



# Frencken Group Limited

(FRKN SP/FREN.SI)

## Blowout 4Q19 results; buying opportunity

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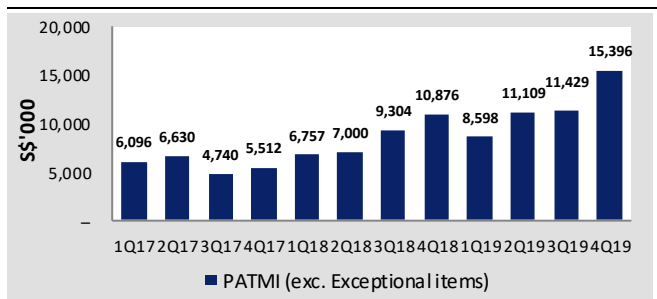
- **Above expectations.** FRKN reported a 1% YoY increase in 4Q19 profits to S\$11.2mn. However, 4Q19 core net profit excluding the S\$4.2mn impairment loss would have been S\$15.4mn, or a 42% YoY increase. For the full-year, core profits increased 37% YoY to S\$46.5mn. It raised its final dividend to 3.0 cents from 2.14 cents in the prior year.
- **Margin improvement.** The outperformance in 4Q19 was driven mainly by higher gross profit margins. For the full-year, gross profit margins improved to 16.9% from 16.3% in 2018 on better performance of its filter business within the IMS division.
- **Upgrade to Outperform.** The recent weakness of its share price presents an attractive opportunity to buy FRKN as the company continues to build on its strength and diversified business base. FRKN trades at only 8.5x FY2020F P/E and 1.1x 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)	10.6	7.8	8.5	8.1	8.0
DPS (\$GCents)	2.1	3.0	3.0	3.0	3.0
Div Yield (%)	2.5	3.5	3.5	3.5	3.5
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)	1.4	1.2	1.1	1.0	0.9
ROE (%)	11.2	14.2	12.2	11.7	11.0

Source: Company Data, KGI Research

**Higher-than-expected 4Q19.** FRKN reported its third consecutive quarter of QoQ core net profit growth as 4Q19 core net profit surged 42% YoY to S\$15mn. It recognised S\$4.1mn of exceptional losses in the quarter due to impairments. S\$1.5mn impairment was due to an operating unit within its Mechatronics division and the remaining S\$2.6mn was taken by Juken (Zhuhai) Co Ltd, an operating unit within its IMS division. Gross profit margin expanded to 18.9% in the quarter due to improvements at the filter business within the IMS division. IMS' operating income, which has historically been a drag to overall performance, rose to S\$6.1mn in 2019 from S\$0.8mn in 2018.

Figure 1: PATMI trend (excluding exceptional items)



Source: Company data, KGI Research

### OUTPERFORM - Upgrade

Price as of 28 Feb 20 (SGD)	0.86	<b>Performance (Absolute)</b>	
12M TP (\$)	1.01	1 Month (%)	3.0
Previous TP (\$)	0.93	3 Month (%)	-4.4
Upside (%)	17.4	12 Month (%)	90.5
<b>Trading data</b>		<b>Perf. vs STI Index (Red)</b>	
Mkt Cap (\$mn)	367		
Issued Shares (mn)	424		
Vol - 3M Daily avg (mn)	2.0		
Val - 3M Daily avg (\$mn)	1.4		
Free Float (%)	62.0%		
<b>Major Shareholders</b>		<b>Previous Recommendations</b>	
Gooi Soon Chai	23.4%	18-Nov-19	N \$0.93
		7-Nov-19	OP \$0.93
		10-Sep-19	OP \$0.81

**Strength in its diversified geographical footprint.** FRKN's factories in China was closed for an extended period after the CNY holidays but have since resumed operations. We expect the impact on FRKN's 1Q20 performance to be minimal as the group derives most of its business outside of China. 1Q is usually the weaker quarter for the group, and we expect it to ramp up production in 2H20. FRKN's diversified facilities across the world is a key advantage compared to peers who are more geographically exposed to China.

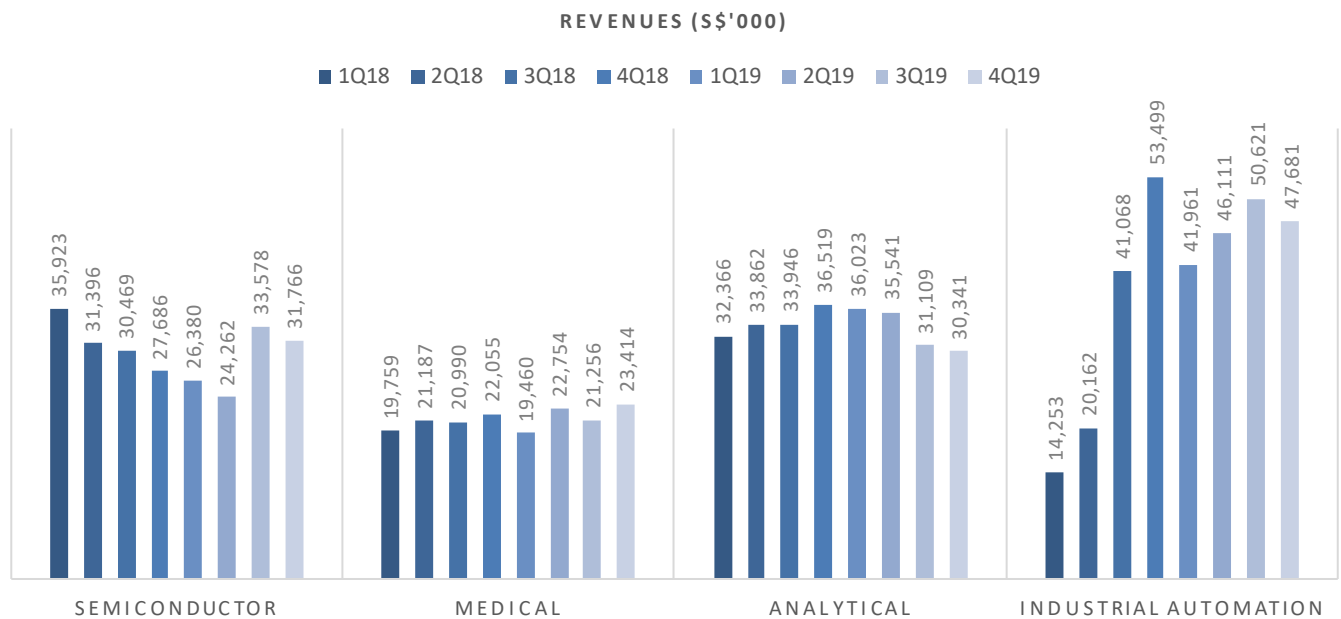
**1Q20 outlook.** Management has guided for both its semiconductor and medical segment to post YoY sales growth in 1Q20. However, there will be YoY top line declines under its analytical, industrial automation and automotive segments. Overall, we forecast 1Q20 revenues to decline at least 5-9% QoQ and YoY, but would be in line with a seasonally weaker 1Q. COVID-19 presents an uncertain 2020 outlook but the group's S\$69mn net cash position and strong client base strengthens its long-term prospects in the global technology sector.

