

HLIB Research

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Tan J Young
jt看@hlib.hongleong.com.my

(603) 2083 1721

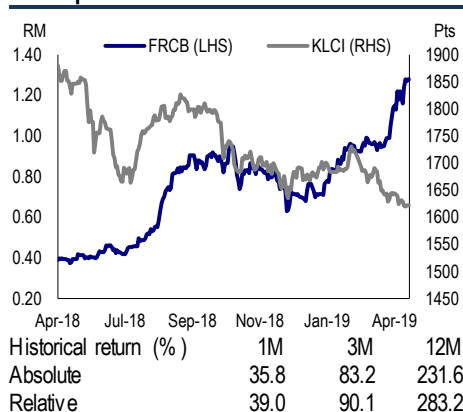
BUY (Maintain)

Target Price: **RM1.55**
Previously: **RM1.18**
Current Price: **RM1.31**

Capital upside	18.3%
Dividend yield	1.9%
Expected total return	20.2%

Sector coverage: Technology

Company description: Frontken is a leading surface engineering service provider in semiconductor and O&G markets.

Share price

Stock information

Bloomberg ticker	FRCB MK
Bursa code	0128
Issued shares (m)	1,048
Market capitalisation (RM m)	1,373
3-mth average volume ('000)	11,482
SC Shariah compliant	Yes

Major shareholders

Dazzle Clean	27.8%
Ooi Keng Thye	14.5%
CIMB Group Holdings Bhd	4.8%

Earnings summary

FYE (Dec)	FY18	FY19f	FY20f
PATMI – core (RM m)	54.4	65.5	70.3
EPS – core (sen)	5.2	6.2	6.7
P/E (x)	25.3	21.1	19.6

Frontken Corporation

More than Moore growth

Despite the seasonal weakness, Frontken recorded strongest 1Q ever with core net profit of RM15m (+118% YoY, -21% QoQ) which beat expectations. This outstanding performance was driven by both semiconductor and O&G segments. In the “more than Moore” era, wafer fabrication process multiplies in terms of frequency and complexity and will lead to more cleaning requirements. Our upward forecast revisions have led to higher TP of RM1.55, pegged to 25x of FY19 EPS. Maintain BUY.

Above expectations. 1Q19 revenue of RM84m translated into core net profit of RM15m, accounting for 25% and 24% of HLIB and consensus full year forecasts, respectively. This is considered an outperformance as 1Q is seasonally weak and historically only account for 10-20% of full year earnings. 1Q19 is another milestone for Frontken as the strongest 1Q ever.

QoQ. Due to seasonal weakness (lesser working days as a result of long festive holidays), turnover moderated 6% attributable to lower contributions from Taiwan (-5%) and Singapore (-24%), offsetting the growth in Malaysia (+20%). Core net profit fell by 21% after being dragged by higher D&A and effective tax rate (1Q19: 27% vs. 4Q8: 18%), nullified the lower MI charge subsequent to the increased stake in AGTC.

YoY. Top line's 18% gain was driven by both semiconductor and O&G businesses with expansions registered in Singapore (+39%), Malaysia (+58%), Philippines (+14%) and Taiwan (+4%). With better economies of scale and continuous operational excellence, core net profit swelled 118% to RM15m.

Semiconductor. Management shared that although the general outlook for the sector is somewhat tepid, the recent positive development following the settlement of a long outstanding dispute by major players had somewhat boosted the outlook and is positive for the company. Since Moore's Law has reached the physical limitation, the industry has entered “more than Moore” era to further scale transistors. As foundry continuously develops smaller node, wafer fabrication process multiplies in terms of frequency and complexity and will lead to more cleaning requirements.

O&G. Recorded 4th consecutive quarterly profit with RM2.5m in 1Q19. It noticed that number of enquiries had picked up and hope that they will be rendered into orders. Recognizing that the unresolved trade spat remains a key risk, it will relentlessly enforce capital discipline, portfolio realignments and productivity efficiencies. We believe the turnaround story remains intact and this performance is sustainable going forward considering Brent crude price remains stable at current levels.

