

Frencken Group Limited

(FRKN SP/FREN.SI)

BUY - Maintain

Price as of 15 Nov 2017	0.54
12M target price (S\$)	0.66
Previous target price (S\$)	0.73
Upside (%)	23.5

Trading data

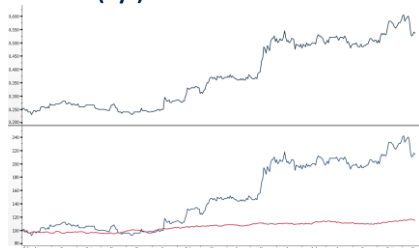
Mkt Cap (S\$m) / (US\$m)	222.7 / 164
Issued Shares (m)	416.3
Ave Daily Traded (3-Month) Vol / Val	1.0m / \$0.5m
52 week lo / hi	\$0.23 / \$0.62
Free Float	59.6%

Major Shareholders

Gooi Soon Chai	22.0%
Lim Mee Hwa	6.0%

Previous Recommendations

Date	Rating	Share Price (S\$)	Target Price (S\$)
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.

Opportunity to accumulate
Event

Frencken reported a 3Q17 net profit of S\$5.0m (+15% YoY), slightly below our expectations and making up 68% of our full year forecasts. The lower-than-expected results was due mainly to lower gross profit margins following a change of product mix.

Impact

We lower our FY17-19F earnings forecasts by 6-9% to account for lower margins. Our revised earnings, implying a 9.5/8.2/7.5x FY17-19F P/E, would still make Frencken undervalued compared to its peers who are trading at an average 12x forward P/E.

Price pressure due to a fund selling down. We noted that Yeoman 3-Rights Value Asia Fund had decreased its stake on 30 Oct to below the 5% threshold where they are not required to disclose further transactions. This may be a short-term overhang on Frencken's share price. On a positive note, management and major shareholder Dato' Gooi have been buying back shares in recent months.

Valuation & Action

We reiterate our BUY recommendation on Frencken and peg a fair value of S\$0.66 based on 10x FY18F earnings. We like Frencken's diversified business model of having five key segments that have kept the company profitable for the last 15 years. The only exception was the losses incurred in FY12 due to quality issues at its automotive segment, a business unit which it has since sold off earlier this year.

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)	2015	2016	2017F	2018F	2019F
Revenue	439.4	466.4	525.2	551.4	579.0
PATMI	9.2	15.9	33.4	27.1	29.4
Core PATMI	15.2	15.9	23.2	27.1	29.4
Core EPS	3.7	3.9	5.7	6.6	7.2
Core EPS grth (%)	25.3	3.9	45.7	16.8	8.6
Core P/E (x)	14.3	13.8	9.5	8.1	7.5
DPS (SGCents)	0.8	1.2	2.0	2.3	2.5
Div Yield (%)	1.4	2.2	3.7	4.3	4.7
Net Margin (%)	2.1	3.4	6.4	4.9	5.1
Gearing (%)	18.1	18.8	-1.0	-4.4	-8.8
Price / Book (x)	1.1	1.0	0.9	0.9	0.8
ROE (%)	4.5	7.4	13.9	10.5	10.6

Source: Company Data, KGI Research

3Q17 results review

Figure 1: Results comparison

FYE Dec (S\$m)	2017 Q3	2016 Q3	yoy % chg	2017 Q2	qoq % chg	KGI est. FY18F	Comments
Revenue	129.2	120.7	7.1	126.0	2.6	536.4	In line. 9M17 revenue made up 73% of our full year forecasts.
Operating costs	(122.6)	(114.2)	7.3	(117.6)	4.2	(499.2)	
EBITDA	10.1	10.4	(3.1)	12.1	(16.5)	53.3	
EBITDA margin (%)	7.8%	8.6%		9.6%		9.9%	
Depn & amort.	(3.5)	(4.0)	(12.3)	(3.8)	(7.9)	(16.1)	
EBIT	6.6	6.5	2.5	8.3	(20.3)	37.2	
Interest expense	(0.4)	(0.4)	1.1	(0.4)	(3.5)	(1.7)	
Int & Inv income	0.4	0.0	1,083.9	0.4	(5.7)	0.1	
Associates' contrib	-	-	nm	-	nm	-	
Exceptionals	0.3	-	nm	0.0	4,466.7	10.2	
Pretax profit	6.9	5.7	21.2	8.4	(17.2)	45.7	
Tax	(1.9)	(1.4)	36.7	(1.6)	19.1	(9.7)	
Tax rate (%)	0.3	0.2		0.2		0.2	
NCI	(0.0)	0.0	(169.0)	(0.1)	(79.9)	(0.5)	
Net profit	5.0	4.4	14.5	6.6	(24.4)	35.5	
Core profit	4.7	4.4	8.2	6.6	(28.5)	25.3	Below expectations duo lower-than-expected margins. 9M17 core net profit made up 69% of our full year forecast
EPS (cts)	1.2	1.1	13.6	1.6	(24.4)	8.7	
Core EPS (cts)	1.2	1.1	7.4	1.6	(28.5)	6.2	

