April 24, 2019

Maybank IB Research

Frontken Corp. Bhd (FRCB MK)

Continues to stand out

BUY

Share Price	MYR 1.31
12m Price Target	MYR 1.58 (+21%)
Previous Price Target	*MYR 1.22*

More to excite; maintain BUY

1Q19 net profit, on strong YoY growth, was above at 25%/26% of our full-year estimates/consensus. We see the next leg of growth ahead on work orders for its Customer X's advanced process technologies and stronger work order flow from its O&G customers. Reflecting this, we raise our core net profit by 9%/4% for FY19E/20E. Maintain BUY with a higher TP of MYR1.58, pegged to an unchanged 20x PER (+1SD of 5-year mean) on rolling forward valuations (to CY20).

Beat expectations!

Stripping out one-off items, FRCB reported a higher YoY 1Q19 core net profit of MYR16.1m (+>100% YoY; -12.7% QoQ). This represents 25%/26% of ours/consensus full-year forecast – above expectations as we had expected 1Q19 earnings to make up 17%-21% of FY19 forecasts. The YoY strength was largely on margin expansion and higher revenue of MYR83.8m (+18% YoY) from the semiconductor business in Singapore and greater work orders for its Customer X's 7nm in Taiwan, and increased work orders for its O&G customers in Malaysia (as highlighted in our previous report dated 4 Apr 2019) and Philippines.

More to offer from the semiconductor segment

With the continuous advancement in its Customer X's process technologies to 7+nm in 2H19 and seamless migration to 6nm in FY20 from 7nm, we believe this should translate into higher work orders for FRCB, in terms of both volume and value. We also could see cleaning/coating works expanding greatly for process equipment for 3D NAND and new DRAM from its collaboration with its partner, Lam Research (LRCX US, Not Rated). This is in view of increasing demand for 3D NAND on stronger demand for big-data analysis due to the evolution of artificial intelligence and 5G communication.

Raising our earnings forecasts

We raise FY19E/20E core net profit by 9%/4% after revising higher our work orders and margin improvement projections for its Taiwan segment. We leave our FY21E core net profit unchanged for now.

FYE Dec (MYR m)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	297	327	390	441	483
EBITDA	65	92	118	136	157
Core net profit	36	53	69	83	96
Core EPS (sen)	3.4	5.1	6.6	7.9	9.1
Core EPS growth (%)	98.8	50.1	29.9	19.3	15.9
Net DPS (sen)	0.5	1.5	2.0	2.4	2.7
Core P/E (x)	13.6	13.8	19.8	16.6	14.3
P/BV (x)	1.7	2.3	3.7	3.2	2.8
Net dividend yield (%)	1.1	2.1	1.5	1.8	2.1
ROAE (%)	11.0	17.2	19.8	20.5	20.6
ROAA (%)	8.5	12.0	14.5	15.4	15.6
EV/EBITDA (x)	6.3	6.8	10.4	8.6	7.1
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	63	73	84
MKE vs. Consensus (%)	-	-	10.0	13.2	14.6

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Company Description

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

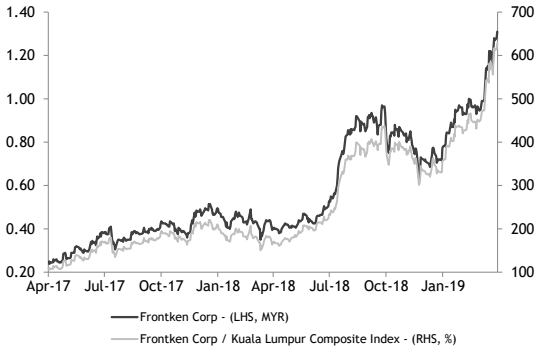
Statistics

52w high/low (MYR)	1.31/0.38
3m avg turnover (USDm)	2.8
Free float (%)	47.6
Issued shares (m)	1,053
Market capitalisation	MYR1.4B
	USD334M

