RESULTS UPDATE

Technology ▪ Singapore

KGI CHINA DEVELOPMENT FINANCIAL

Frencken Group Limited

(FRKN SP/FREN.SI)

Riding on the wave of business and technology transformation

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- Frencken reported a strong set of 3Q19 results. 3Q19 PATMI excluding exceptional items rose 23% YoY to S$11.4mn.
- 9M19 PATMI made up 93% of our full-year estimates mainly due to stronger-than-expected performance from its semiconductor and industrial automation businesses.
- We maintain OUTPERFORM as its share price still offers an attractive entry level.

Financials & Key Operating Statistics

YE Dec (S$m)	2017	2018	2019F	2020F	2021F
Revenue	515.1	625.8	657.1	683.4	710.7
PATMI	33.1	30.0	39.4	38.1	39.5
Core PATMI	23.0	33.9	39.4	38.1	39.5
Core EPS	5.6	8.3	9.6	9.3	9.6
Core EPS grth (%)	44.5	47.7	16.2	-3.3	3.7
Core P/E (x)	12.8	8.7	7.5	7.7	7.5
DPS (SGCents)	2.4	2.1	2.6	2.6	2.6
Div Yield (%)	3.3	3.0	3.6	3.6	3.6
Net Margin (%)	6.4	4.8	6.0	5.6	5.6
Gearing (%)	-1.8	0.6	-17.6	-24.7	-31.3
Price / Book (x)	1.2	1.1	0.9	0.9	0.8
ROE (%)	13.3	11.2	12.3	10.9	10.5

Source: Company Data, KGI Research

Stronger than expected quarter. 3Q19 revenue was once again driven by a 7% YoY and 6% QoQ increase in its mechatronics division, which more than offset the ongoing weakness in the IMS business. In particular, semiconductor sales rose 10% YoY and 38% QoQ to the highest in six quarters, while its industrial automation surprised on the upside as sales in this segment increased 23% YoY and 10% QoQ.

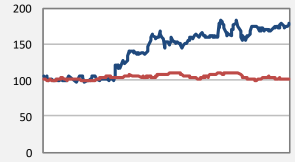
Turn around in semiconductor. Frencken's semiconductor segment had been a weak spot in an otherwise stellar performance in 1H19. 3Q19 finally marks a turnaround as semiconductor segment sales rose S$33.6mn, its highest in six quarters, and we expect semiconductor industry sales to grow at 5-10% CAGR for 2020-22F, compared to low-single digits in 2017-19F, driven mainly by higher semiconductor content value in new product pushes.

Key clients in semiconductor and industrial automation are upbeat on the ramp up of new technologies.

1) Semiconductor. In its 3Q19 earnings call, ASML had guided for a stronger 4Q19 and expects 2019 to be another record year with around EUR11.7bn of sales, driven mainly by delivery of its Extreme Ultraviolet Lithography (EUV) systems. Demand for EUV has been stronger-than-expected, with logic order intake making up 73% of total value in 3Q19 system bookings, 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.

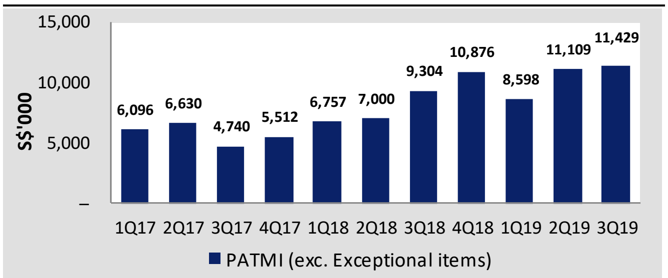
OUTPERFORM - Maintain

Price as of 6 Nov 19 (SGD)	0.72	**Performance (Absolute)**	
12M TP ($)	0.93	1 Month (%)	6.7
Previous TP ($)	0.81	3 Month (%)	10.8
Upside (%)	29.2	12 Month (%)	86.1
Trading data		**Perf. vs STI Index (Red)**	
Mkt Cap ($mn)	305		
Issued Shares (mn)	424		
Vol - 3M Daily avg (mn)	2.0		
Val - 3M Daily avg ($mn)	1.4		
Free Float (%)	62.0%		
Major Shareholders		**Previous Recommendations**	
Gooi Soon Chai	23.4%	10-Sep-19	OP $0.81
		22-Aug-19	N $0.81
		13-May-19	OP $0.67



2) Industrial Automation. Seagate's current capex plans, which will be in the range of 6-8% of its 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 1: PATMI trend (excluding exceptional items)



