



Frencken Group Limited

(FRKN SP/FREN.SI)

HOLD - Downgrade

Price as of 23 Feb 2018	0.67
12M target price (S\$)	0.72
Previous target price (S\$)	0.66
Upside (%)	8.2

Trading data

Mkt Cap (S\$m) / (US\$m)	277.1 / 209
Issued Shares (m)	416.7
Ave Daily Traded (3-Month) Vol / Val	1.0m / \$0.6m
52 week lo / hi	\$0.31 / \$0.69
Free Float	57.4%

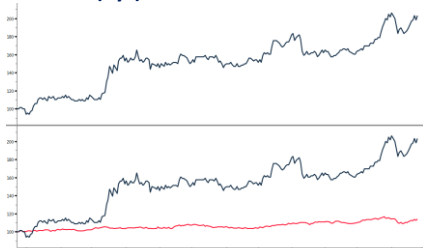
Major Shareholders

Gooi Soon Chai	22.0%
Lim Mee Hwa	6.0%

Previous Recommendations

Date	Rating	Share Price (S\$)	Target Price (S\$)
15-Nov-18	BUY	0.540	0.660
15-Aug-17	BUY	0.520	0.730
15-May-17	BUY	0.450	0.630

FRKN SP (1yr) VS STI



Source: Bloomberg

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See the last page for important disclosures.

Results in line; 2.39 SG cents dividend declared

Event

4Q17 in line; net cash position. Frencken reported a 4Q17 net profit of S\$5.2m (+19% YoY), in line with our expectations. The performance was mainly driven by its semiconductor, medical and analytical business segments. The group generated free cash flow of S\$9m for 2017 and cash inflow of S\$39m from divestments of several subsidiaries (e.g. Precico Electronics, NTZ). As a result, Frencken had a net cash position of S\$4.5m as at end 4Q17, compared to a net debt position of S\$40.3m as at end 4Q16.

Special dividends declared. The group declared 1.66 SG cents final and 0.73 SG cents special dividend for 2017, bringing full-year dividend to 2.39 SG cents (3.6% dividend yield). We expect the group to be able to pay dividend of 2.0 SG cents for 2018F based on a pay-out ratio of 33%, implying a 3.0% dividend yield.

Impact

Positive forward guidance. Frencken has guided for positive YoY growth in 1Q18 across all its business segments. Interestingly, the underperforming industrial automation segment is expected to pickup due to improvement in demand for production equipment for storage drivers. On a macro level and medium-term outlook, Eurozone business activity remains at a 12-year high according to IHS Market PMI data, providing a basis for sustained growth for the group. As a recap, ~50% of its sales is derived from Europe.

Valuation & Action

Downgrade to HOLD but accumulate on price weakness. Since our last report in Nov-17, Frencken's share price has gained 25% and has reached our target price. Thus, we downgrade to HOLD, with a fair value of S\$0.72 based on 12x 2018F EPS (previously 10x 2018F EPS). We continue to like Frencken's diversified business model and list of blue-chip customers, which helps provide stability in cash flows and dividend pay-outs. However, we would prefer to wait for opportunities to accumulate on price weakness.

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.

Financials & Key Operating Statistics

YE Dec (S\$m)	2016	2017	2018F	2019F	2020F
Revenue	466.4	515.1	540.8	567.9	590.6
PATMI	15.9	33.1	24.6	26.7	31.1
Core PATMI	15.9	23.0	24.6	26.7	31.1
Core EPS	3.9	5.6	6.0	6.5	7.6
Core EPS grth (%)	3.9	44.5	6.9	8.6	16.6
Core P/E (x)	17.1	11.9	11.1	10.2	8.8
DPS (SGCents)	1.2	2.4	2.0	2.0	2.2
Div Yield (%)	1.8	3.6	3.0	3.0	3.3
Net Margin (%)	3.4	6.4	4.5	4.7	5.3
Gearing (%)	18.8	-1.8	-14.4	-16.5	-24.1
Price / Book (x)	1.3	1.1	1.0	1.0	0.9
ROE (%)	7.4	13.3	9.4	9.5	10.3

