April 3, 2019

Maybank IB Research

Frontken Corp. Bhd (FRCB MK)

On twin growth engine

Raising earnings and TP. Still a BUY

Frontken's long-term growth prospect remains attractive. We expect the next major catalyst to be a step up in earnings contribution from services for its O&G customers while the semiconductor segment remains the primary growth driver. We raise our FY19E/20E/21E core net profit by 11%/17%/26%. Our TP is raised by 17% to MYR1.22 based on 20x FY19 PER, pegged at unchanged +1SD of its updated 5-year mean (previously MYR1.04 on 18.8x FY19 PER). Reiterate BUY.

Expect stronger 1Q19 earnings

We expect Frontken to report better earnings at its upcoming 1Q19 results release (to be announced by end of this month). We estimate its 1Q19 core net profit to be higher YoY at MYR11-15m (1Q18: MYR6.7m) due to greater work orders recognition for its Customer X's 7nm technology. We also posit that the growth could come from more repair and maintenance, and refurbishment works for its O&G customers' equipment in East Malaysia, and more coating services for its Customer F's new O&G equipment in Johor.

More to come from the O&G segment

We believe earnings contributions from its O&G segment is likely to improve to ~10% in FY19 from ~4% in FY18 due to increase in the amount of work orders for refurbishing its customers' wellhead, rotating equipment (both upstream and downstream), and steam or gas turbines. This is leveraging on potential ramp-up in upstream O&G activities in Malaysia in 2Q19 and onwards, and new opportunity at PETRONAS's downstream project in Pengerang, Johor. Given its current capabilities, one of its major O&G customers has also enquired about a long-term services arrangement. If it materialises, this should provide good revenue visibility.

Raising our earnings forecasts

We raise our FY19E/20E/21E core net profit by 11%/17%/26% to incorporate higher revenue and margin expansion on better cost management from its O&G segment, particularly from its Malaysia and Philippines geographical segments. Following our core net profit revision, we now forecast a decent 22% FY18-21E CAGR in core net profit (previously 12%).

FYE Dec (MYR m)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	297	327	374	428	483
EBITDA	65	92	110	133	157
Core net profit	36	53	64	80	96
Core EPS (sen)	3.4	5.1	6.1	7.6	9.1
Core EPS growth (%)	98.8	50.1	20.1	24.0	20.5
Net DPS (sen)	0.5	1.5	1.8	2.3	2.7
Core P/E (x)	13.6	13.8	16.2	13.0	10.8
P/BV (x)	1.7	2.3	2.8	2.4	2.1
Net dividend yield (%)	1.1	2.1	1.9	2.3	2.8
ROAE (%)	11.0	17.2	18.5	20.0	20.9
ROAA (%)	8.5	12.0	13.5	15.0	15.8
EV/EBITDA (x)	6.3	6.8	8.1	6.4	5.0
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	60	67	74
MKE vs. Consensus (%)	-	-	7.2	18.3	30.3

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BUY

Share Price	MYR 1.05
12m Price Target	MYR 1.22 (+16%)
Previous Price Target	*MYR 1.04*

Company Description

Frontken specialises in engineering and precision cleaning services, mostly for semiconductors and O&G markets in Taiwan, Singapore and Malaysia.

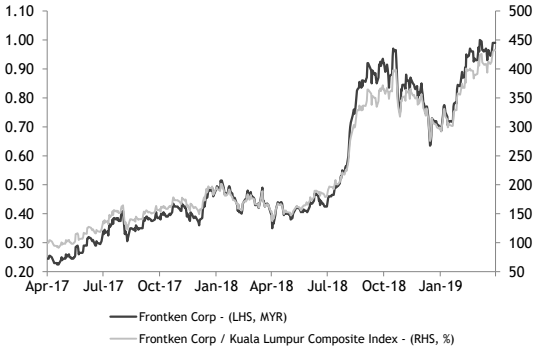
Statistics

52w high/low (MYR)	1.00/0.35
3m avg turnover (USDm)	2.2
Free float (%)	47.6
Issued shares (m)	1,053
Market capitalisation	MYR1.0B
	USD255M

Major shareholders:

