August 1, 2019

Maybank IB Research

Frontken Corp. Bhd (FRCB MK)

Steady and on course

BUY

Share Price	MYR 1.65
12m Price Target	MYR 1.85 (+12%)
Previous Price Target	*MYR 1.85*

Strong work order growth ahead. Maintain BUY

2Q19 core net profit (+60% YoY; 14% QoQ) was in-line with our/consensus estimates and 1H19 equaled 47% of our/consensus 2019E. We make no estimate revisions; The next growth leg remains intact, factored into our estimates, driven by: (i) increasing adoption of its Customer X's 7/7nm+ in 2H19 and 5G deployment into FY20; and (ii) better local O&G activities in 2H19. We reiterate BUY with an unchanged TP of MYR1.85, pegged to an unchanged 23.5x PER (+1.5SD of 5-year mean to reflect the positive earnings growth outlook).

Within our and consensus expectations

Excluding one-off items, Frontken's 2Q19 core net profit was MYR17.2m (+60% YoY), which took its 1H19 core net profit to MYR32.4m (85% YoY). The growth was attributable to the: (i) Profit margin improvement from vigilance in cost management; and ii) Improved topline from its Singapore segment at MYR16.9m (+10% YoY, +4% QoQ) and possibly contribution from its Customer X's 7nm (as we had highlighted in our previous report). We posit overall topline growth decreased 2.0% YoY and 4.4% QoQ due to lower contributions from other semiconductor customers and Customer X's matured nodes. The Group declared a first single tier DPS of 1sen, representing a 50% DPR and meeting our full-year estimate as well.

Strong demand for smaller node to boost work orders

Frontken is well placed to gain from the growing demand for its Customer X's continuous advancement in cutting-edge process and capacity expansion. As the rapid 5G deployment globally will generate a tremendous amount of data to process, it would spur demand for: (i) its Customer X's 7/7nm+ and upcoming 5nm chips in 2020 that can deliver greater power efficiency and faster processing capability; and (ii) its memory customer's 3D NAND chips. With the growing complexity in the chipmaking process equipment to produce these advanced chips, it will boost more high value work orders for Frontken.

No changes to earnings estimates

We leave our FY19E-20E earnings forecasts unchanged, having imputed the above factors. We expect an even improved 2H19 on: (i) more high value work orders fuelled by its Customer X's production ramp-up of 7/7nm+ process nodes; and (ii) sustainable work orders from its major O&G customers.

FYE Dec (MYR m)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	297	327	390	441	483
EBITDA	65	92	117	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	50.0	29.9	19.3	15.8
Net DPS (sen)	0.5	1.5	2.0	2.4	2.7
Core P/E (x)	13.6	13.8	24.9	20.9	18.1
P/BV (x)	1.7	2.3	4.6	4.0	3.5
Net dividend yield (%)	1.1	2.1	1.2	1.4	1.7
ROAE (%)	11.0	17.2	19.8	20.5	20.6
ROAA (%)	8.5	12.0	14.5	15.7	16.3
EV/EBITDA (x)	6.3	6.7	13.5	11.6	9.9
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	67	77	86
MKE vs. Consensus (%)	-	-	2.9	8.1	12.0

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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.

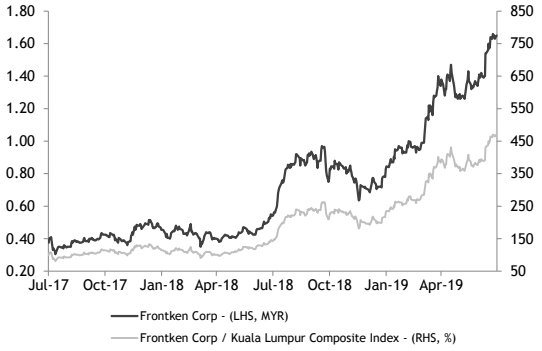
Statistics

52w high/low (MYR)	1.66/0.55
3m avg turnover (USDm)	2.9
Free float (%)	47.6
Issued shares (m)	1,053
Market capitalisation	MYR1.7B
	USD421M

Major shareholders:

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

Price Performance



	-1M	-3M	-12M
Absolute (%)	23	20	206
Relative to index (%)	25	20	229

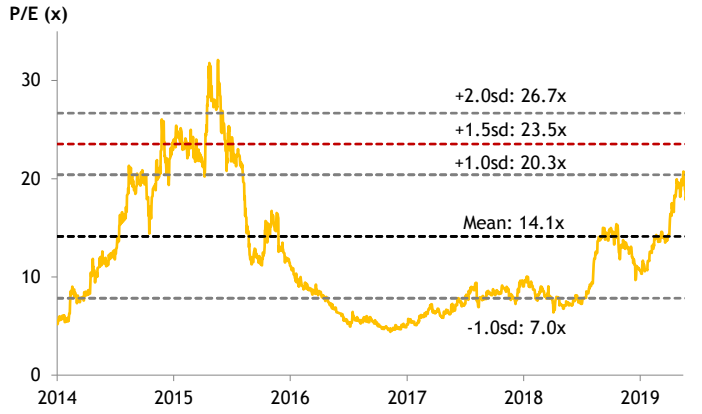
Source: FactSet

Fig 1: Results summary

FYE Dec (MYR'm)	Quarterly					Cumulative		
	2Q19	2Q18	%YoY	1Q19	%QoQ	1H19	1H18	%YoY
Revenue	**80.1**	**81.8**	***(2.0)***	**83.8**	***(4.4)***	**164.0**	**152.7**	***7.4***
EBITDA	**27.7**	**23.8**	***16.4***	**27.4**	***1.0***	**55.0**	**37.0**	***48.6***
Depreciation	(4.6)	(4.3)	*6.8*	(4.8)	*(3.7)*	(9.5)	(8.8)	*7.2*
Other income	0.3	1.0	*(70.6)*	1.0	*(71.1)*	1.3	2.3	*(46.0)*
EBIT	**23.0**	**19.4**	***18.5***	**22.6**	***2.0***	**45.6**	**30.5**	***49.2***
Finance income	0.3	0.2	*46.0*	0.2	*22.5*	0.5	0.4	*50.0*
Finance costs	(0.2)	(0.2)	*27.0*	(0.2)	*(18.9)*	(0.4)	(0.4)	*14.0*
Associate profit/loss	0.0	0.1	*nm*	0.0	*nm*	0.0	0.0	*nm*
PBT	**23.1**	**19.5**	***18.4***	**22.5**	***2.5***	**45.7**	**30.5**	***49.5***
Tax expense	(5.3)	(6.2)	*(15.3)*	(6.2)	*(14.9)*	(11.5)	(10.1)	*13.9*
Headline PATAMI	**16.5**	**12.1**	***36.7***	**15.4**	***7.2***	**31.9**	**18.4**	***73.6***
Core PATAMI	**17.2**	**10.8**	***60.3***	**15.2**	***13.8***	**32.4**	**17.5**	***85.2***
Basic EPS (sen)	1.58	1.15	*37.4*	1.47	***7.5***	3.05	1.75	*74.3*
Margin (%)	**2Q19**	**2Q18**	**+/- ppt**	**1Q19**	**+/- ppt**	**1H19**	**1H18**	**+/- ppt**
EBITDA	34.5	29.0	*5.5*	32.6	*1.9*	33.6	24.3	*9.3*
EBIT	28.7	23.7	*5.0*	26.9	*1.8*	27.8	20.0	*7.8*
PBT	28.8	23.9	*5.0*	26.9	*1.9*	27.8	20.0	*7.8*
Core net profit	21.5	13.2	*8.4*	18.1	*3.4*	19.8	11.5	*8.3*
Net gearing (x)	**net cash**	**net cash**	**nm**	**net cash**	**nm**	**net cash**	**net cash**	**nm**
Segmental revenue (MYR'm)	**2Q19**	**2Q18**	**%YoY**	**1Q19**	**%QoQ**	**1H19**	**1H18**	**%YoY**
Taiwan	43.7	46.0	*(5.0)*	45.2	*(3.5)*	88.9	89.5	*(0.7)*
Singapore	16.9	15.4	*9.8*	16.3	*3.9*	33.2	27.4	*21.1*
Malaysia	15.1	15.6	*(3.1)*	18.0	*(15.9)*	33.2	27.0	*22.6*
Philippines	4.1	4.5	*(8.4)*	4.2	*(1.3)*	8.3	8.2	*2.0*
Indonesia	0.3	0.3	*9.7*	0.1	*143.8*	0.4	0.6	*(21.4)*
Segmental EBIT (MYR'm)	**2Q19**	**2Q18**	**%YoY**	**1Q19**	**%QoQ**	**1H19**	**1H18**	**%YoY**
Taiwan	13.0	11.6	*12.5*	12.4	*5.5*	25.4	22.1	*14.9*
Singapore	5.9	5.7	*3.2*	5.0	*18.5*	10.9	5.2	*109.2*
Malaysia	3.4	1.5	*119.1*	4.6	*(26.8)*	7.9	2.6	*209.4*
Philippines	0.7	0.8	*(9.4)*	0.7	*(1.5)*	1.5	1.4	*6.6*
Indonesia	(0.0)	(0.2)	*(92.9)*	(0.1)	*(84.8)*	(0.1)	(0.7)	*(81.7)*
Segmental EBIT margin (%)	**2Q19**	**2Q18**	**+/- ppt**	**1Q19**	**+/- ppt**	**1H19**	**1H18**	**+/- ppt**
Taiwan	29.9	25.2	*4.6*	27.3	*2.6*	28.6	24.7	*3.9*
Singapore	34.9	37.2	*(2.2)*	30.6	*4.3*	32.8	19.0	*13.8*
Malaysia	22.2	9.8	*12.4*	25.5	*(3.3)*	24.0	9.5	*14.5*
Philippines	17.7	17.9	*(0.2)*	17.7	*(0.0)*	17.7	16.9	*0.8*
Indonesia	nm	nm	*nm*	nm	*nm*	nm	nm	*nm*