Source: Company Data, KGI Research

4Q17 results review
Figure 1: Results comparison

FYE Dec (S\$m)	2017 Q4	2016 Q4	yoy % chg	2017 Q3	qoq % chg	KGI est. FY18F	Comments
Revenue	125.5	111.2	12.9	129.2	(2.9)	525.2	In line. 2017F revenue made up 98% of our full year forecasts.
Operating costs	(118.8)	(106.0)	12.0	(122.6)	(3.1)	(490.7)	
EBITDA	10.9	17.3	(37.3)	10.1	7.3	50.2	
EBITDA margin (%)	8.6%	-		7.8%		9.6%	
Depn & amort.	(4.2)	(12.2)	(65.5)	(3.5)	20.9	(15.8)	
EBIT	6.7	5.1	29.6	6.6	0.3	34.4	
Interest expense	(0.6)	(0.4)	48.7	(0.4)	60.5	(1.7)	
Int & Inv income	0.5	0.0	1,157.5	0.4	37.1	0.1	
Associates' contrib	-	-	nm	-	nm	-	
Exceptionals	(0.3)	-	nm	0.3	(219.3)	10.2	
Pretax profit	6.3	4.8	30.6	6.9	(9.6)	43.0	
Tax	(1.0)	(0.4)	176.9	(1.9)	(47.8)	(9.2)	
Tax rate (%)	0.2	0.1		0.3		0.2	
NCI	(0.1)	(0.1)	23.1	(0.0)	231.0	(0.5)	
Net profit	5.2	4.4	18.9	5.0	3.4	33.4	
Core profit	5.5	4.4	26.4	4.7	16.3	23.2	In line. 2017F core net profit made up 99% of our full year forecast
EPS (cts)	1.3	1.1	18.9	1.2	3.4	8.1	
Core EPS (cts)	1.3	1.1	26.4	1.2	16.3	5.7	

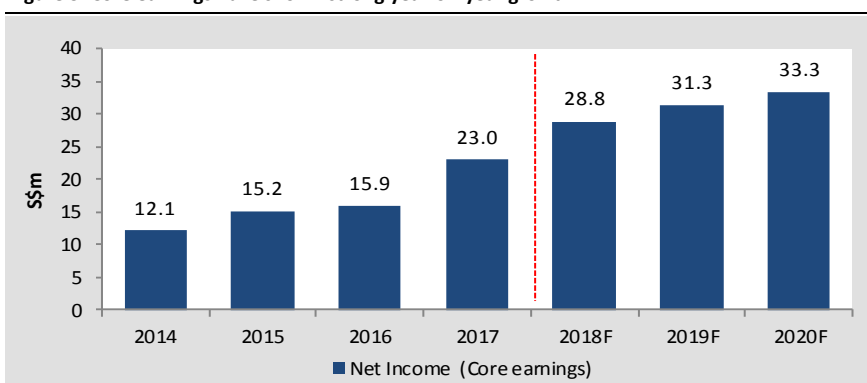
Source: Company data, KGI Research

Figure 2: 4Q17 revenue by business segments

Sales	4Q17	4Q16	yoy	3Q17	qoq	12M17	12M16	yoy
	S\$'000	S\$'000	%	S\$'000	%	S\$'000	S\$'000	%
MECHATRONICS DIVISION								
Semiconductor	26,570	15,540	71.0	28,100	(5.4)	116,433	74,390	56.5
Medical	21,424	15,081	42.1	18,486	15.9	72,004	63,780	12.9
Analytical	31,429	21,680	45.0	27,807	13.0	114,478	85,230	34.3
Industrial Automation	8,251	10,478	(21.3)	16,593	(50.3)	50,886	59,440	(14.4)
Others	4,569	6,789	(32.7)	5,534	(17.4)	19,523	19,090	2.3
Mechatronics Total	92,243	69,568	32.6	96,520	(4.4)	373,324	301,930	23.6
IMS DIVISION								
Automotive	24,425	32,138	(24.0)	22,791	7.2	102,750	126,156	(18.6)
Consumer & Industrial								
Electronics	5,183	4,774	8.6	5,362	(3.3)	21,319	20,315	4.9
Others	1,001	1,275	(21.5)	891	12.3	3,885	4,490	(13.5)
Tooling	2,547	3,427	(25.7)	3,612	(29.5)	13,600	13,520	0.6
IMS Total	33,156	41,614	(20.3)	32,656	1.5	141,554	164,481	(13.9)

