Shariah Compliant

Industrials

Malaysia

February 13, 2019

Maybank IB Research

Frontken Corp. Bhd (FRCB MK)

Record-breaking net profit

BUY

Share Price	MYR 0.91
12m Price Target	MYR 1.04 (+15%)
Previous Price Target	*MYR 1.01*

Maintain BUY with a higher TP of MYR1.04

4Q/FY18 results were ahead of our forecast. We expect earnings growth momentum to sustain this year, albeit at a slower pace, fuelled by work orders for its key customers' leading-edge technology in Singapore and Taiwan, and a gradual pick-up in work orders for its O&G segment in Malaysia and Singapore. We raise our FY19E/20E earnings by 3%/2% and introduce our FY21 forecast. Correspondingly, our TP is raised by 3% to MYR1.04, pegged to an unchanged 18.8x FY19 EPS (+1SD of 5-year mean).

4Q18 surprisingly beat expectations

Stripping out one-off items, 4Q18 core earnings of MYR18.4m (+67% YoY, +23% QoQ) lifted FY18 core earnings to a record high of MYR53.4m (+50% YoY), at 117% of ours and consensus forecasts. FY18 EBITDA of MYR88.0m (+43% YoY), however, was in-line at 102% of our estimate. The Group declared a second interim single tier DPS of 0.8sen, which lifts full-year DPS to 1.5sen, representing a 30% DPR and meeting our full-year estimate as well.

A spectacular major segments performance

The bottomline outperformance and stronger earnings growth in 4Q18 was due to a much higher revenue contribution of MYR21.8m (+41% YoY, +37% QoQ) from its Singapore segment on stronger work orders, which we posit was mainly from its memory customer. This contributed to the expansion in 4Q18 EBIT margin from its Singapore operations to 42.6% (3Q18: 24.7%, 4Q17: 15.2%). EBIT margin from its Taiwan operations were stable, benefiting much from work orders for its Customer X's 7nm technology (as highlighted in our previous report).

Raising our earnings forecasts

We raise FY19E net profit forecasts by 3% after revising higher our Singapore revenue and EBIT projections to MYR79.4m and MYR18.8m (from MYR71.5m and MYR12.9m) on strong backlog orders mainly from its memory customer, and margin improvement across all its segments. We also raise our FY20E net profit forecast by 2%.

FYE Dec (MYR m)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	297	327	361	424	476
EBITDA	65	88	100	115	127
Core net profit	36	53	58	68	76
Core EPS (sen)	3.4	5.1	5.5	6.5	7.2
Core EPS growth (%)	98.8	50.1	8.1	17.4	11.6
Net DPS (sen)	0.5	1.5	1.7	1.9	2.2
Core P/E (x)	13.6	13.8	16.4	14.0	12.5
P/BV (x)	1.7	2.3	2.6	2.3	2.0
Net dividend yield (%)	1.1	2.1	1.8	2.1	2.4
ROAE (%)	11.0	17.2	16.7	17.4	17.2
ROAA (%)	8.5	12.1	12.4	13.3	13.0
EV/EBITDA (x)	6.3	7.1	8.0	6.6	5.5
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	56	64	na
MKE vs. Consensus (%)	-	-	3.9	5.9	na

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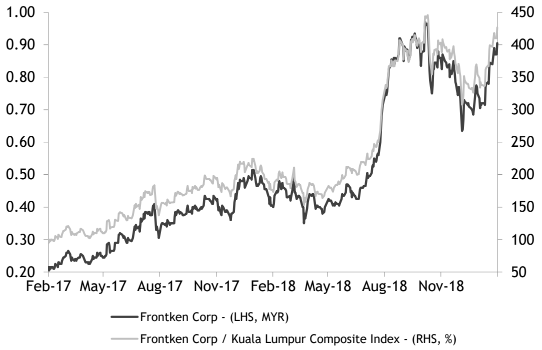
Company Description

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)	0.97/0.35
3m avg turnover (USDm)	1.5
Free float (%)	47.6
Issued shares (m)	1,053
Market capitalisation	MYR953.4M
	USD234M
Major shareholders:	
Dazzle Clean Ltd	27.8%
Ooi Keng Thye	14.5%
CIMB-Principal Asset Management	5.2%