Dazzle Clean Ltd	27.8%
Ooi Keng Thye	14.5%
CIMB-Principal Asset Management	5.2%

Price Performance



	-1M	-3M	-12M
Absolute (%)	6	41	148
Relative to index (%)	11	45	182

Source: FactSet

Fig 1: 1-year forward PER

Source: Bloomberg, Company data, Maybank KE

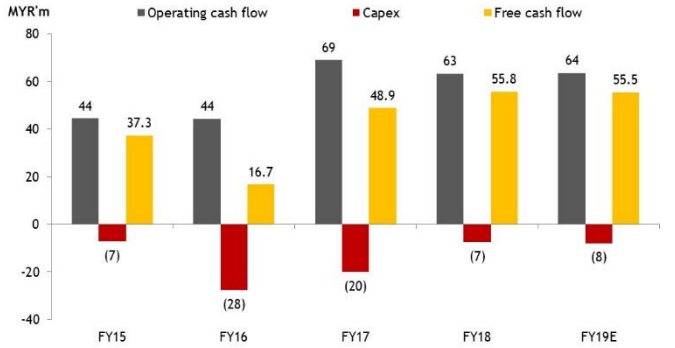
Fig 2: 1-year forward PBV

Source: Bloomberg, Company data, Maybank KE

Value Proposition

- Frontken is a leading service provider of cleaning and coating of high-tech equipment in Malaysia and Taiwan.
- Group earnings have reached an inflection point with growth to pick up from increasing demand for advanced chips and the recovery of O&G industries.
- High barriers to entry for precision cleaning services due to stringent customer compliance that require in-depth knowledge, skills and expertise.
- Highly cash generative with operating cash flow in FY18 of MYR63.3m against net profit of MYR52.3m (depreciation MYR17.3m) and FCF of MYR55.8m.
- ROE has continued to improve from 4.3% in FY15 to 17.2% in FY18, through better profit margins.

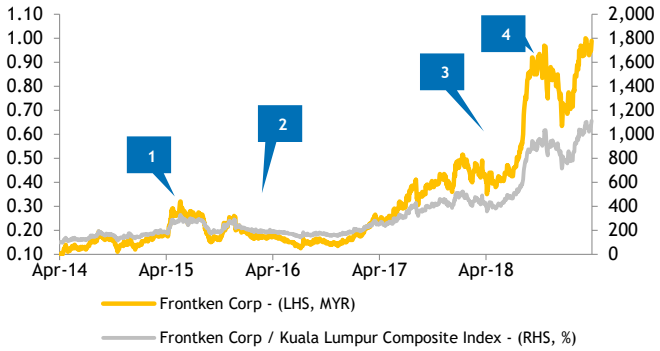
Sustainable FCF and OCF



Source: Company, Maybank KE

Price Drivers

Historical share price trend



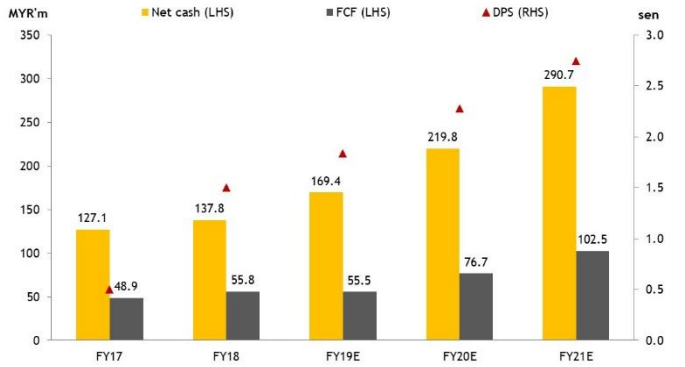
Source: Company, FactSet, Maybank Kim Eng

1. Achieved higher revenue due to the ramp-up in semiconductor business in Taiwan and recognition of one-off EPCC project, which was the ATB project at Tanjung Bin.
2. Slump in oil and gas price naturally affected production and maintenance activities, coupled with unfortunate cost overrun in its ATB project.
3. The global semiconductor market grew at an impressive rate throughout 2017 (+21.6% YoY), posting the highest-ever annual revenue for Frontken.
4. The start of a slowdown in global sales of smartphones to end users.

Financial Metrics

- We expect Frontken's revenue to continue to grow in the next three years on increasing demand for advanced chips and improving O&G industries outlook.
- Higher profit margins due to better services fees for handling complex process of advance wafer fabrication process from 16nm and beyond.
- Net cash position (13sen/sh) in FY18 on low borrowings and strong cash flow.
- The Group resumed a dividend in FY18 of 1.5sen, equal to a 30.1% payout ratio. We forecast a 30% payout ahead, supported by strong FCF and an increasing net cash position in FY19E-21E.

