

HLIB Research

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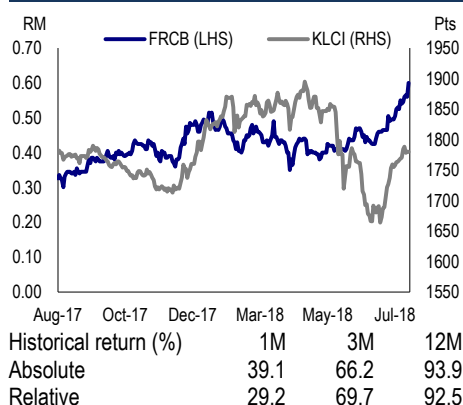
BUY (Maintain)

Target Price: **RM0.84**
Previously: **RM0.84**
Current Price: **RM0.64**

Capital upside	31.3%
Dividend yield	3.0%
Expected total return	34.3%

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)	671
3-mth average volume ('000)	6,960
SC Shariah compliant	Yes

Major shareholders

Dazzle Clean	27.8%
Ooi Keng Thye	14.5%
CIMB Group Holdings Bhd	5.8%

Earnings summary

	FY17	FY18f	FY19f
FYE (Dec)			
PATMI – core	34.3	40.2	49.1
EPS – core (sen)	3.3	3.8	4.7
P/E (x)	19.7	16.8	13.7

Frontken Corporation

2Q18 results: Strongest Ever

2Q18 is Frontken's record quarter, propelling 1H18 core net profit to RM20m (+46% YoY) which meets expectations. This was mainly driven by stronger semiconductor contribution from Taiwan, Singapore and Malaysia. Excluding withholding tax, effective tax run rate was at 19%. Forecasts were unchanged. Reiterate BUY with unchanged TP of RM0.84.

Within expectations. 2Q18 results were its best quarterly performance in terms of both top and bottom lines. 1H18 revenue of RM153m was translated into a core net profit of RM20m, accounting for 50% and 51% of HLIB and consensus full year forecasts, respectively.

Dividend. None (2Q17: none).

QoQ. Turnover increased 15% to reach all-time high at RM82m thanks to higher contributions from Taiwan, Malaysia and Singapore's and we believe this is driven by the semiconductor business segment. After one-off adjustments, core net profit surged 82% to RM13m attributable to better economies-of-scale as EBITDA margin gained 7-ppt.

YoY. Top line expanded 16% attributable to the growth from semiconductor business, where Taiwan and Singapore improved 12% and 24%, respectively. Malaysia and Philippines also recorded a better performance due to new works secured and expanded business portfolio. As a result, core earnings ballooned 88% on the back of higher productivity and lower MI with increased stake in AGTC.

YTD. Revenue accelerated 11% supported by Taiwan (+17%), Singapore (+7%) and Malaysia (+4%) leveraging on stronger semiconductor demand. After FOREX and withholding tax adjustments, bottom line gained 46% to RM20m for the same reason mentioned above.

Withholding tax amounted to RM2.4m was incurred in 2Q18 due to the dividend declared by AGTC. This one-off item has artificially inflated 2Q18 tax to RM6.2m or 32% tax rate. After adjustment, effective tax implies a usual run rate of 19%.

Management's prospects. While global semiconductor market leading indicators continue to be encouraging, Frontken stated the ongoing trade war as a risk. It is cautiously optimistic for 2H18 while continue to be vigilant in cost management and improve efficiency. Its priority is to focus on quality to maintain competitiveness.

Forecast: Maintain as results were in line.

Reiterate **BUY** with unchanged fair value of **RM0.84**, pegged to 18.0x of FY19 EPS. This valuation is in line with the average of global suppliers to the fab industry. Frontken is expected to experience multi-year growth ahead on the back of (1) Bullish global semiconductor market outlook; (2) Robust fab investment; (3) Leading edge technology; and (4) O&G recovery. We welcome the recent major change in shareholding despite the heavy discount. Frontken has a strong balance sheet and we foresee that it may adopt dividend policy.

