

HLIB Research

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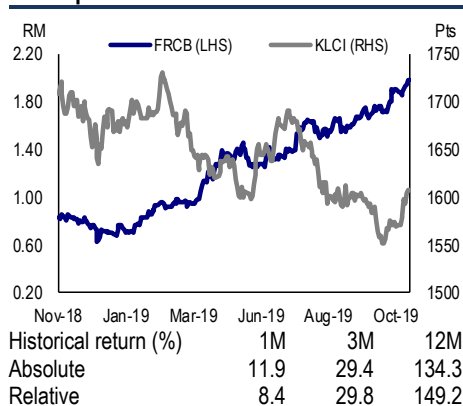
HOLD (from Buy)

Target Price: **RM1.94**
Previously: **RM1.77**
Current Price: **RM1.98**

Capital upside	-2.0%
Dividend yield	1.0%
Expected total return	-1.0%

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)	2,075
3-mth average volume ('000)	6,105
SC Shariah compliant	Yes

Major shareholders

Dazzle Clean	27.8%
Ooi Keng Thye	14.5%
CIMB Group Holdings Bhd	5.7%

Earnings summary

FYE (Dec)	FY18	FY19f	FY20f
PATMI – core (RM m)	54.4	71.7	82.4
EPS – core (sen)	5.2	6.8	7.8
P/E (x)	38.3	29.1	25.3

Frontken Corporation

Commendable 3Q19 showing

Frontken's 9M19 core net profit of RM51m (+45% YoY) matched expectations. Relentless focus on operational excellence has yielded strong bottom line growth outpacing top line expansion. Outlook for both business segments remain positive: semiconductor to be driven by 5G while O&G to leverage on Petronas appointment. We lifted our projections leading to higher TP of RM1.95. However, we downgrade to HOLD and believe that share price is fairly valued.

Within expectations. 3Q19 core net profit of RM18m (+4% QoQ, +20% YoY) brings 9M19's total to RM51m (+45% YoY), accounting for 73% and 75% of HLIB and consensus full year forecasts, respectively. 3Q19 one-off adjustment includes forex gain amounting to RM1m.

Dividend. None (3Q18: 0.7 sen per share). YTD distribution totalled 1 sen (9M18: 0.7 sen) per share.

QoQ. Turnover gained 9% attributable to higher contributions from Taiwan (+12%), Singapore (+12%) and Malaysia (+1%), offsetting the declines in Philippines and Indonesia (-8%). However, core net profit grew at a slower pace of 4% as core EBITDA margin (adjusted for one-offs) shrank 1.6ppt to 34%.

YoY. Top line's 1% increase was solely driven by Singapore's semiconductor seasonal strength (+19%) while Taiwan was flattish (dragged by TFT-LCD), more than sufficient to cushion the weakness in Malaysia (-3%), Philippines and Indonesia (-22%). However, core earnings jumped 20% to RM18m on the back of improved economies of scale and continuous operational excellence.

YTD. Revenue increased 5% to RM251m stimulated by Singapore (+20%) and Malaysia (+13%) offsetting slips in Taiwan (-1%), Philippines and Indonesia (-8%). However, core earnings strengthened 45% thanks to leaner operations and lower MI charge (due to higher AGTC holdings), despite higher D&A and effective tax rate (excluding withholding tax, 9M19: 24.5% vs. 9M18: 23.0%).

Semiconductor. Increased AGTC stake by 1.26% to 90.85% in Sept. Generated 77% of group revenue in 3Q19. Outlook remains positive leveraging on 5G proliferation driving robust electronic demand. One of its main customers indicated sequential improvement due to higher demand and new orders of its advanced high performance chips for 5G rollout. Frontken hopes that this will be translated into higher sales.

O&G. Accounted for the remaining 23% of group turnover in 3Q19 with sustainable profitability. It noticed that number of enquiries had picked up and have translated into orders since 2H19. It has been appointed as one of the panel contractors for the provision of manpower supply and also mechanical rotating equipment services and parts for Petronas which may lead to new income stream going forward.