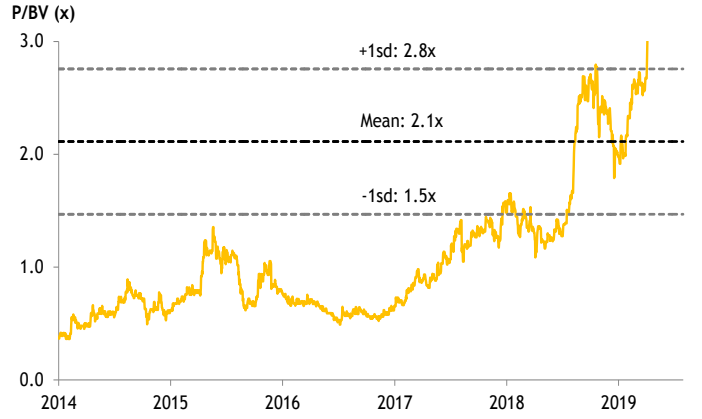
Source: Company data

Fig 2: 1-year forward PER



Source: Bloomberg, Company data, Maybank KE

Fig 3: 1-year forward PBV

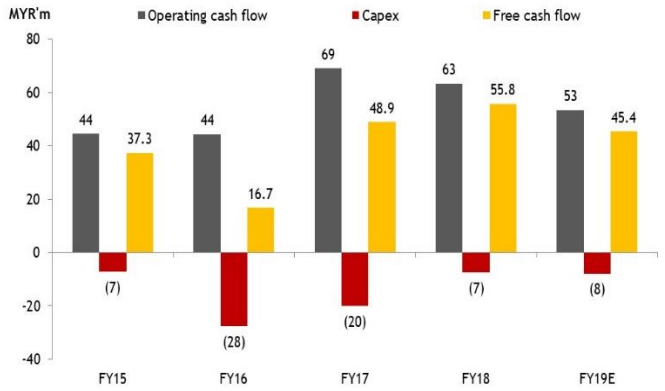


Source: Bloomberg, Company data, Maybank KE

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 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, and 19.8% in FY19E through wider profit margins.