Net cash and strong FCF to support higher dividend payout



Source: Company data, Maybank KE

Swing Factors

Upside

- Higher utilisation rate of wafer fabrication equipment and capacity expansion of logic foundry and memory companies.
- Higher-than-expected chip demand from other markets, such as automotive, artificial intelligence, etc.
- Rally in oil prices and higher capex that can spur O&G activities.

Downside

- Lower utilisation rate on tapering demand for smartphones and electronic devices.
- Lack of development in other markets and investment on new advanced technological nodes.
- Sharp fall in oil prices and industry capex lead to lower O&G sector demand for services.

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FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Key Metrics					
P/E (reported) (x)	11.1	12.0	16.2	13.0	10.8
Core P/E (x)	13.6	13.8	16.2	13.0	10.8
P/BV (x)	1.7	2.3	2.8	2.4	2.1
P/NTA (x)	1.7	2.3	3.3	2.8	2.4
Net dividend yield (%)	1.1	2.1	1.9	2.3	2.8
FCF yield (%)	10.1	7.6	5.4	7.4	9.9
EV/EBITDA (x)	6.3	6.8	8.1	6.4	5.0
EV/EBIT (x)	8.8	8.3	9.6	7.3	5.6
INCOME STATEMENT (MYR m)					
Revenue	296.6	327.2	373.6	428.1	483.3
Gross profit	104.8	121.1	152.4	178.4	205.8
EBITDA	64.8	92.1	110.1	132.7	156.8
Depreciation	(18.5)	(17.3)	(16.9)	(17.3)	(17.7)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	46.3	74.8	93.2	115.5	139.1
Net interest income /(exp)	(0.1)	0.3	0.1	0.1	0.2
Associates & JV	(0.1)	0.1	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	46.1	75.6	93.3	115.6	139.3
Income tax	(9.7)	(18.6)	(22.4)	(27.8)	(33.4)
Minorities	(6.6)	(4.7)	(6.7)	(8.3)	(10.1)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	29.9	52.3	64.1	79.5	95.8
Core net profit	35.6	53.4	64.1	79.5	95.8
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	129.3	149.9	181.5	231.9	302.8
Accounts receivable	97.0	113.6	131.4	157.6	177.9
Inventory	13.5	13.7	13.7	15.5	17.2
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	150.0	140.4	131.5	122.2	112.5
Intangible assets	33.8	33.8	33.8	33.8	33.8
Investment in Associates & JVs	2.0	0.0	0.0	0.0	0.0
Other assets	5.5	3.7	3.7	3.7	3.7
Total assets	**431.1**	**455.1**	**495.5**	**564.7**	**647.9**
ST interest bearing debt	16.9	4.8	2.7	2.7	2.7
Accounts payable	79.6	81.6	75.2	82.9	92.0
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	11.7	8.9	8.1	8.1	8.1
Other liabilities	17.0	15.0	15.0	15.0	15.0
Total Liabilities	**125.1**	**110.4**	**101.3**	**108.9**	**118.1**
Shareholders Equity	281.6	325.0	369.9	425.6	492.7
Minority Interest	24.4	19.6	24.3	30.2	37.2
Total shareholder equity	**306.0**	**344.6**	**394.3**	**455.8**	**529.9**
Total liabilities and equity	**431.1**	**455.1**	**495.5**	**564.7**	**647.9**
CASH FLOW (MYR m)					
Pretax profit	46.1	75.6	93.3	115.6	139.3
Depreciation & amortisation	18.5	17.3	16.9	17.3	17.7
Adj net interest (income)/exp	0.1	(0.3)	(0.1)	(0.1)	(0.2)
Change in working capital	6.9	(15.9)	(24.2)	(20.3)	(12.9)
Cash taxes paid	(7.9)	(14.2)	(22.4)	(27.8)	(33.4)
Other operating cash flow	5.4	(0.4)	0.0	0.0	0.0
Cash flow from operations	69.0	63.3	63.5	84.7	110.5
Capex	(20.2)	(7.5)	(8.0)	(8.0)	(8.0)
Free cash flow	48.9	55.8	55.5	76.7	102.5
Dividends paid	(7.2)	(10.0)	(21.3)	(26.4)	(31.8)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	(0.2)	(17.3)	(1.9)	0.0	0.0
Other invest/financing cash flow	(12.9)	(0.2)	0.1	0.1	0.2
Effect of exch rate changes	(6.4)	0.3	0.1	0.0	0.0
Net cash flow	22.2	28.7	32.5	50.4	70.9

FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Key Ratios					
Growth ratios (%)					
Revenue growth	13.3	10.3	14.2	14.6	12.9
EBITDA growth	26.9	42.2	19.6	20.6	18.1
EBIT growth	36.8	61.5	24.6	23.9	20.4
Pretax growth	38.4	63.9	23.3	24.0	20.5
Reported net profit growth	49.0	75.1	22.7	24.0	20.5
Core net profit growth	98.8	50.1	20.2	24.0	20.5
Profitability ratios (%)					
EBITDA margin	21.8	28.1	29.5	31.0	32.4
EBIT margin	15.6	22.8	24.9	27.0	28.8
Pretax profit margin	15.6	23.1	25.0	27.0	28.8
Payout ratio	17.5	30.1	30.0	30.0	30.0
DuPont analysis					
Net profit margin (%)	10.1	16.0	17.2	18.6	19.8
Revenue/Assets (x)	0.7	0.7	0.8	0.8	0.7
Assets/Equity (x)	1.5	1.4	1.3	1.3	1.3
ROAE (%)	11.0	17.2	18.5	20.0	20.9
ROAA (%)	8.5	12.0	13.5	15.0	15.8
Liquidity & Efficiency					
Cash conversion cycle	(0.3)	(1.2)	12.7	28.6	32.7
Days receivable outstanding	120.3	115.8	118.0	121.5	125.0
Days inventory outstanding	23.0	23.7	22.3	21.1	21.2
Days payables outstanding	143.5	140.8	127.6	114.0	113.5
Dividend cover (x)	5.7	3.3	3.3	3.3	3.3
Current ratio (x)	2.2	2.8	3.6	4.2	4.7
Leverage & Expense Analysis					
Asset/Liability (x)	3.4	4.1	4.9	5.2	5.5
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Net gearing (%) (excl. perps)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	nm	na	na	na	na
Debt/EBITDA (x)	0.4	0.1	0.1	0.1	0.1
Capex/revenue (%)	6.8	2.3	2.1	1.9	1.7
Net debt/ (net cash)	(100.7)	(136.3)	(170.6)	(221.0)	(291.9)

Source: Company; Maybank

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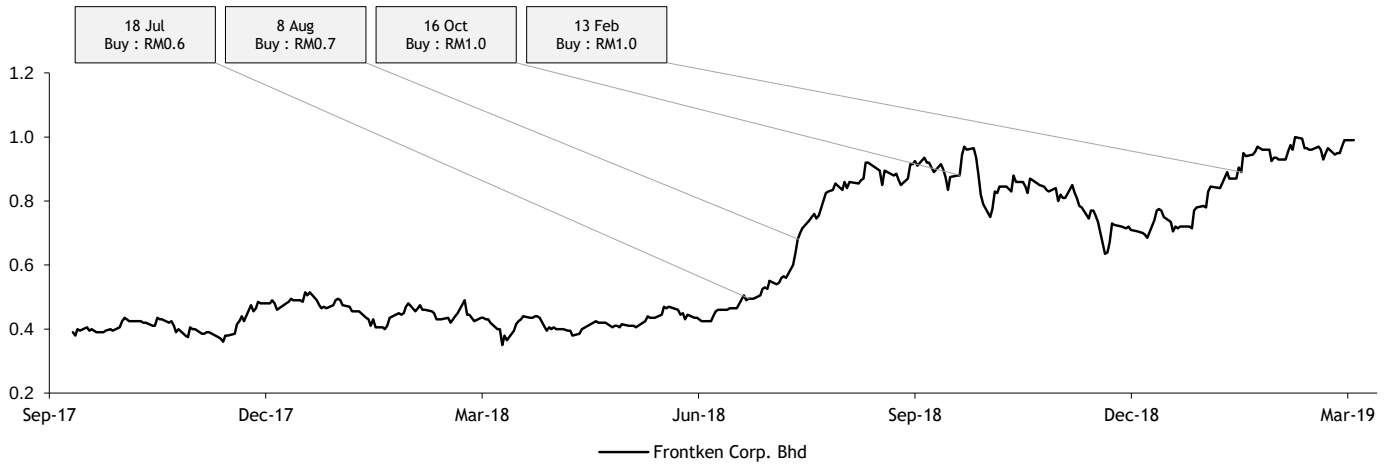

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