Shariah compliant. Although cash and equivalents are piling up (RM149m as end of FY18), they are still below the 33% threshold and we do not see any disqualification risk.

Forecast. Tweaked both semiconductor and O&G EBITDA margin assumptions as well as housekeeping adjustments based on FY18 audited account. In turn, FY19-21 EPS revised upward by 5-6%.

Reiterate **BUY** with a higher fair value of **RM1.55** from RM1.18, reflecting the earnings revision. Our TP is pegged to 25x (previously 20x) of FY19 EPS, matching regional peers' average PE (see Figure #2). We expect Frontken to experience multi-year growth ahead on the back of (1) sustainable global semiconductor market outlook; (2) robust fab investment; (3) leading edge technology (7nm and below); (4) O&G recovery; and (5) strong balance sheet (net cash of RM144m or 13.7 sen per share).

Financial Forecast

All items in (RM m) unless otherwise stated

Income statement

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Revenue	296.6	327.2	358.2	376.1	394.9
COGS	(231.9)	(234.7)	(252.5)	(265.1)	(278.4)
EBITDA	64.7	92.6	105.7	111.0	116.5
D&A	(18.5)	(17.3)	(16.5)	(15.8)	(15.2)
EBIT	46.2	75.3	89.2	95.2	101.3
Net Interest Income	(0.1)	0.3	0.8	1.2	1.7
Associates	0.0	0.0	0.0	0.0	0.0
PBT	46.1	75.6	90.0	96.4	103.1
Tax	(9.7)	(18.6)	(19.0)	(20.3)	(21.8)
Net Profit	36.4	57.0	71.0	76.1	81.3
MI	(6.6)	(4.7)	(5.5)	(5.8)	(6.1)
PATAMI	29.9	52.3	65.5	70.3	75.3
Exceptionals	4.4	2.2	0.0	0.0	0.0
Adj PATAMI	34.3	54.4	65.5	70.3	75.3
Basic Shares (m)	1,053.0	1,053.0	1,053.0	1,053.0	1,053.0
Rep EPS (sen)	2.8	5.0	6.2	6.7	7.1
Adj EPS (sen)	3.3	5.2	6.2	6.7	7.1
Adj FD EPS (sen)	3.3	5.2	6.2	6.7	7.1

Balance sheet

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Cash	119.3	133.0	187.2	245.8	307.4
Receivables	91.7	106.8	117.8	123.6	129.8
Inventories	13.5	13.7	13.8	14.5	15.3
Investment	2.0	0.0	0.0	0.0	0.0
PPE	150.0	140.4	133.9	128.1	122.9
Intangibles	33.8	33.8	33.8	33.8	33.8
Other Assets	20.8	27.4	27.4	27.4	27.4
Total Assets	431.1	455.1	513.8	573.2	636.6
Payables	79.8	82.4	89.9	94.4	99.2
ST borrowings	21.9	3.9	3.9	3.9	3.9
LT borrowings	11.5	7.5	7.5	7.5	7.5
Other Liabilities	11.8	16.5	16.5	16.5	16.5
Total liabilities	125.1	110.4	117.9	122.4	127.1
Shareholders' Funds	281.6	325.0	370.8	419.9	472.4
MI	24.4	19.6	25.1	30.9	37.0
Total S/H Equity	306.0	344.6	395.9	450.8	509.4
Ttl Liab&S/H Funds	431.1	455.1	513.8	573.2	636.6