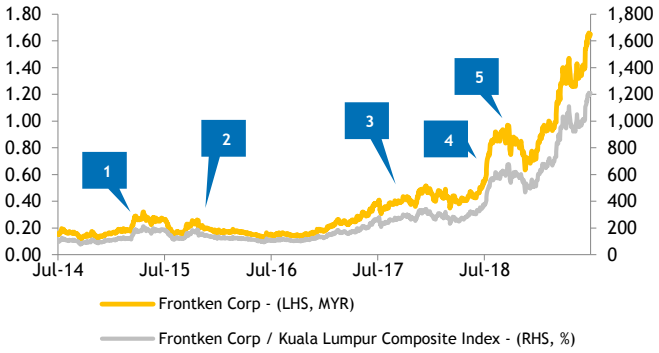
Sustainable FCF and OCF



Source: Company, Maybank KE

Price Drivers

Historical share price trend



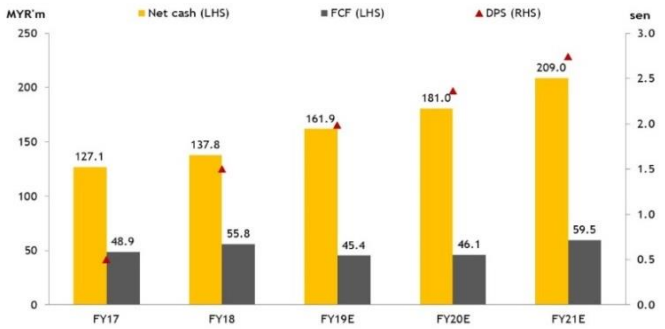
Source: Company, FactSet, Maybank Kim Eng

1. Achieved higher revenue from the 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 higher core net profit of 99% YoY for Frontken.
4. CEO of Frontken, Ng Wai Pin emerged as the largest shareholder after an indirect acquisition of 27.77% was made via Dazzle Clean Ltd in Aug 2018.
5. Negative sentiment on 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 equipment of advanced wafer fabrication process from 7nm and beyond.
- Net cash position (13sen/sh) in FY18 on low borrowings and strong cash flow.
- The Group paid a higher dividend in FY18 of 1.5sen vs. 0.5sen in FY17), 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 work orders from new advanced technological nodes.
- 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	24.9	20.9	18.1
Core P/E (x)	13.6	13.8	24.9	20.9	18.1
P/BV (x)	1.7	2.3	4.6	4.0	3.5
P/NTA (x)	1.7	2.3	5.4	4.6	4.0
Net dividend yield (%)	1.1	2.1	1.2	1.4	1.7
FCF yield (%)	10.1	7.6	2.6	2.7	3.4
EV/EBITDA (x)	6.3	6.7	13.5	11.6	9.9
EV/EBIT (x)	8.8	8.3	15.8	13.2	11.2
INCOME STATEMENT (MYR m)					
Revenue	296.6	327.2	390.3	441.2	483.1
Gross profit	104.8	126.6	160.1	182.5	205.8
EBITDA	64.8	92.5	117.4	136.2	156.5
Depreciation	(18.5)	(17.3)	(16.7)	(17.0)	(17.5)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	46.3	75.2	100.7	119.1	139.0
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	139.2
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	174.0	193.1	221.1
Accounts receivable	97.0	113.6	147.2	185.3	229.2
Inventory	13.5	13.7	14.3	18.5	23.1
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	150.0	140.4	127.5	118.5	109.0
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**	**500.5**	**552.8**	**619.9**
ST interest bearing debt	16.9	4.8	2.7	2.7	2.7
Accounts payable	79.6	81.6	76.9	65.7	58.7
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**	**103.0**	**91.8**	**84.8**
Shareholders Equity	281.6	325.0	373.6	431.4	498.5
Minority Interest	24.4	19.6	24.0	29.6	36.6
Total shareholder equity	**306.0**	**344.6**	**397.6**	**461.0**	**535.1**
Total liabilities and equity	**431.1**	**455.1**	**500.5**	**552.8**	**619.9**
CASH FLOW (MYR m)					
Pretax profit	46.1	75.6	100.8	119.3	139.2
Depreciation & amortisation	18.5	17.3	16.7	17.0	17.5
Adj net interest (income)/exp	0.1	(0.3)	(0.1)	(0.1)	(0.2)
Change in working capital	6.9	(15.9)	(38.9)	(53.5)	(55.6)
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	53.4	54.1	67.5
Capex	(20.2)	(7.5)	(8.0)	(8.0)	(8.0)
Free cash flow	48.9	55.8	45.4	46.1	59.5
Dividends paid	(7.2)	(10.0)	(22.7)	(27.2)	(31.7)
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	21.0	19.0	28.0