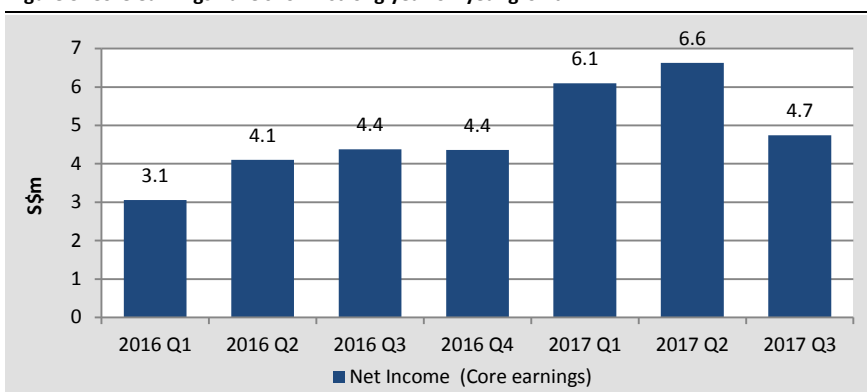
Source: Company data, KGI Research

Figure 2: 3Q17 revenue by business segments

Sales	3Q17	3Q16	yoy	2Q17	qoq	9M17	9M16	yoy
	S\$'000	S\$'000	%	S\$'000	%	S\$'000	S\$'000	%
MECHATRONICS DIVISION								
Semiconductor	28,100	18,650	50.7	30,594	(8.2)	89,863	58,850	52.7
Medical	18,486	16,283	13.5	16,606	11.3	50,580	48,699	3.9
Analytical	27,807	22,156	25.5	27,083	2.7	83,049	63,550	30.7
Industrial Automation	16,593	18,545	(10.5)	15,365	8.0	42,635	48,962	(12.9)
Others	5,534	4,203	31.7	5,302	4.4	14,954	12,301	21.6
Mechatronics Total	96,520	79,837	20.9	94,950	1.7	281,081	232,362	21.0
IMS DIVISION								
Automotive	22,791	31,249	(27.1)	20,986	8.6	78,325	94,018	(16.7)
Consumer & Industrial								
Electronics	5,362	5,122	4.7	5,700	(5.9)	16,136	15,541	3.8
Others	891	1,031	(13.6)	903	(1.3)	2,884	3,215	(10.3)
Tooling	3,612	3,468	4.2	3,353	7.7	11,053	10,093	9.5
IMS Total	32,656	40,870	(20.1)	30,942	5.5	108,398	122,867	(11.8)

Source: Company

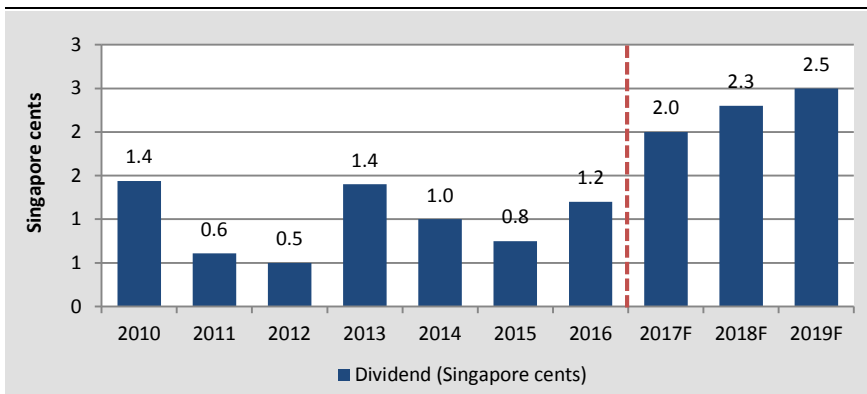
Performance driven by 51% YoY growth in semiconductor segment. Revenue at Frencken's Mechatronics Division improved 21% YoY to S\$96.5m in 3Q17 from S\$79.8m in 3Q16, driven mainly by increased sales in its semiconductor, medical, and analytical segments.

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


Source: Company data, KGI Research

Decent dividend yield of 3.7% to 4.6%. We forecast 2.0/2.3/2.5 SG cents dividend for FY17-19F, based on a conservative payout ratio of 35%. 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 increase in the next three years on the back of stable and steady growth in its key business segments. Our dividend estimates are based on a 35% payout ratio.