Source: Company

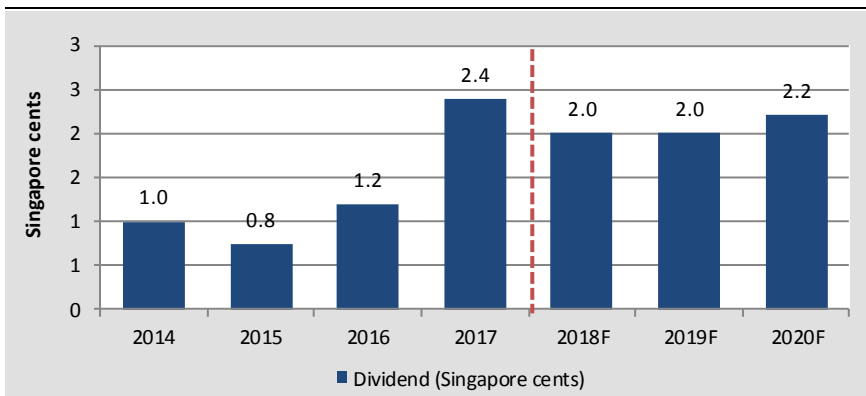
2017F Performance driven by 71% YoY growth in semiconductor segment. Frencken's higher-margins mechatronics division improved 33% YoY to S\$92.2m in 4Q17 from S\$69.6m in 4Q16, driven mainly by increased sales in its semiconductor, medical, and analytical segments.

Figure 3: Core earnings have shown strong year-on-year growth


Source: Company data, KGI Research

Decent dividend yield of 3.0%. We forecast 2.0/2.0/2.2 SG cents dividend for 2018F-2020F, based on a conservative payout ratio of 31%. Frencken has historically rewarded shareholder even in tough times – it paid out a dividend of 0.5 SG cents in FY12 amid a loss of S\$11.8m that year. We believe its dividends are sustainable given that its healthy operating cash flow (which averaged S\$20m p.a. for FY14-16) is greater than our dividend payout estimate of S\$8m for FY17.

Figure 4: We expect dividends to remain stable over the next three years on the back of steady growth in its key business segments. Our dividend estimates are based on a 35% payout ratio.



Source: Company data, KGI Research

Frencken – valuations still undemanding despite recent share price run-up. Frencken’s PE and PB ratios are both lower by 20-30% compared to peer average. Frencken is a laggard and may perhaps be under the radar of many investors given its lower profile relative to peers. Venture, Hi-P, UMS and Valuetronics are trading at 13-23x forward P/E and may be trading at a premium to industry average in view of their larger size. Still, smaller peers like Fu Yu, Memtech, Micro-Mechanics and Jadason are trading at 9x-15x forward P/E.

Figure 5: Peer comparison

BBG TICKER	Company	PRICE (SGD)	MKT CAP (SGDm)	P/E (HIST)	P/E (FWD)	P/B	EV/EBITDA (TTM)	DIV YIELD (%)	1 YR TOTAL RETURN (%)
VMS SP EQUITY	Venture Corp Ltd	26.66	7617	26.4	22.6	3.7	3.7	2.5	169
HIP SP EQUITY	Hi-P International Ltd	2.41	1947	16.0	13.8	3.7	3.7	2.5	410
UMSH SP EQUITY	UMS Holdings Ltd	1.15	617	14.6	13.1	3.0	3.0	5.0	126
VALUE SP EQUITY	Valuetronics Holdings Ltd	1.00	427	12.4	12.3	2.5	2.5	4.1	70
SUNN SP EQUITY	Sunningdale Tech Ltd	1.97	373	11.8	9.2	1.0	1.0	4.2	57
FRKN SP EQUITY	Frencken Group Ltd	0.67	279	8.3	10.3	1.2	1.2	-	110
MMH SP EQUITY	Micro-Mechanics Holdings	2.23	310	18.1	14.9	5.4	5.4	3.6	144
AEM SP EQUITY	AEM Holdings Ltd	6.36	420	13.2	10.3	8.2	8.2	2.4	735
FISC SP EQUITY	Fischer Tech Pte Ltd	-	-	-	-	-	-	-	-
FUYU SP EQUITY	Fu Yu Corp Ltd	0.20	150	19.5	-	0.9	0.9	-	2
MTEC SP EQUITY	Memtech International Ltd	1.40	197	10.3	14.3	1.2	1.2	2.9	122
SPE SP EQUITY	Spindex Industries Ltd	0.91	105	9.8	-	1.1	1.1	-	9
ELL SP EQUITY	Ellipsiz Ltd	0.69	114	9.8	-	0.8	0.8	-	80
AVIT SP EQUITY	Avi-Tech Electronics Ltd	0.51	87	12.2	10.2	1.8	1.8	5.9	66
JAD SP EQUITY	Jadason Enterprises Ltd	0.08	57	16.0	15.6	1.1	1.1	3.8	179
GSSE SP EQUITY	GSS Energy Ltd	0.17	82	13.6	-	1.9	1.9	-	23
INNOT SP EQUITY	InnoTek Ltd	0.50	111	9.4	-	0.9	0.9	-	50
JEP SP EQUITY	JEP Holdings Ltd	0.09	133	242.0	-	2.9	2.9	-	318
Average				27.3	13.3	2.4	2.4	3.7	157.0