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	42.8	26.9	16.0	14.9
EBIT growth	36.8	62.4	33.9	18.3	16.7
Pretax growth	38.4	63.9	33.2	18.4	16.7
Reported net profit growth	49.0	75.0	32.7	19.3	15.8
Core net profit growth	98.8	50.0	29.9	19.3	15.8
Profitability ratios (%)					
EBITDA margin	21.8	28.3	30.1	30.9	32.4
EBIT margin	15.6	23.0	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	0.8
Assets/Equity (x)	1.5	1.4	1.3	1.3	1.2
ROAE (%)	11.0	17.2	19.8	20.5	20.6
ROAA (%)	8.5	12.0	14.5	15.7	16.3
Liquidity & Efficiency					
Cash conversion cycle	(0.3)	(4.4)	18.2	59.2	100.7
Days receivable outstanding	120.3	115.8	120.3	135.7	154.5
Days inventory outstanding	23.0	24.4	21.9	22.8	27.0
Days payables outstanding	143.5	144.6	123.9	99.2	80.8
Dividend cover (x)	5.7	3.3	3.3	3.3	3.3
Current ratio (x)	2.2	2.8	3.7	5.0	6.5
Leverage & Expense Analysis					
Asset/Liability (x)	3.4	4.1	4.9	6.0	7.3
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)	(163.2)	(182.2)	(210.2)

Source: Company; Maybank

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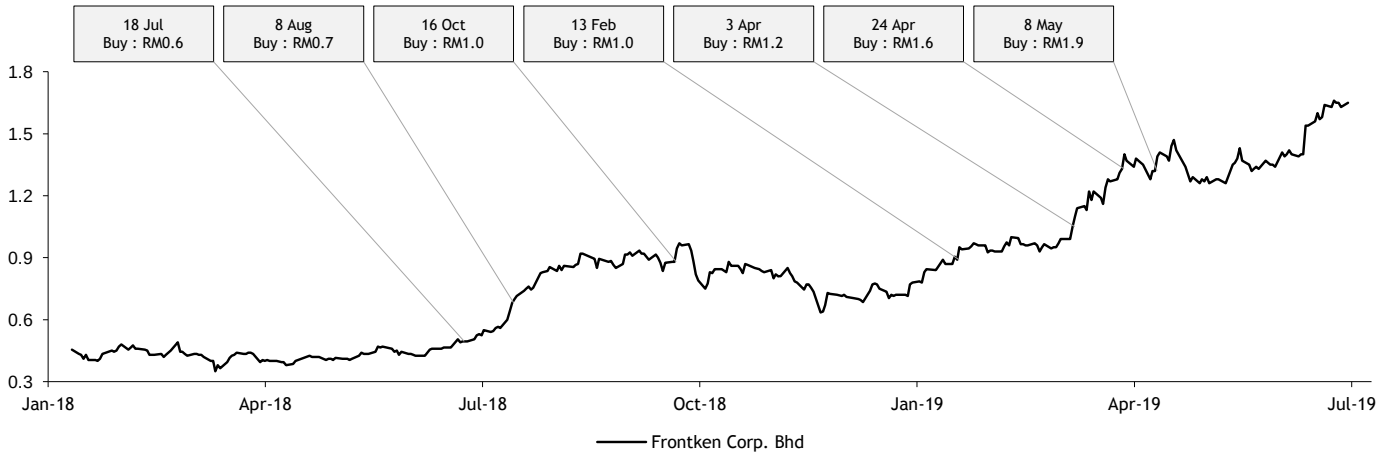

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