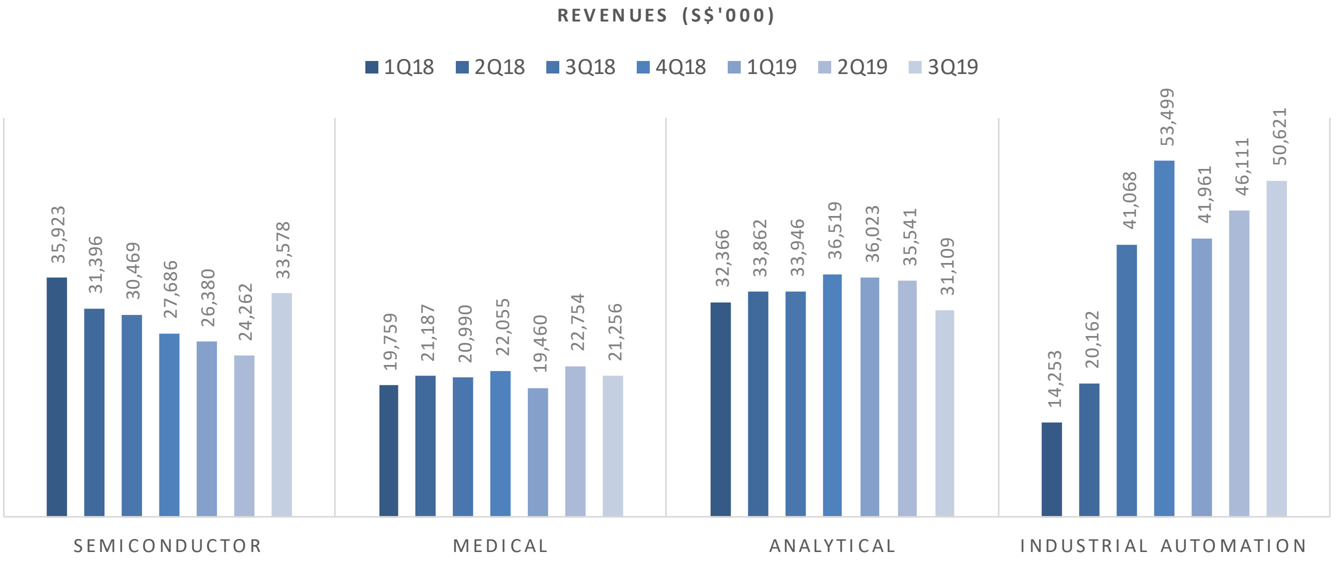
Source: Company data, KGI Research

Valuation & Action: We reiterate our OUTPERFORM recommendation and raise our fair value to S$0.93, based on 10x FY20F earnings (in line with its peer average). Its decent 4% dividend yield, while slightly lower than its peers, may be more sustainable given the group's diversified operations. As a bonus, we believe Frencken is an attractive takeover target for a larger company given the group's diverse client and product base, which would be the key catalyst for 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 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)	3Q 19	3Q 18	YoY (%)	2Q19	QoQ (%)
Semiconductor	33,578	30,469	10.2%	24,262	38.4%
Medical	21,256	20,990	1.3%	22,754	(6.6%)
Analytical	31,109	33,946	(8.4%)	35,541	(12.5%)
Industrial Automation	50,621	41,068	23.3%	46,111	9.8%
Others	4,495	4,829	(6.9%)	4,342	3.5%
Mechatronics Total	**141,059**	**131,302**	**7.4%**	**133,010**	**6.1%**
Automotive	22,212	23,804	(6.7%)	24,992	(11.1%)
Consumer & Industrial Elect.	4,822	5,441	(11.4%)	4,686	2.9%
Others	1,333	326	308.9%	1,150	15.9%
Tooling	1,057	2,968	(64.4%)	855	23.6%
IMS Total	**29,424**	**32,539**	**(9.6%)**	**31,683**	**(7.1%)**

Source: Company data, KGI Research

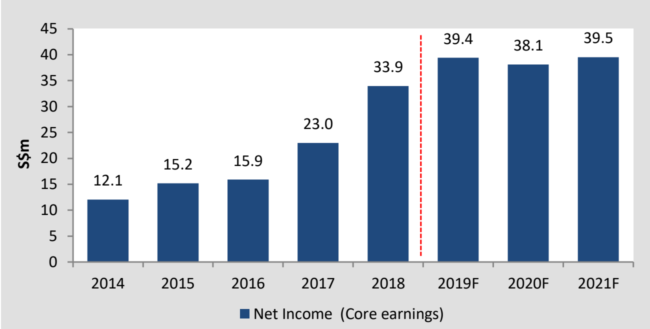
Figure 4: Company profile

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.

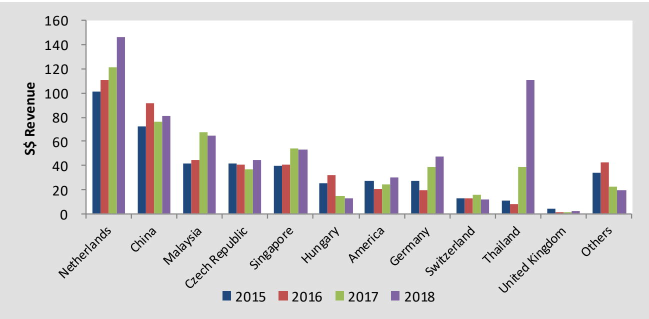
Source: KGI Research

Figure 5: Core net earnings (excluding exceptional items)



Source: Company data, KGI Research

Figure 6: Revenue breakdown by geography



Source: Company data, KGI Research

Figure 7: Frencken's clients include many multinational companies

Source: Company data, KGI Research

Frencken – still among the cheapest. Frencken's PE and PB ratios have both widened to around 20-30% to its closest peers. Venture, Hi-P, UMS, AEM and Fu Yu are trading at 9-12x forward P/E.

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