P/E (FWD)	P/B	EV/EBITDA (TTM)	CASH (\$GDm)	MKT CAP/CASH	DIV YIELD (%)
VMS SP EQUITY	Venture Corp Ltd	15.26	4400	13.0	12.1	1.8	7.5	712.8	6.2	4.8
HIP SP EQUITY	Hi-P International Ltd	1.22	981	9.5	11.1	1.8	2.9	286.7	3.4	3.0
UMSH SP EQUITY	UMS Holdings Ltd	0.64	341	10.5	11.5	1.5	6.2	18.9	18.0	6.3
VALUE SP EQUITY	Valuetronics Holdings Ltd	0.63	273	7.8	8.6	1.3	3.1	160.6	1.7	6.6
SUNN SP EQUITY	Sunningdale Tech Ltd	1.30	248	13.9	28.9	0.7	5.2	88.7	2.8	6.2
FRKN SP EQUITY	Frencken Group Ltd	0.73	309	8.6	8.7	1.1	2.9	67.1	4.6	3.6
MMH SP EQUITY	Micro-Mechanics Holdings Ltc	1.60	222	15.7	16.0	4.0	8.3	21.1	10.5	6.3
AEM SP EQUITY	AEM Holdings Ltd	1.18	319	8.4	8.7	3.0	3.7	58.9	5.4	2.9
FUYU SP EQUITY	Fu Yu Corp Ltd	0.22	162	13.1	11.9	1.0	3.0	83.9	1.9	8.8
MTEC SP EQUITY	Memtech International Ltd	1.34	188	14.2	11.4	1.1	3.0	30.2	6.2	3.3
INNOT SP EQUITY	InnoTek Ltd	0.47	106	4.7	-	0.7	1.3	60.1	1.8	-
SPE SP EQUITY	Spindex Industries Ltd	0.97	112	6.7	-	1.0	3.4	29.2	3.8	-
ELL SP EQUITY	Ellipsiz Ltd	0.39	64	-	-	0.6	-	73.2	0.9	-
GVTL SP EQUITY	Grand Venture Technology Ltd	0.22	52	8.2	16.9	2.6	-	2.5	20.8	-
AVIT SP EQUITY	Avi-Tech Electronics Ltd	0.28	48	15.6	14.0	1.0	5.0	32.7	1.5	7.1
JAD SP EQUITY	Jadason Enterprises Ltd	0.04	25	-	-	0.6	3.4	10.7	2.4	-
GSSE SP EQUITY	GSS Energy Ltd	0.07	36	17.4	-	0.8	8.6	10.5	3.4	-
JEP SP EQUITY	JEP Holdings Ltd	0.14	57	9.6	-	1.0	8.6	4.5	12.5	-
<b>Average</b>				<b>11.1</b>	<b>13.3</b>	<b>1.4</b>	<b>4.8</b>	<b>97.4</b>	<b>6.0</b>	<b>5.3</b>

Source: Bloomberg, KGI Research

Figure 5: Core net earnings (excluding exceptional items)



Source: Company data, KGI Research

Figure 7: Frencken’s clients include many multinational companies



Source: Company data, KGI Research

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