Major shareholders:

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

Price Performance



	-1M	-3M	-12M
Absolute (%)	36	83	232
Relative to index (%)	39	91	284

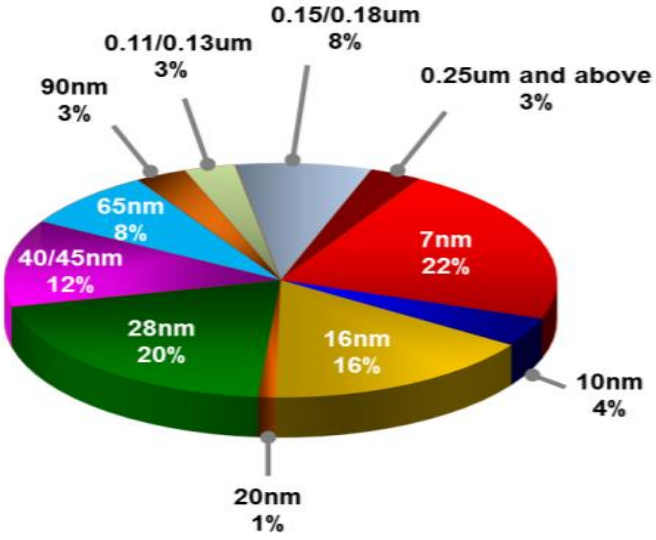
Source: FactSet

Fig 1: Summary results table

FYE Dec (MYR'm)	Quarterly				
	1Q19	1Q18	%YoY	4Q18	%QoQ
Revenue	**83.8**	**70.9**	***18.2***	**88.7**	***(5.5)***
EBITDA	**27.4**	**15.3**	***79.1***	**28.5**	***(3.9)***
Depreciation	(4.8)	(4.5)	*7.7*	(4.3)	*12.9*
Other income	1.0	1.1	*(7.9)*	1.1	*(8.5)*
EBIT	**22.6**	**10.8**	***>100***	**24.2**	***(6.8)***
Interest income	0.2	0.2	*55.3*	0.3	*(24.4)*
Finance costs	(0.2)	(0.2)	*5.3*	(0.1)	*>100*
Associate profit/loss	0.0	(0.0)	*nm*	0.0	*nm*
PBT	**22.5**	**11.0**	***>100***	**24.4**	***(7.7)***
Tax expense	(6.2)	(3.8)	*61.2*	(4.4)	*40.6*
Headline PATAMI	**15.4**	**6.3**	***>100***	**18.7**	***(17.6)***
Core PATAMI	**16.1***	**6.7****	***>100***	**18.4**	***(12.7)***
Basic EPS (sen)	**1.47**	**0.60**	***>100***	**1.78**	***(17.4)***
Margin (%)	**1Q19**	**1Q18**	**+/- ppt**	**4Q18**	**+/- ppt**
EBITDA	32.6	21.6	*11.1*	32.1	*0.5*
EBIT	26.9	15.2	*11.7*	27.3	*(0.4)*
PBT	26.9	15.6	*11.3*	27.5	*(0.6)*
Core net profit	19.2	9.5	*9.7*	20.8	*(1.6)*
Net gearing (x)	**net cash**	**net cash**	**nm**	**net cash**	**nm**
Segmental revenue (MYR'm)	**1Q19**	**1Q18**	**%YoY**	**4Q18**	**%QoQ**
Taiwan	45.2	43.6	*3.8*	47.7	*(5.1)*
Singapore	16.3	12.0	*35.7*	21.8	*(25.4)*
Malaysia	18.0	11.4	*57.7*	14.9	*20.5*
Philippines	4.2	3.6	*14.8*	4.1	*1.4*
Indonesia	0.1	0.3	*(53.6)*	0.1	*(10.3)*
Segmental EBIT (MYR'm)	**1Q19**	**1Q18**	**%YoY**	**4Q18**	**%QoQ**
Taiwan	12.4	10.5	*17.7*	13.5	*(8.6)*
Singapore	5.0	(0.5)	*>100*	9.3	*(46.4)*
Malaysia	4.6	1.0	*>100*	0.8	*>100*
Philippines	0.7	0.6	*29.1*	0.4	*67.6*
Indonesia	(0.1)	(0.5)	*(76.0)*	0.1	*>-100*
Segmental EBIT margin (MYR'm)	**1Q19**	**1Q18**	**+/- ppt**	**4Q18**	**+/- ppt**
Taiwan	27.3	24.1	*3.2*	28.4	*(1.1)*
Singapore	30.6	(4.3)	*34.9*	42.6	*(12.0)*
Malaysia	25.5	9.1	*16.4*	5.6	*19.9*
Philippines	17.7	15.8	*2.0*	10.7	*7.0*
Indonesia	nm	nm	*nm*	61.4	*nm*