Source: Company data, KGI Research

Frencken – among the cheapest contract manufacturer in Singapore. Frencken's PE and PB ratios are both lower by 20-30% vs. peers. 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 12-18x 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, Avi-Tech and Jadason are trading at 9x-14x forward P/E, a premium to Frencken.

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	21.10	5999	20.9	18.3	3.0	3.0	2.9	127
HIP SP EQUITY	Hi-P International Ltd	1.89	1527	16.9	14.5	3.2	3.2	11.1	344
UMSH SP EQUITY	UMS Holdings Ltd	1.10	590	14.0	12.5	2.8	2.8	5.3	138
VALUE SP EQUITY	Valuetronics Holdings Ltd	1.01	433	13.2	13.4	2.5	2.5	3.9	121
SUNN SP EQUITY	Sunningdale Tech Ltd	2.02	380	8.4	10.3	1.1	1.1	3.4	96
FRKN SP EQUITY	Frencken Group Ltd	0.54	225	6.8	8.7	0.9	0.9	3.7	107
MMH SP EQUITY	Micro-Mechanics Holdings	2.02	281	17.0	12.6	4.7	4.7	4.0	154
AEM SP EQUITY	AEM Holdings Ltd	3.36	220	9.7	8.4	4.4	4.4	3.0	806
FISC SP EQUITY	Fischer Tech Ltd	3.00	167	12.8	-	1.5	1.5	-	-
FUYU SP EQUITY	Fu Yu Corp Ltd	0.22	162	21.1	-	1.0	1.0	-	18
MTEC SP EQUITY	Memtech International Ltd	1.11	156	7.9	10.9	0.9	0.9	3.9	91
SPE SP EQUITY	Spindex Industries Ltd	1.16	134	9.5	-	1.4	1.4	-	65
ELL SP EQUITY	Ellipsiz Ltd	0.85	141	17.6	-	1.1	1.1	-	154
AVIT SP EQUITY	Avi-Tech Electronics Ltd	0.51	86	11.9	10.1	1.8	1.8	4.0	98
JAD SP EQUITY	Jadason Enterprises Ltd	0.08	60	17.1	16.6	1.2	1.2	3.6	295
GSSE SP EQUITY	GSS Energy Ltd	0.17	86	14.2	-	2.2	2.2	-	108
INNOT SP EQUITY	InnoTek Ltd	0.35	77	6.5	-	0.6	0.6	-	59
JEP SP EQUITY	JEP Holdings Ltd	0.03	45	82.4	-	1.0	1.0	-	38
Average				17.1	12.4	2.0	2.0	4.4	165.8

Source: Bloomberg, KGI Research

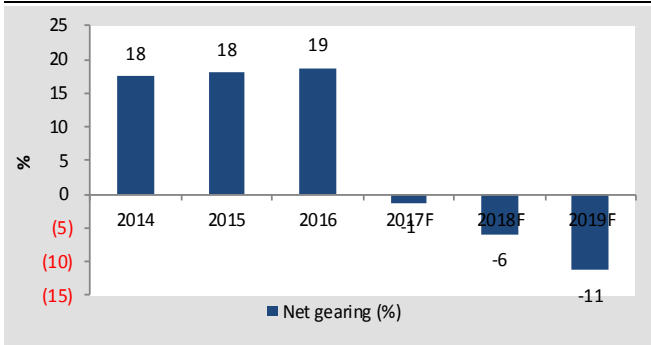
Figure 6: Company profile

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.