Source: Bloomberg, KGI Research

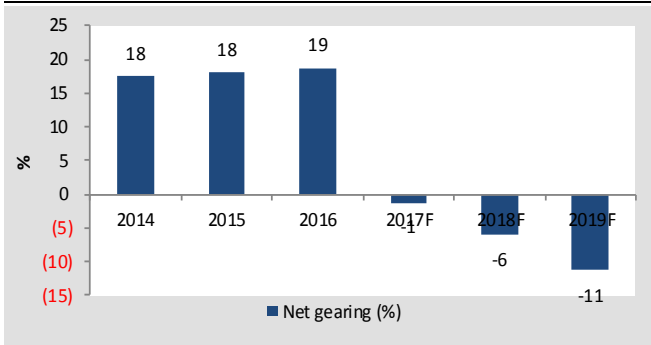
Figure 6: Company profile

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 48% and 48% of FY16 total sales, respectively.

Frencken was listed on the SGX in May 2005.

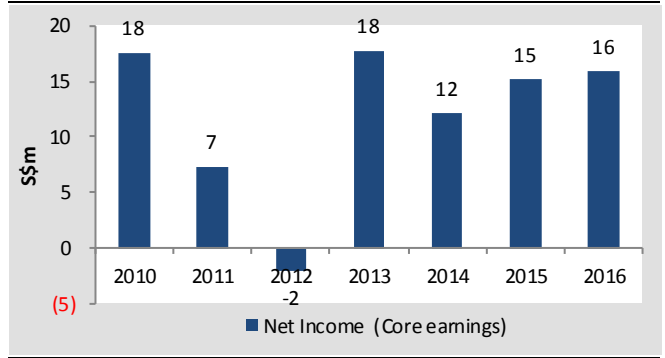
Source: KGI Research

Figure 8: We expect net cash position to strengthen going forward



Source: Company data, KGI Research

Figure 7: Core net earnings have stabilised and is ready for growth



Source: Company data, KGI Research

Figure 9: Frencken's clients include many multinational companies



Source: Company data, KGI Research

YE 31 Dec

INCOME STATEMENT (S\$m)	2016	2017	2018F	2019F	2020F
Revenue	466.4	515.1	540.8	567.9	590.6
Cost of sales	(395.7)	(431.2)	(454.3)	(477.0)	(496.1)
Gross Profit	70.8	83.9	86.5	90.9	94.5
Other operating income/(expenses)	5.9	6.3	5.1	4.7	4.7
Selling and distribution	(11.3)	(10.9)	(11.4)	(11.4)	(11.8)
Admin	(42.4)	(46.9)	(48.7)	(50.0)	(50.2)
Profit from Operations	21.6	30.3	31.6	34.2	37.2
Finance income/(expenses)	(1.4)	(0.3)	(1.6)	(1.7)	0.8
Share of JV results	0.0	0.0	0.0	0.0	0.0
Exceptionals/Investment income	0.0	10.1	0.0	0.0	0.0
Profit before Tax	20.3	40.1	30.0	32.6	37.9
Income tax	(4.3)	(6.6)	(5.4)	(5.9)	(6.8)
Non-controlling interests	(0.1)	(0.4)	(0.0)	(0.0)	(0.0)
PATMI	15.9	33.1	24.6	26.7	31.1
PATMI Normalized	15.9	23.0	24.6	26.7	31.1
BALANCE SHEET (S\$m)	2016	2017	2018F	2019F	2020F
Cash and cash equivalents	18.5	68.2	103.4	114.0	143.3
Trade and other receivables	90.7	100.3	81.1	85.2	88.6
Inventory	109.3	112.2	113.6	119.3	124.0
Other current assets	11.4	13.5	13.5	13.5	13.5
Current Assets	229.8	294.1	311.6	331.9	369.4
Property, plant and equipment	100.0	93.9	96.6	99.8	86.4
Other non-current assets	33.2	32.1	33.5	34.9	36.4
Non-current Assets	133.2	126.0	130.0	134.7	122.8
Total assets	363.0	420.2	441.7	466.6	492.2
Trade and other payables	81.9	99.4	104.7	109.9	114.3
Borrowings (current)	57.4	61.7	64.8	68.1	70.8
Other current liabilities	2.9	2.4	1.7	2.1	3.1
Current Liabilities	142.2	163.5	171.2	180.1	188.2
Borrowings (non-current)	1.3	1.9	1.6	1.3	1.1