Forecast. Tweaked revenue and EBITDA margin assumptions based both business prospects above. In turn, FY19-21 EPS are raised by 3%, 10% and 13%, respectively.

Our TP is higher at **RM1.94**, pegged to 25x of FY20 EPS but we downgrade to **HOLD**. Since our initiation (Aug 2018), its share price has rallied 230%. We still like Frontken for its 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) favourable O&G market; and (5) strong balance sheet (net cash of RM141m or 13.3 sen per share). However, we feel that the stock is fairly valued at current level.

Financial Forecast

All items in (RM m) unless otherwise stated

Income statement

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Revenue	296.6	327.2	340.0	376.8	404.7
COGS	(231.9)	(234.7)	(226.7)	(251.4)	(270.2)
EBITDA	64.7	92.6	113.2	125.4	134.5
D&A	(18.5)	(17.3)	(16.5)	(15.8)	(15.2)
EBIT	46.2	75.3	96.7	109.6	119.3
Net Interest Income	(0.1)	0.3	0.8	1.3	1.8
Associates	0.0	0.0	0.0	0.0	0.0
PBT	46.1	75.6	97.5	110.9	121.1
Tax	(9.7)	(18.6)	(20.6)	(23.4)	(25.6)
Net Profit	36.4	57.0	76.9	87.5	95.6
MI	(6.6)	(4.7)	(5.3)	(5.1)	(5.3)
PATAMI	29.9	52.3	71.7	82.4	90.2
Exceptionals	4.4	2.2	0.0	0.0	0.0
Adj PATAMI	34.3	54.4	71.7	82.4	90.2
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	6.8	7.8	8.6
Adj EPS (sen)	3.3	5.2	6.8	7.8	8.6
Adj FD EPS (sen)	3.3	5.2	6.8	7.8	8.6

Balance sheet

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Cash	119.3	133.0	189.5	253.3	323.3
Receivables	91.7	106.8	111.8	123.9	133.0
Inventories	13.5	13.7	12.4	13.8	14.8
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	508.7	580.1	655.2
Payables	79.8	82.4	80.8	89.5	96.2
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	108.7	117.5	124.2
Shareholders' Funds	281.6	325.0	375.1	432.7	495.7
MI	24.4	19.6	24.9	29.9	35.3
Total S/H Equity	306.0	344.6	400.0	462.6	531.0
Ttl Liab&S/H Funds	431.1	455.1	508.7	580.1	655.2

Cashflow Analysis

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
EBITDA	64.7	92.6	113.2	125.4	134.5
Tax Paid	(7.9)	(14.2)	(20.6)	(23.4)	(25.6)
WC Changes	6.9	(14.6)	(5.3)	(4.7)	(3.5)
Other	5.3	(0.4)	0.8	1.3	1.8
CFO	69.0	63.3	88.1	98.6	107.2
FCF	48.9	55.8	78.1	88.6	97.2
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)	(21.6)	(24.8)	(27.2)
Debt changes	0.0	(16.7)	0.0	0.0	0.0
Other	(3.2)	(1.1)	0.0	0.0	0.0
CCF	(8.4)	(27.8)	(21.6)	(24.8)	(27.2)
Net Cashflow	28.6	28.4	56.5	63.8	70.0

Quarterly financial summary

FYE Dec	3Q18	4Q18	1Q19	2Q19	3Q19
Revenue	85.9	88.7	83.8	80.1	87.0
COGS	(61.2)	(60.2)	(56.5)	(52.5)	(56.4)
EBITDA	24.7	28.5	27.4	27.7	30.6
D&A	(4.2)	(4.3)	(4.8)	(4.6)	(4.6)
EBIT	20.5	24.2	22.6	23.0	26.0
Net Interest Income	0.2	0.2	(0.0)	0.1	0.1
Associates	0.0	0.0	0.0	0.0	0.0
PBT	20.6	24.4	22.5	23.1	26.1
Tax	(4.1)	(4.4)	(6.2)	(5.3)	(5.6)
Net Profit	16.5	20.0	16.3	17.8	20.5
MI	(1.3)	(1.3)	(0.9)	(1.3)	(1.4)
PATAMI	15.2	18.7	15.4	16.5	19.0
Exceptionals	(0.2)	0.9	(0.0)	0.8	(1.0)
Adj PATAMI	15.0	19.6	15.4	17.3	18.0
Basic Shares (m)	1,053.0	1,053.0	1,053.0	1,053.0	1,053.0
Rep EPS (sen)	1.4	1.8	1.5	1.6	1.8
Adj EPS (sen)	1.4	1.9	1.5	1.6	1.7
Adj FD EPS (sen)	1.4	1.9	1.5	1.6	1.7