Financial Forecast

All items in (RM m) unless otherwise stated

Income statement

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Revenue	261.8	296.6	330.3	366.3	394.2
COGS	(210.9)	(231.9)	(256.5)	(281.4)	(302.0)
EBITDA	50.9	64.7	73.8	84.9	92.2
D&A	(17.2)	(18.5)	(17.2)	(16.4)	(15.7)
EBIT	33.7	46.2	56.7	68.5	76.5
Net Interest Income	(0.4)	(0.1)	0.0	0.2	0.5
Associates	0.0	0.0	0.0	0.0	0.0
PBT	33.3	46.1	56.7	68.8	77.0
Tax	(6.1)	(9.7)	(12.0)	(14.5)	(16.3)
Net Profit	27.3	36.4	44.7	54.3	60.7
MI	(7.2)	(6.6)	(4.6)	(5.2)	(5.6)
PATAMI	20.0	29.9	40.2	49.1	55.1
Exceptionals	(2.2)	4.4	0.0	0.0	0.0
Adj PATAMI	17.8	34.3	40.2	49.1	55.1
Basic Shares (m)	1,053.0	1,053.0	1,053.0	1,053.0	1,053.0
Rep EPS (sen)	1.9	2.8	3.8	4.7	5.2
Adj EPS (sen)	1.7	3.3	3.8	4.7	5.2
Adj FD EPS (sen)	1.7	3.3	3.8	4.7	5.2

Balance sheet

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Cash	88.7	119.3	145.2	177.0	212.9
Receivables	96.1	91.7	108.6	120.4	129.6
Inventories	11.0	13.5	14.1	15.4	16.5
Investment	2.0	2.0	2.0	2.0	2.0
PPE	152.1	150.0	142.9	136.5	130.8
Intangibles	33.8	33.8	33.8	33.8	33.8
Other Assets	24.1	20.8	20.8	20.8	20.8
Total Assets	407.8	431.1	467.3	505.9	546.4
Payables	73.5	79.8	91.3	100.2	107.6
ST borrowings	8.5	21.9	21.9	21.9	21.9
LT borrowings	20.3	11.5	11.5	11.5	11.5
Other Liabilities	10.1	11.8	11.8	11.8	11.8
Total liabilities	112.4	125.1	136.6	145.5	152.9
Shareholders' Funds	261.6	281.6	301.7	326.2	353.8
MI	33.8	24.4	28.9	34.1	39.8
Total S/H Equity	295.4	306.0	330.6	360.3	393.5
Ttl Liab&S/H Funds	407.8	431.1	467.3	505.9	546.4

Cashflow Analysis

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
EBITDA	50.9	64.7	73.8	84.9	92.2
Tax Paid	(6.7)	(7.9)	(12.0)	(14.5)	(16.3)
WC Changes	1.1	6.9	(5.9)	(4.3)	(2.9)
Other	(0.9)	5.3	0.0	0.2	0.5
CFO	44.4	69.0	56.0	66.3	73.5
FCF	16.7	48.9	46.0	56.3	63.5
CAPEX (CF)	(27.7)	(20.2)	(10.0)	(10.0)	(10.0)
Acquisitions	(7.4)	(13.3)	0.0	0.0	0.0
Other	0.1	1.3	0.0	0.0	0.0
CFI	(35.0)	(32.1)	(10.0)	(10.0)	(10.0)
Dividend	0.0	(5.2)	(20.1)	(24.5)	(27.5)
Debt changes	(14.4)	0.0	0.0	0.0	0.0
Other	(4.1)	(3.2)	0.0	0.0	0.0
CFF	(18.5)	(8.4)	(20.1)	(24.5)	(27.5)
Net Cashflow	(9.1)	28.6	25.9	31.8	35.9