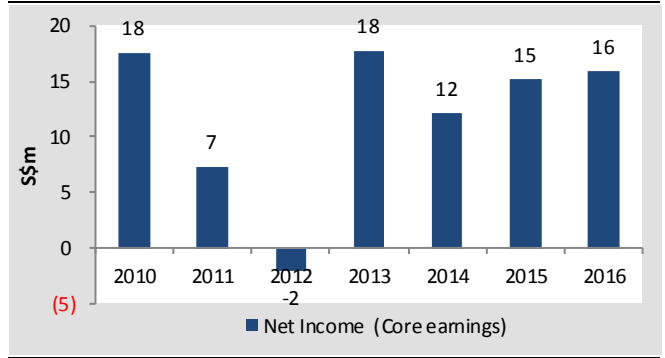
Source: KGI Research

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)	2015	2016	2017F	2018F	2019F
Revenue	439.4	466.4	525.2	551.4	579.0
Cost of sales	(372.1)	(395.7)	(438.0)	(459.9)	(482.9)
Gross Profit	67.3	70.8	87.2	91.5	96.1
Other operating income/(expenses)	6.8	5.9	6.1	6.3	6.1
Selling and distribution	(11.2)	(11.3)	(11.6)	(11.6)	(11.6)
Admin	(39.0)	(42.4)	(47.3)	(49.6)	(51.0)
Profit from Operations	22.0	21.6	34.4	36.6	39.7
Finance income/(expenses)	(1.3)	(1.4)	(1.6)	(1.7)	(1.8)
Share of JV results	0.0	0.0	0.0	0.0	0.0
Exceptionals/Investment income	(6.0)	0.0	10.2	0.0	0.0
Profit before Tax	14.7	20.3	43.0	34.9	37.9
Income tax	(5.1)	(4.3)	(9.2)	(7.4)	(8.1)
Non-controlling interests	(0.4)	(0.1)	(0.5)	(0.4)	(0.4)
PATMI	9.2	15.9	33.4	27.1	29.4
PATMI Normalized	15.2	15.9	23.2	27.1	29.4
BALANCE SHEET (S\$m)	2015	2016	2017F	2018F	2019F
Cash and cash equivalents	14.7	18.5	68.2	80.4	96.6
Trade and other receivables	87.4	90.7	78.8	82.7	86.9
Inventory	98.9	109.3	109.5	115.0	120.7
Other current assets	8.3	11.4	11.4	11.4	11.4
Current Assets	209.4	229.8	267.9	289.4	315.6
Property, plant and equipment	97.7	100.0	81.2	80.8	80.1
Other non-current assets	32.4	33.2	34.6	36.0	37.5
Non-current Assets	130.1	133.2	115.7	116.9	117.6
Total assets	339.5	363.0	383.6	406.3	433.2
Trade and other payables	74.0	81.9	65.7	69.0	72.4
Borrowings (current)	50.1	57.4	64.7	67.9	71.3
Other current liabilities	3.6	2.9	6.6	4.9	5.5
Current Liabilities	127.7	142.2	137.0	141.8	149.2
Borrowings (non-current)	1.8	1.3	1.2	1.0	0.8
Other non-current liabilities	4.4	4.8	4.8	4.8	4.8
Non-current liabilities	6.2	6.1	6.0	5.8	5.7
Shareholders equity	203.6	212.7	238.1	255.7	274.9
Non-controlling interests	2.0	2.0	2.5	2.9	3.4
Total Equity	205.6	214.7	240.6	258.7	278.3
Total Liabilities and Equity	339.5	363.0	383.6	406.3	433.2
CASH FLOW STATEMENT (S\$m)	2015	2016	2017F	2018F	2019F
Net income before tax	14.7	20.3	43.0	34.9	37.9
Depreciation & non cash adjustments	20.1	10.3	(2.8)	16.6	17.5
Change in Working Capital	(9.9)	(5.7)	(4.4)	(6.0)	(6.3)
Income Tax Paid	(4.1)	(4.9)	(5.4)	(9.2)	(7.4)
Interest Paid	(1.5)	(1.5)	(1.7)	(1.8)	(1.9)
CF from operating activities	19.3	18.5	28.6	34.5	39.7
Purchase/Disposal of PPE	(18.0)	(20.0)	(16.2)	(16.2)	(16.6)
Other CFI	0.7	0.5	38.3	0.0	0.0
CF from investing activities	(17.2)	(19.5)	22.1	(16.2)	(16.6)
Dividends Paid	(4.0)	(3.0)	(8.2)	(9.4)	(10.2)
Debt Raised / (Repaid)	(5.2)	5.2	7.1	3.0	3.2
Equity Raised / (Bought Back)	0.0	0.4	0.0	0.0	0.0
Other Cash from Financing	0.0	(0.0)	0.0	0.0	0.0
CF from financing activities	(9.2)	2.6	(1.1)	(6.4)	(7.0)
Net increase in cash & cash equiv.	(6.7)	1.6	49.8	12.1	16.3
FX effects	0.4	0.2	0.2	0.2	0.2
Beginning Cash	(4.9)	(11.6)	(10.0)	39.8	51.9
Ending Cash	14.7	18.5	68.2	80.4	96.6
KEY RATIOS	2015	2016	2017F	2018F	2019F
Profitability					
Core EPS	3.7	3.9	5.7	6.6	7.2
Core EPS Growth (%)	25.3	3.9	45.7	16.8	8.6
DPS (SGD Cents)	0.8	1.2	2.0	2.3	2.5
Dividend Yield (%)	1.4	2.2	3.7	4.3	4.7
Profitability					
Gross margin	15.3%	15.2%	16.6%	16.6%	16.6%
EBITDA margin	9.1%	8.1%	9.6%	9.6%	9.9%
Net margin	2.1%	3.4%	6.4%	4.9%	5.1%
ROE	4.5%	7.4%	13.9%	10.5%	10.6%
ROA	2.7%	4.4%	8.7%	6.7%	6.8%
Financial Structure (x)					
Interest coverage	14.3	14.2	20.2	20.5	21.2
Total Debt/Equity	0.3	0.3	0.3	0.3	0.3
Net Gearing	0.2	0.2	0.0	0.0	-0.1

Source: KGI Research

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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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