Cashflow Analysis

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
EBITDA	64.7	92.6	105.7	111.0	116.5
Tax Paid	(7.9)	(14.2)	(19.0)	(20.3)	(21.8)
WC Changes	6.9	(14.6)	(3.6)	(2.1)	(2.2)
Other	5.3	(0.4)	0.8	1.2	1.7
CFO	69.0	63.3	83.9	89.8	94.3
FCF	48.9	55.8	73.9	79.8	84.3
CAPEX(CF)	(20.2)	(7.5)	(10.0)	(10.0)	(10.0)
Acquisitions	(13.3)	(7.1)	0.0	0.0	0.0
Other	1.3	7.5	0.0	0.0	0.0
CFI	(32.1)	(7.1)	(10.0)	(10.0)	(10.0)
Dividend	(5.2)	(10.0)	(19.7)	(21.2)	(22.7)
Debt changes	0.0	(16.7)	0.0	0.0	0.0
Other	(3.2)	(1.1)	0.0	0.0	0.0
CFF	(8.4)	(27.8)	(19.7)	(21.2)	(22.7)
Net Cashflow	28.6	28.4	54.2	58.6	61.6

Quarterly financial summary

FYE Dec	1Q18	2Q18	3Q18	4Q18	1Q19
Revenue	70.9	81.8	85.9	88.7	83.8
COGS	(55.3)	(58.0)	(61.2)	(60.2)	(56.5)
EBITDA	15.6	23.8	24.7	28.5	27.4
D&A	(4.5)	(4.3)	(4.2)	(4.3)	(4.8)
EBIT	11.1	19.5	20.5	24.2	22.6
Net Interest Income	(0.1)	0.0	0.2	0.2	(0.0)
Associates	0.0	0.0	0.0	0.0	0.0
PBT	11.0	19.5	20.6	24.4	22.5
Tax	(3.8)	(6.2)	(4.1)	(4.4)	(6.2)
Net Profit	7.2	13.3	16.5	20.0	16.3
MI	(0.9)	(1.2)	(1.3)	(1.3)	(0.9)
PATAMI	6.3	12.1	15.2	18.7	15.4
Exceptionals	0.8	0.7	(0.2)	0.9	(0.0)
Adj PATAMI	7.1	12.8	15.0	19.6	15.4
Basic Shares (m)	1,053.0	1,053.0	1,053.0	1,053.0	1,053.0
Rep EPS (sen)	0.6	1.1	1.4	1.8	1.5
Adj EPS (sen)	0.7	1.2	1.4	1.9	1.5
Adj FD EPS (sen)	0.7	1.2	1.4	1.9	1.5

Valuation Ratios

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
PER (x)	46.2	26.4	21.1	19.6	18.3
Core PER (x)	40.3	25.3	21.1	19.6	18.3
FD PER (x)	40.3	25.3	21.1	19.6	18.3
DPS (sen)	0.5	1.5	1.9	2.0	2.2
Net DY (%)	0.4	1.1	1.4	1.5	1.6
Book/share (sen)	26.7	30.9	35.2	39.9	44.9
P/Book (x)	4.9	4.2	3.7	3.3	2.9
FCF/share (sen)	4.6	5.3	7.0	7.6	8.0
FCF yield (%)	3.5	4.0	5.4	5.8	6.1
Mkt Cap	1,379.4	1,379.4	1,379.4	1,379.4	1,379.4
Net Cash/Debt	85.8	121.5	175.8	234.4	296.0
EV	1,293.6	1,257.9	1,203.7	1,145.1	1,083.4
EV/EBITDA (x)	20.0	13.6	11.4	10.3	9.3
ROE (%)	12.2	16.7	17.7	16.7	15.9
Current Ratio (x)	2.2	2.9	3.4	3.9	4.4
Quick Ratio (x)	2.1	2.8	3.2	3.8	4.2
Interest Cover (x)	49.7	132.5	259.6	277.1	295.1