Quarterly financial summary

FYE Dec	2Q17	3Q18	4Q17	1Q18	2Q18
Revenue	70.5	78.6	80.4	70.9	81.8
COGS	(55.8)	(60.8)	(62.0)	(55.3)	(58.0)
EBITDA	14.7	17.8	18.4	15.6	23.8
D&A	(4.5)	(4.8)	(4.7)	(4.5)	(4.3)
EBIT	10.2	13.0	13.7	11.1	19.5
Net Interest Income	0.0	(0.1)	(0.1)	(0.1)	0.0
Associates	0.0	0.0	0.0	0.0	0.0
PBT	10.3	12.9	13.6	11.0	19.5
Tax	(2.4)	(2.1)	(2.4)	(3.8)	(6.2)
Net Profit	7.9	10.8	11.3	7.2	13.3
MI	(2.1)	(1.6)	(1.4)	(0.9)	(1.2)
PATAMI	5.8	9.2	9.8	6.3	12.1
Exceptionals	1.0	0.8	0.9	0.8	0.7
Adj PATAMI	6.8	10.0	10.7	7.1	12.8
Basic Shares (m)	1,053.0	1,053.0	1,053.0	1,053.0	1,053.0
Rep EPS (sen)	0.6	0.9	0.9	0.6	1.1
Adj EPS (sen)	0.6	0.9	1.0	0.7	1.2
Adj FD EPS (sen)	0.6	0.9	1.0	0.7	1.2

Valuation Ratios

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
PER (x)	33.6	22.6	16.8	13.7	12.2
Core PER (x)	37.9	19.7	16.8	13.7	12.2
FD PER (x)	37.9	19.7	16.8	13.7	12.2
DPS (sen)	0.0	0.5	1.9	2.3	2.6
Net DY (%)	0.0	0.8	3.0	3.6	4.1
Book/share (sen)	24.8	26.7	28.6	31.0	33.6
P/Book (x)	2.6	2.4	2.2	2.1	1.9
FCF/share (sen)	1.6	4.6	4.4	5.3	6.0
FCF yield (%)	2.5	7.3	6.8	8.4	9.4
Mkt Cap	673.9	673.9	673.9	673.9	673.9
Net Cash(Debt)	60.0	85.8	111.7	143.5	179.4
EV	613.9	588.1	562.2	530.4	494.5
EV/EBITDA (x)	12.1	9.1	7.6	6.2	5.4
ROE (%)	6.8	12.2	13.3	15.0	15.6
Current Ratio (x)	2.4	2.2	2.4	2.6	2.8
Quick Ratio (x)	2.3	2.1	2.2	2.4	2.6
Interest Cover (x)	29.4	49.7	60.9	73.6	82.1

Other Ratios

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Sales Growth (%)		13.3	11.4	10.9	7.6
EBITDA Growth (%)		27.1	14.1	15.0	8.5
EBIT Growth (%)		37.1	22.6	20.9	11.6
PBT Growth (%)		38.4	22.9	21.3	11.9
Net Profit Growth (%)		33.4	22.9	21.3	11.9
EBITDA Margin (%)	19.4	21.8	22.4	23.2	23.4
EBIT Margin (%)	12.9	15.6	17.2	18.7	19.4
PBT Margin (%)	12.7	15.6	17.2	18.8	19.5
Net Profit Margin (%)	10.4	12.3	13.5	14.8	15.4
Net Debt/Equity (%)	N Cash	N Cash	N Cash	N Cash	N Cash
CAPEX/Sales (%)	10.6	6.8	3.0	2.7	2.5

Figure #1 **Quarterly results comparison**

FYE Dec (RM m)	2Q17	1Q18	2Q18	QoQ	YoY	1H17	1H18	YoY
Revenue	70.5	70.9	81.8	15.3%	16.0%	137.6	152.7	11.0%
EBITDA	14.7	15.6	23.8	52.9%	61.5%	28.5	39.4	38.2%
EBITDA Margin	20.9%	22.0%	29.1%			20.7%	25.8%	
EBIT	10.2	11.1	19.5	75.3%	90.1%	19.6	30.6	56.4%
PBT	10.3	11.0	19.5	76.9%	90.1%	19.6	30.5	55.9%
PAT	7.9	7.2	13.3	84.9%	68.4%	14.4	20.5	42.5%
Reported PATMI	5.8	6.3	12.1	91.7%	107.5%	10.8	18.4	69.5%
Core PATMI	6.8	7.1	12.8	81.8%	87.6%	13.6	19.9	46.4%
Reported EPS (sen)	0.6	0.6	1.1	91.7%	107.5%	1.0	1.7	69.5%
Core EPS (sen)	0.6	0.7	1.2	81.8%	87.6%	1.3	1.9	46.4%

Bursa, HLIB Research

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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.