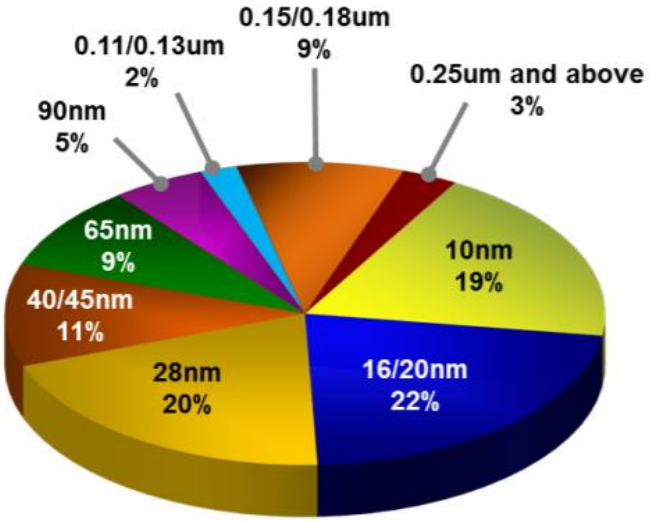
**Excluding unrealised forex gain (MYR0.26m) and additional tax accrued for undistributed retained earnings in Taiwan segment (MYR0.95m)*
***Excluding unrealised forex loss (MYR0.43m)*
Source: Company data

Fig 2: Customer X's 1Q19 revenue by technology



Source: Customer X website

Fig 3: Customer X's 1Q18 revenue by technology



Source: Customer X website

Fig 4: 1-year forward PER

Source: Bloomberg, Company data, Maybank KE

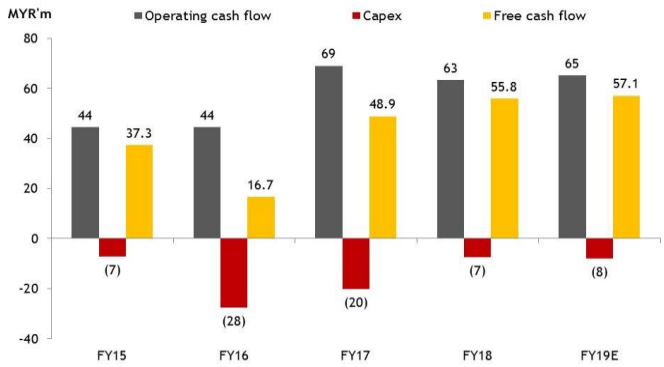
Fig 5: 1-year forward PBV

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.