Valuation Ratios

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
PER (x)	69.8	39.9	29.1	25.3	23.1
Core PER (x)	60.9	38.3	29.1	25.3	23.1
FD PER (x)	60.9	38.3	29.1	25.3	23.1
DPS (sen)	0.5	1.5	2.1	2.4	2.6
Net DY (%)	0.3	0.8	1.0	1.2	1.3
Book/share (sen)	26.7	30.9	35.6	41.1	47.1
P/Book (x)	7.4	6.4	5.6	4.8	4.2
FCF/share (sen)	4.6	5.3	7.4	8.4	9.2
FCF yield (%)	2.3	2.7	3.7	4.2	4.7
Mkt Cap	2,084.9	2,084.9	2,084.9	2,084.9	2,084.9
Net Cash(Debt)	85.8	121.5	178.1	241.8	311.9
EV	1,999.1	1,963.4	1,906.9	1,843.1	1,773.1
EV/EBITDA (x)	30.9	21.2	16.8	14.7	13.2
ROE (%)	12.2	16.7	19.1	19.0	18.2
Current Ratio (x)	2.2	2.9	3.7	4.2	4.7
Quick Ratio (x)	2.1	2.8	3.6	4.0	4.6
Interest Cover (x)	49.7	132.5	281.6	319.2	347.4

Other Ratios

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Sales Growth (%)		10.3	3.9	10.8	7.4
EBITDA Growth (%)		43.1	22.3	10.8	7.2
EBIT Growth (%)		62.8	28.5	13.3	8.8
PBT Growth (%)		63.9	28.9	13.7	9.2
Net Profit Growth (%)		56.6	35.0	13.7	9.2
EBITDA Margin (%)	21.8	28.3	33.3	33.3	33.2
EBIT Margin (%)	15.6	23.0	28.5	29.1	29.5
PBT Margin (%)	15.6	23.1	28.7	29.4	29.9
Net Profit Margin (%)	12.3	17.4	22.6	23.2	23.6
Net Debt/Equity (%)	N Cash	N Cash	N Cash	N Cash	N Cash
CAPEX/Sales (%)	6.8	2.3	2.9	2.7	2.5

Figure #1 **Quarterly results comparison**

FYE Dec (RM m)	3Q18	2Q19	3Q19	QoQ	YoY	9M18	9M19	YoY
Revenue	85.9	80.1	87.0	8.6	1.4	238.6	251.0	5.2
EBITDA	24.7	27.7	30.6	10.8	24.0	64.1	85.6	33.6
EBITDA Margin	28.8	34.5	35.2			26.9	34.1	
EBIT	20.5	23.0	26.0	13.1	27.0	51.1	71.6	40.2
PBT	20.6	23.1	26.1	13.1	26.5	51.2	71.8	40.2
PAT	16.5	17.8	20.5	14.9	23.9	37.0	54.6	47.7
Reported PATMI	15.2	16.5	19.0	15.3	25.4	33.6	51.0	51.8
Core PATMI	15.0	17.3	18.0	4.1	20.3	34.9	50.7	45.4
Reported EPS (sen)	1.4	1.6	1.8	15.3	25.4	3.2	4.8	51.8
Core EPS (sen)	1.4	1.6	1.7	4.1	20.3	3.3	4.8	45.4

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BUY	Expected absolute return of +10% or more over the next 12 months.
HOLD	Expected absolute return of -10% to +10% 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.
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NEUTRAL	Sector expected to perform in-line with the market over the next 12 months.
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