Other Ratios

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Sales Growth (%)		10.3	9.5	5.0	5.0
EBITDA Growth (%)		43.1	14.2	5.0	5.0
EBIT Growth (%)		62.8	18.5	6.7	6.5
PBT Growth (%)		63.9	19.0	7.2	6.9
Net Profit Growth (%)		56.6	24.5	7.2	6.9
EBITDA Margin (%)	21.8	28.3	29.5	29.5	29.5
EBIT Margin (%)	15.6	23.0	24.9	25.3	25.7
PBT Margin (%)	15.6	23.1	25.1	25.6	26.1
Net Profit Margin (%)	12.3	17.4	19.8	20.2	20.6
Net Debt/Equity (%)	N Cash	N Cash	N Cash	N Cash	N Cash
CAPEX/Sales (%)	6.8	2.3	2.8	2.7	2.5

Figure #1 Quarterly results comparison

FYE Dec (RM m)	1Q18	4Q18	1Q19	QoQ	YoY
Revenue	70.9	88.7	83.8	(5.5)	18.2
EBITDA	15.6	28.5	27.4	(3.9)	75.7
EBITDA Margin	22.0	32.1	32.6		
EBIT	11.1	24.2	22.6	(6.8)	103.1
PBT	11.0	24.4	22.5	(7.7)	104.4
PAT	7.2	20.0	16.3	(18.3)	127.6
Reported PATMI	6.3	18.7	15.4	(17.6)	144.4
Core PATMI	7.1	19.6	15.4	(21.4)	118.1
Reported EPS (sen)	0.6	1.8	1.5	(17.6)	144.4
Core EPS (sen)	0.7	1.9	1.5	(21.4)	118.1

Bursa, HLIB Research

Figure #2 Peer comparison

Company	FYE	Price (Local)	Market Cap (USD m)	P/E (x)		P/B (x)		Gross DY (%)
				2018	2019	2018	2019	2018
Malaysia								
Frontken	Dec	0.60	154.1	15.0	15.0	2.1	1.8	1.2
Japan								
Lasertec	Jun	3,230.00	1,368.4	36.2	29.0	5.4	4.9	0.9
Tokyo Electron	Mar	19,585.00	29,076.7	12.2	11.6	3.5	3.0	4.1
Europe								
ASML	Dec	183.90	91,751.3	31.7	26.1	6.6	5.9	0.8
US								
National Instruments	Dec	44.41	5,871.4	30.8	27.0	4.9	4.7	2.1
Teradyne	Dec	43.75	8,370.1	20.9	16.3	5.3	6.8	0.8
Entegris	Dec	36.00	5,098.7	18.6	16.2	4.5	3.9	0.6
FormFactor	Dec	14.20	1,037.1	15.6	11.6	N/A	N/A	0.0
Cabot Microelectronics	Sep	122.50	3,146.1	24.0	21.1	N/A	N/A	1.0
Nanometrics	Dec	42.27	1,020.3	18.6	17.1	4.0	N/A	N/A
Lam Research	Jun	187.29	29,384.3	11.8	10.1	4.2	4.1	2.2
Brooks Automation	Sep	31.79	2,242.5	20.2	17.4	3.0	2.8	1.3
Axcels Technologies	Dec	23.20	750.6	16.1	13.0	N/A	N/A	N/A
Avg excl. Frontken				21.4	18.0	4.6	4.5	1.4

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Hong Leong Investment Bank Berhad (10209-W)

Level 28, Menara Hong Leong,

No. 6, Jalan Damanlela,

Bukit Damansara,

50490 Kuala Lumpur

Tel: (603) 2083 1800

Fax: (603) 2083 1766

Stock rating definitions

BUY	Expected absolute return of +10% or more over the next 12 months.
HOLD	Expected absolute return of -10% to +15% over the next 12 months.
SELL	Expected absolute return of -10% or less over the next 12 months.
UNDER REVIEW	Rating on the stock is temporarily under review which may or may not result to a change from the previous rating.
NOT RATED	Stock is not or no longer within regular coverage.

Sector rating definitions

OVERWEIGHT	Sector expected to outperform the market over the next 12 months.
NEUTRAL	Sector expected to perform in-line with the market over the next 12 months.
UNDERWEIGHT	Sector expected to underperform the market over the next 12 months.