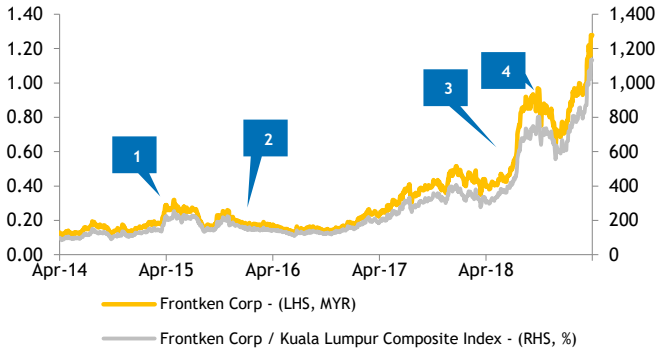
Sustainable FCF and OCF



Source: Company, Maybank KE

Price Drivers

Historical share price trend



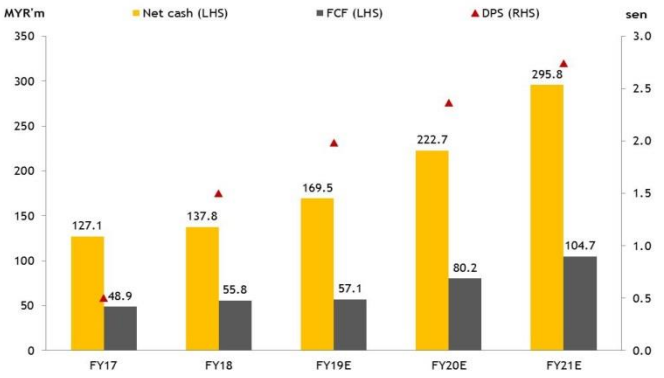
Source: Company, FactSet, Maybank Kim Eng

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	19.8	16.6	14.3
Core P/E (x)	13.6	13.8	19.8	16.6	14.3
P/BV (x)	1.7	2.3	3.7	3.2	2.8
P/NTA (x)	1.7	2.3	4.3	3.7	3.2
Net dividend yield (%)	1.1	2.1	1.5	1.8	2.1
FCF yield (%)	10.1	7.6	4.2	5.8	7.6
EV/EBITDA (x)	6.3	6.8	10.4	8.6	7.1
EV/EBIT (x)	8.8	8.3	12.2	9.9	8.0
INCOME STATEMENT (MYR m)					
Revenue	296.6	327.2	390.4	441.3	483.3
Gross profit	104.8	121.1	160.1	182.5	205.8
EBITDA	64.8	92.1	117.6	136.4	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	100.7	119.2	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	100.8	119.3	139.3
Income tax	(9.7)	(18.6)	(25.1)	(28.6)	(33.4)
Minorities	(6.6)	(4.7)	(6.3)	(8.0)	(10.1)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	29.9	52.3	69.3	82.7	95.8
Core net profit	35.6	53.4	69.3	82.7	95.8
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	129.3	149.9	181.6	234.8	307.9
Accounts receivable	97.0	113.6	137.3	162.5	177.9
Inventory	13.5	13.7	14.3	16.1	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**	**502.1**	**573.0**	**653.0**
ST interest bearing debt	16.9	4.8	2.7	2.7	2.7
Accounts payable	79.6	81.6	78.5	85.9	91.8
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**	**104.5**	**111.9**	**117.9**
Shareholders Equity	281.6	325.0	373.6	431.5	498.5
Minority Interest	24.4	19.6	24.0	29.6	36.6
Total shareholder equity	**306.0**	**344.6**	**397.6**	**461.1**	**535.2**
Total liabilities and equity	**431.1**	**455.1**	**502.1**	**573.0**	**653.0**
CASH FLOW (MYR m)					
Pretax profit	46.1	75.6	100.8	119.3	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)	(27.4)	(19.5)	(10.7)
Cash taxes paid	(7.9)	(14.2)	(25.1)	(28.6)	(33.4)
Other operating cash flow	5.4	(0.4)	0.0	0.0	0.0
Cash flow from operations	69.0	63.3	65.1	88.2	112.7
Capex	(20.2)	(7.5)	(8.0)	(8.0)	(8.0)
Free cash flow	48.9	55.8	57.1	80.2	104.7
Dividends paid	(7.2)	(10.0)	(22.7)	(27.2)	(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	32.7	53.2	73.1

FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Key Ratios					
Growth ratios (%)					
Revenue growth	13.3	10.3	19.3	13.0	9.5
EBITDA growth	26.9	42.2	27.8	16.0	14.9
EBIT growth	36.8	61.5	34.7	18.4	16.7
Pretax growth	38.4	63.9	33.3	18.4	16.8
Reported net profit growth	49.0	75.1	32.6	19.3	15.9
Core net profit growth	98.8	50.1	29.9	19.3	15.9
Profitability ratios (%)					
EBITDA margin	21.8	28.1	30.1	30.9	32.4
EBIT margin	15.6	22.8	25.8	27.0	28.8
Pretax profit margin	15.6	23.1	25.8	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	17.8	18.7	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	19.8	20.5	20.6
ROAA (%)	8.5	12.0	14.5	15.4	15.6
Liquidity & Efficiency					
Cash conversion cycle	(0.3)	(1.2)	12.4	29.1	33.1
Days receivable outstanding	120.3	115.8	115.7	122.3	126.8
Days inventory outstanding	23.0	23.7	21.9	21.1	21.6
Days payables outstanding	143.5	140.8	125.2	114.3	115.3
Dividend cover (x)	5.7	3.3	3.3	3.3	3.3
Current ratio (x)	2.2	2.8	3.6	4.1	4.7
Leverage & Expense Analysis					
Asset/Liability (x)	3.4	4.1	4.8	5.1	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	2.0	1.8	1.7
Net debt/ (net cash)	(100.7)	(136.3)	(170.7)	(223.9)	(297.0)

Source: Company; Maybank

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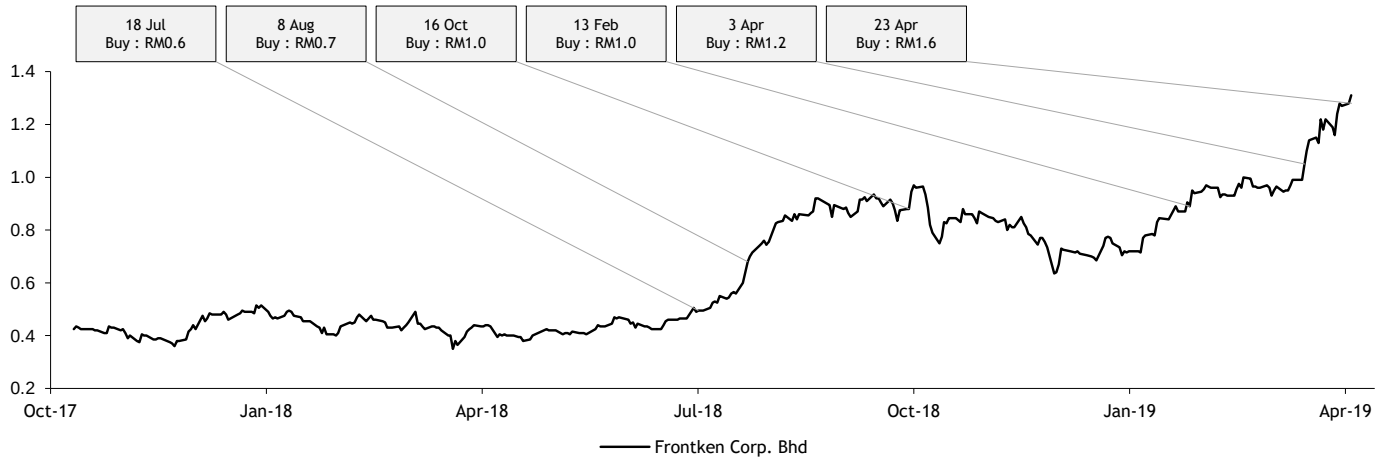

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