Other non-current liabilities	4.8	5.3	5.3	5.3	5.3
Non-current liabilities	6.1	7.1	6.8	6.6	6.3
Shareholders equity	212.7	247.2	259.0	276.6	298.7
Non-controlling interests	2.0	2.3	2.4	2.4	2.4
Total Equity	214.7	249.5	261.3	279.0	301.1
Total Liabilities and Equity	363.0	420.2	439.3	465.7	495.7
CASH FLOW STATEMENT (S\$m)	2016	2017	2018F	2019F	2020F
Net income before tax	20.3	40.1	30.0	32.6	37.9
Depreciation & non cash adjustments	10.3	(4.2)	16.6	17.5	18.1
Change in Working Capital	(5.7)	4.9	23.2	(4.4)	(1.2)
Income Tax Paid	(4.9)	(4.3)	(6.1)	(5.4)	(5.9)
Interest Paid	(1.5)	(1.6)	(1.7)	(1.8)	(1.8)
CF from operating activities	18.5	34.9	62.0	38.4	47.1
Purchase/Disposal of PPE	(20.0)	(26.1)	(19.2)	(20.6)	(10.0)
Other CFI	0.5	38.6	0.0	0.0	0.0
CF from investing activities	(19.5)	14.2	(19.2)	(20.6)	(10.0)
Dividends Paid	(3.0)	(5.0)	(9.0)	(9.0)	(9.0)
Debt Raised / (Repaid)	5.2	10.6	2.8	3.0	2.5
Equity Raised / (Bought Back)	0.4	0.0	0.0	0.0	0.0
Other Cash from Financing	(0.0)	1.1	0.0	0.0	0.0
CF from financing activities	2.6	6.8	(6.2)	(6.0)	(6.5)
Net increase in cash & cash equiv.	1.6	54.6	35.3	10.6	29.4
FX effects	0.2	(1.3)	(1.3)	(1.3)	(1.3)
Beginning Cash	(11.6)	(11.6)	43.0	78.2	88.8
Ending Cash	18.5	68.2	103.4	114.0	143.3
KEY RATIOS	2016	2017	2018F	2019F	2020F
Profitability					
Core EPS	3.9	5.6	6.0	6.5	7.6
Core EPS Growth (%)	3.9	44.5	6.9	8.6	16.6
DPS (SGD Cents)	1.2	2.4	2.2	2.2	2.2
Dividend Yield (%)	1.8	3.6	3.3	3.3	3.3
Profitability					
Gross margin	15.2%	16.3%	16.0%	16.0%	16.0%
EBITDA margin	8.1%	8.9%	8.9%	9.1%	9.4%
Net margin	3.4%	6.4%	4.5%	4.7%	5.3%
ROE	7.4%	13.3%	9.4%	9.6%	10.3%
ROA	4.4%	7.9%	5.6%	5.7%	6.3%
Financial Structure (x)					
Interest coverage	14.2	18.6	18.6	19.2	20.2
Total Debt/Equity	0.3	0.3	0.3	0.2	0.2
Net Gearing	0.2	0.0	-0.1	-0.2	-0.2

Source: KGI Research

KGI's Ratings

Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
BUY	>10% total return over the next 12 months
HOLD	-10% to +10% total return over the next 12 months
SELL	<-10% total return over the next 12 months

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