Price Performance



	-1M	-3M	-12M
Absolute (%)	21	5	123
Relative to index (%)	20	6	142

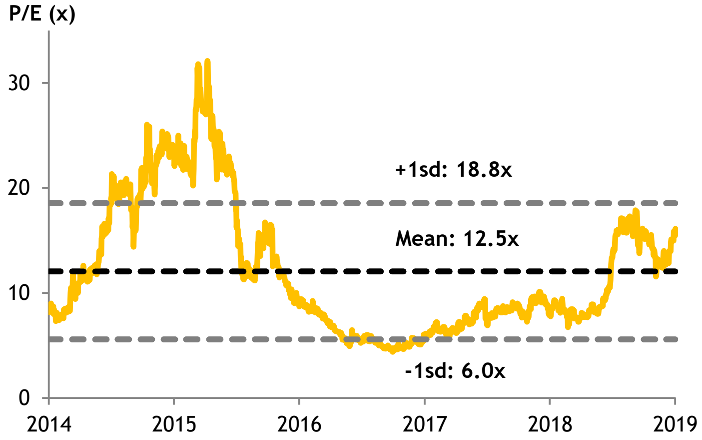
Source: FactSet

Fig 1: Summary results table

FYE Dec (MYR'm)	4Q18	4Q17	%YoY	3Q18	%QoQ	FY18	FY17	%YoY
	Quarterly					Cumulative		
Revenue	88.7	80.4	*10.3*	85.9	*3.3*	327.2	296.6	*10.3*
EBITDA	**27.4**	**17.6**	***55.7***	**23.5**	***16.5***	**88.0**	**61.4**	***43.3***
Depreciation	(4.3)	(4.7)	*(9.2)*	(4.2)	*1.4*	(17.3)	(18.5)	*(6.3)*
Other income	1.1	1.2	*(11.7)*	1.1	*22.2*	4.5	4.6	*(1.6)*
EBIT	**24.2**	**14.1**	***71.5***	**20.5**	***19.9***	**75.2**	**47.5**	***58.3***
Interest income	0.3	0.2	*82.5*	0.3	*22.4*	0.9	0.8	*8.5*
Finance costs	(0.1)	(0.2)	*(62.1)*	(0.1)	*(6.1)*	(0.6)	(0.9)	*(39.0)*
Associate profit/loss	0.0	0.0	*nm*	0.0	*nm*	0.1	(0.1)	*>100*
PBT	**24.4**	**13.6**	***79.1***	**20.6**	***18.3***	**75.6**	**46.1**	***63.9***
Tax expense	(4.4)	(2.4)	*85.9*	(4.2)	*4.8*	(18.6)	(9.7)	*91.1*
Headline net profit	**18.7**	**9.8**	***90.1***	**15.2**	***23.0***	**52.3**	**29.9**	***75.0***
Core net profit	**18.4***	**11.1**	***66.8***	**15.0**	***22.6***	**53.4****	**35.6**	***50.0***
Basic EPS (sen)	1.78	0.94	*89.4*	1.5	*22.8*	4.99	2.85	*75.1*
Margin (%)	**4Q18**	**4Q17**	**+/- ppt**	**3Q18**	**+/- ppt**	**FY18**	**FY17**	**+/- ppt**
EBITDA	30.9	21.9	*9.0*	27.4	*3.5*	26.9	20.7	*6.2*
EBIT	27.7	17.3	*10.4*	23.8	*3.8*	23.3	15.9	*7.4*
PBT	27.5	17.0	*10.6*	24.0	*3.5*	23.1	15.6	*7.5*
Core net profit	20.8	13.7	*7.1*	17.5	*3.3*	16.3	12.0	*4.3*
Net gearing (x)	net cash	net cash	nm	net cash	nm	net cash	net cash	nm
Segmental revenue (MYR'm)	**4Q18**	**4Q17**	**%YoY**	**3Q18**	**%QoQ**	**FY18**	**FY17**	**%YoY**
Taiwan	47.7	47.9	*(0.5)*	48.9	*(2.5)*	186.1	171.4	*8.5*
Singapore	21.8	15.5	*40.6*	16.0	*36.6*	65.2	55.6	*17.1*
Malaysia	14.9	11.9	*25.2*	15.8	*(5.4)*	57.8	50.3	*14.9*
Philippines	4.1	4.2	*(2.9)*	5.0	*(16.8)*	17.2	17.5	*(1.5)*
Indonesia	0.1	0.8	*(82.1)*	0.3	*(42.9)*	1.0	1.7	*(44.1)*
Segmental EBIT (MYR'm)	**4Q18**	**4Q17**	**%YoY**	**3Q18**	**%QoQ**	**FY18**	**FY17**	**%YoY**
Taiwan	13.5	11.1	*22.2*	13.8	*(2.0)*	49.4	40.1	*23.3*
Singapore	9.3	2.4	*>100*	3.9	*>100*	18.4	4.4	*>100*
Malaysia	0.8	0.1	*>100*	1.6	*(46.8)*	5.0	0.6	*>100*
Philippines	0.4	0.3	*29.6*	0.8	*(46.8)*	2.7	2.6	*3.0*
Indonesia	0.1	(0.2)	*>100*	(0.3)	*>100*	(0.9)	(1.4)	*(32.9)*
Segmental EBIT margin (MYR'm)	**4Q18**	**4Q17**	**+/- ppt**	**3Q18**	**+/- ppt**	**FY18**	**FY17**	**+/- ppt**
Taiwan	28.4	23.1	*5.3*	28.2	*0.2*	26.5	23.4	*3.2*
Singapore	42.6	15.2	*27.4*	24.7	*18.0*	28.3	7.9	*20.4*
Malaysia	5.6	0.8	*4.8*	9.9	*(4.3)*	8.6	1.3	*7.3*
Philippines	10.7	8.0	*2.7*	16.7	*(6.0)*	15.4	14.7	*0.7*
Indonesia	61.4	(20.0)	*81.4*	(127.6)	*188.9*	(97.0)	(80.8)	*(16.2)*