**Valuation & Action:** We upgrade FRKN to Outperform. Our fair value of S\$1.01 is based on a conservative 10x FY20F earnings and a 20-30% discount to peers' P/E and P/B valuations. FRKN trades at only 4x FY20F 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)	4Q 19	4Q 18	YoY (%)	3Q19	QoQ (%)
Semiconductor	31,766	27,686	14.7%	33,578	(5.4%)
Medical	23,414	22,055	6.2%	21,256	10.2%
Analytical	30,341	36,519	(16.9%)	31,109	(2.5%)
Industrial Automation	47,681	53,499	(10.9%)	50,621	(5.8%)
Others	4,296	4,806	(10.6%)	4,495	(4.4%)
<b>Mechatronics Total</b>	<b>137,498</b>	<b>144,565</b>	<b>(4.9%)</b>	<b>141,059</b>	<b>(2.5%)</b>
Automotive	22,208	24,029	(7.6%)	22,212	(0.0%)
Consumer & Industrial Ele	4,047	4,657	(13.1%)	4,822	(16.1%)
Others	1,084	559	93.9%	1,333	(18.7%)
Tooling	1,067	1,828	(41.6%)	1,057	0.9%
<b>IMS Total</b>	<b>28,406</b>	<b>31,073</b>	<b>(8.6%)</b>	<b>29,424</b>	<b>(3.5%)</b>
Total	165,904	175,638	(5.5%)	170,483	(2.7%)

Source: Company data, KGI Research

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

1) Semiconductor. In its 4Q19 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 a matter of timing of when the memory market recovers this year.

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.

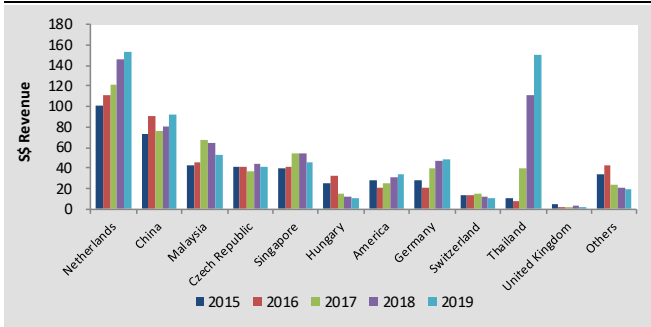
**Figure 4: Company profile**

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.

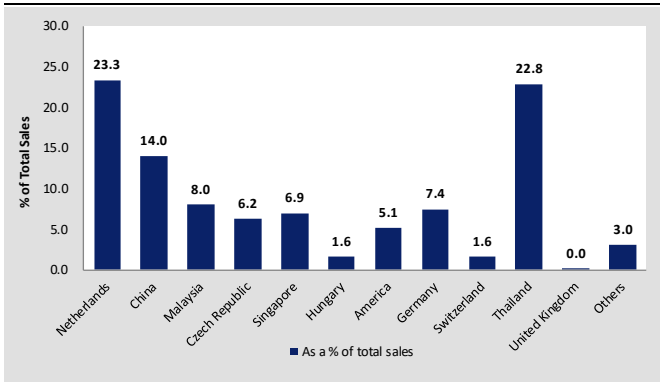
Source: KGI Research

**Figure 6: Revenue breakdown by geography**



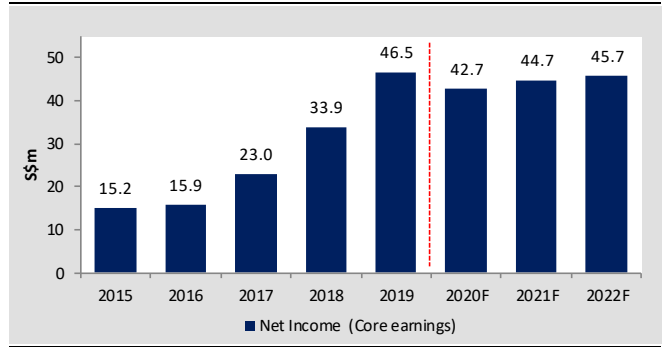
Source: Company data, KGI Research

**Figure 8: Geographical contribution as a percentage of total sales**



Source: Company data, 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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<b>Neutral (N)</b>	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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