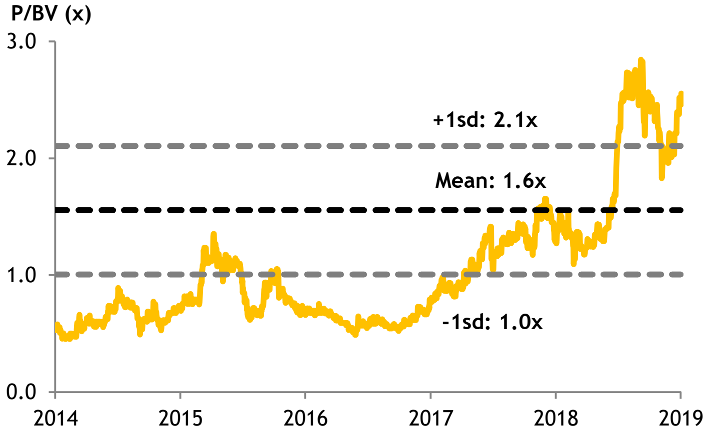
**Excluding unrealised forex gain (MYR0.2m) and gain on disposal of an associate (MYR0.03m)*
***Excluding unrealised forex gain (MYR0.6m), gain on disposal of an associate (MYR0.7m) and withholding tax (MYR2.4m)*
Source: Company data, Maybank KE

Fig 2: 1-year forward PER



Source: Bloomberg, Company data, Maybank KE

Fig 3: 1-year forward PBV

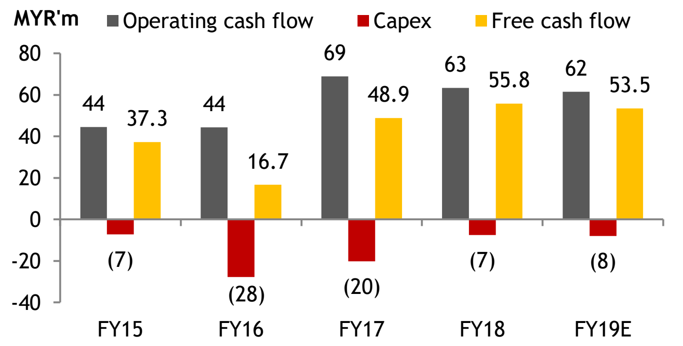


Source: Bloomberg, Company data, Maybank KE

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 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 MYR55.8m.
- ROE has continued to improve from 4.3% in FY15 to 17.2% in FY18, through better profit margins.

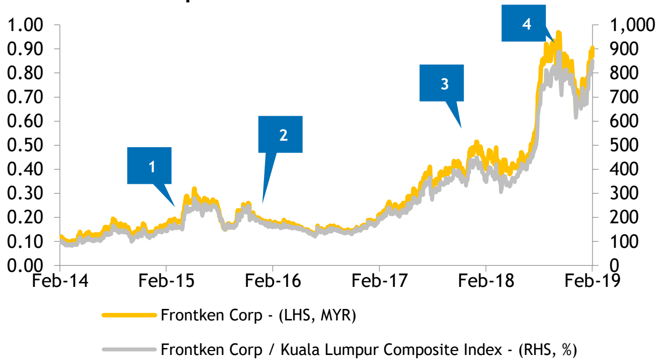
Sustainable FCF and OCF



Source: Company, Maybank KE

Price Drivers

Historical share price trend



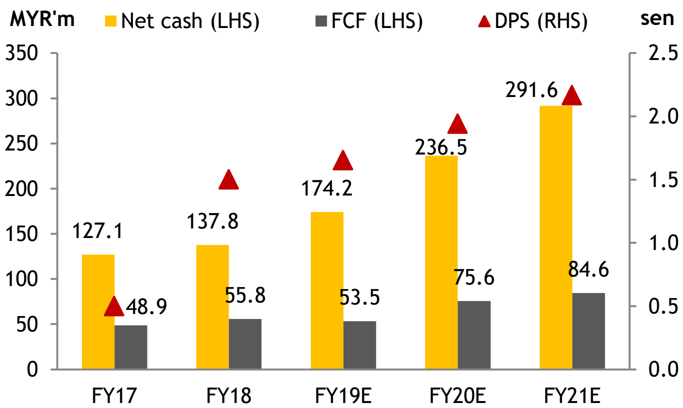
Source: Company, FactSet, Maybank Kim Eng

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 chips.
- 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	16.4	14.0	12.5
Core P/E (x)	13.6	13.8	16.4	14.0	12.5
P/BV (x)	1.7	2.3	2.6	2.3	2.0
P/NTA (x)	1.7	2.3	3.0	2.6	2.3
Net dividend yield (%)	1.1	2.1	1.8	2.1	2.4
FCF yield (%)	10.1	7.6	5.6	8.0	8.9
EV/EBITDA (x)	6.3	7.1	8.0	6.6	5.5
EV/EBIT (x)	8.8	8.3	9.7	7.7	6.4
INCOME STATEMENT (MYR m)					
Revenue	296.6	327.2	360.9	423.8	475.6
Gross profit	104.8	0.0	171.9	193.3	216.9
EBITDA	64.8	88.0	99.8	114.6	126.6
Depreciation	(18.5)	(17.3)	(17.1)	(17.4)	(17.8)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	46.3	75.2	82.8	97.2	108.8
Net interest income /(exp)	(0.1)	0.3	0.1	0.0	(0.1)
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	82.9	97.3	108.6
Income tax	(9.7)	(18.6)	(19.1)	(22.4)	(25.0)
Minorities	(6.6)	(4.7)	(6.1)	(7.1)	(7.9)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	29.9	52.3	57.7	67.8	75.7
Core net profit	35.6	53.4	57.7	67.8	75.7
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	129.3	149.9	186.3	248.6	303.7
Accounts receivable	97.0	113.6	108.2	127.0	142.5
Inventory	13.5	13.7	12.4	15.2	17.0
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	150.0	140.4	130.0	120.6	110.8
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**	**474.4**	**548.8**	**611.5**
ST interest bearing debt	16.9	4.8	6.1	10.1	7.1
Accounts payable	79.6	81.6	55.6	68.6	76.9
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	11.7	8.9	8.1	13.2	12.0
Other liabilities	17.0	15.0	15.0	15.0	15.0
Total Liabilities	**125.1**	**110.4**	**85.1**	**107.1**	**111.2**
Shareholders Equity	281.6	325.0	365.5	412.9	465.9
Minority Interest	24.4	19.6	23.8	28.8	34.4
Total shareholder equity	**306.0**	**344.6**	**389.3**	**441.7**	**500.3**
Total liabilities and equity	**431.1**	**455.1**	**474.4**	**548.8**	**611.5**
CASH FLOW (MYR m)					
Pretax profit	46.1	75.6	82.9	97.3	108.6
Depreciation & amortisation	18.5	17.3	17.1	17.4	17.8
Adj net interest (income)/exp	0.1	(0.3)	(0.1)	(0.0)	0.1
Change in working capital	6.9	(15.9)	(19.3)	(8.6)	(9.0)
Cash taxes paid	(7.9)	(14.2)	(19.1)	(22.4)	(25.0)
Other operating cash flow	5.4	(0.4)	0.0	0.0	0.0
Cash flow from operations	69.0	63.3	61.5	83.6	92.6
Capex	(20.2)	(7.5)	(8.0)	(8.0)	(8.0)
Free cash flow	48.9	55.8	53.5	75.6	84.6
Dividends paid	(7.2)	(10.0)	(19.1)	(22.5)	(25.1)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	(0.2)	(17.3)	1.9	9.1	(4.2)
Other invest/financing cash flow	(12.9)	(0.2)	0.1	0.0	(0.1)
Effect of exch rate changes	(6.4)	0.3	(1.0)	0.0	0.0
Net cash flow	22.2	28.7	35.3	62.3	55.1

FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Key Ratios					
Growth ratios (%)					
Revenue growth	13.3	10.3	10.3	17.4	12.2
EBITDA growth	26.9	35.9	13.4	14.8	10.4
EBIT growth	36.8	62.5	10.1	17.5	11.9
Pretax growth	38.4	63.9	9.6	17.4	11.6
Reported net profit growth	49.0	75.1	10.4	17.4	11.6
Core net profit growth	98.8	50.1	8.1	17.4	11.6
Profitability ratios (%)					
EBITDA margin	21.8	26.9	27.7	27.0	26.6
EBIT margin	15.6	23.0	22.9	22.9	22.9
Pretax profit margin	15.6	23.1	23.0	23.0	22.8
Payout ratio	17.5	30.1	30.0	30.0	30.0
DuPont analysis					
Net profit margin (%)	10.1	16.0	16.0	16.0	15.9
Revenue/Assets (x)	0.7	0.7	0.8	0.8	0.8
Assets/Equity (x)	1.5	1.4	1.3	1.3	1.3
ROAE (%)	11.0	17.2	16.7	17.4	17.2
ROAA (%)	8.5	12.1	12.4	13.3	13.0
Liquidity & Efficiency					
Cash conversion cycle	(0.3)	nm	4.8	24.4	23.2
Days receivable outstanding	120.3	115.8	110.6	99.9	102.0
Days inventory outstanding	23.0	nm	24.9	21.5	22.4
Days payables outstanding	143.5	nm	130.7	97.0	101.2
Dividend cover (x)	5.7	3.3	3.3	3.3	3.3
Current ratio (x)	2.2	2.8	4.2	4.3	4.8
Leverage & Expense Analysis					
Asset/Liability (x)	3.4	4.1	5.6	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	nm
Debt/EBITDA (x)	0.4	0.2	0.1	0.2	0.2
Capex/revenue (%)	6.8	2.3	2.2	1.9	1.7
Net debt/ (net cash)	(100.7)	(136.3)	(172.1)	(225.3)	(284.6)

Source: Company; Maybank

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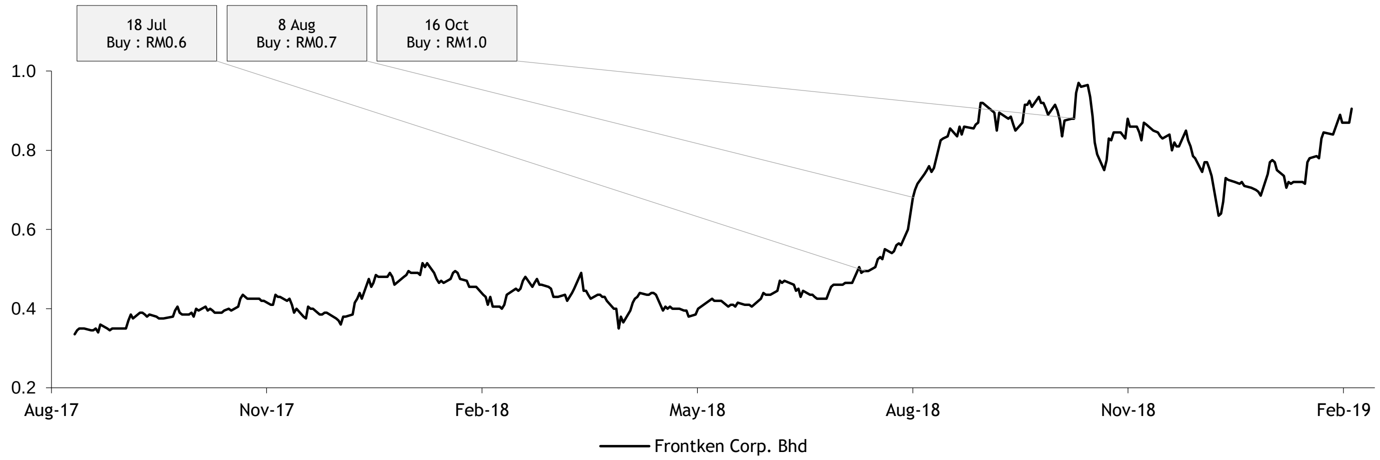

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