

Frontken Corp

2Q21 earnings in-line; expect sequentially stronger earnings amid semis tightness. Stay OW

FRCB core PATMI grew 25% Y/Y and 14% Q/Q to RM25.4mn in 2Q21 with 1H21 PATMI hitting RM46.5mn, representing 45/43% of JPM/street estimates. As 2H is seasonally stronger, we view the result to be within expectations. We expect FRCB to report sequentially stronger earnings amid the semis upcycle, evidenced by recent commentaries by TSMC, UMC and Intel. Stay OW with PT RM3.80.

- **2Q21 revenue grew 24% Y/Y and 5% Q/Q.** FRCB registered sales of RM109mn in 2Q21 (2Q20: RM87.6mn, 1Q21: RM104mn), attributable to greater volume loading especially in its Taiwan plant, where revenue has grown 27% Y/Y. Specifically, FRCB saw higher demand and strong orders from one of its semiconductor customers in advanced node chips.
- **Expansion plans on track.** FRCB is in the process of setting up a new 118k sqft plant in Taiwan which will potentially double its existing capacity. The plant is expected to be operational by 2H22, in tandem with its key customers' proposed commercial production of 3nm chips.
- **Semi supply tightness unlikely to ease before 2023; Positive for FRCB's volume.** We believe the semi upcycle should continue into 2022 as UMC's (covered by Gokul Hariharan) recent [2Q21 result](#) suggested strong demand visibility into end-2022. This serves as a read-through to FRCB, as fab's higher utilization rate will mean higher volume loading for FRCB.
- **Aligned with our bullish view on key customer TSMC.** We remain positive on FRCB's key customer TSMC (covered by Gokul Hariharan) on [strong evidence](#) of an accelerated product roadmap, fast-growing customer base in High Performance Computing (HPC) and continued track record of market share gains. We expect TSMC to grow overall revenues at a ~15% CAGR in the next few years, at the high-end of its 10-15% CAGR guidance for 2020-25. As we pointed out on pg.41 of our [initiation report](#), FRCB's revenue growth has a high correlation with TSMC's.
- **Reiterate OW as FRCB is a strong proxy for the semis upcycle.** Its foundry customers' robust revenue outlook is positive for FRCB. Moreover, semis supply is likely to remain tight as we enter 2022. Stay OW with a PT of RM3.80.

Overweight

FRNK.KL, FRCB MK

Price (29 Jul 21): RM3.29

Price Target (Jun-22): RM3.80

Malaysia

Semiconductor Equipment

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Style Exposure

Quant Factors	Current %Rank	Hist %Rank (1=Top)			
		6M	1Y	3Y	5Y
Value	83	81	87	39	11
Growth	15	6	6	15	100
Momentum	9	23	13	4	97
Quality	30	13	9	97	92
Low Vol	85	88	90	95	100

Sources for: Style Exposure – J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

See page 6 for analyst certification and important disclosures, including non-US analyst disclosures.

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Price Performance



Company Data

Shares O/S (mn)	1,572
52-week range (RM)	3.97-2.03
Market cap (\$ mn)	1,221
Exchange rate	4.23
Free float(%)	57.4%
3M - Avg daily vol (mn)	6.43
3M - Avg daily val (\$ mn)	4.6
Volatility (90 Day)	40
Index	FBMKLCI - FTSE BURSA MALAYSIA KLCI
BBG BUY HOLD SELL	4 0 0

Key Metrics (FYE Dec)

RM in millions	FY20A	FY21E	FY22E	FY23E
Financial Estimates				
Revenue	368	457	537	649
Adj. EBITDA	132	166	200	249
Adj. EBIT	114	146	180	228
Adj. net income	83	107	131	167
Adj. EPS	0.08	0.07	0.08	0.11
BBG EPS	0.05	0.07	0.08	0.10
Cashflow from operations	120	119	139	168
FCFF	114	53	102	131
Margins and Growth				
Revenue growth	8.4%	24.1%	17.4%	21.0%
EBITDA margin	35.9%	36.3%	37.3%	38.3%
EBITDA growth	16.4%	25.4%	20.6%	24.4%
EBIT margin	30.9%	32.0%	33.5%	35.1%
Net margin	22.5%	23.4%	24.5%	25.7%
Adj. EPS growth	18.9%	(14.0%)	22.9%	26.9%
Ratios				
Adj. tax rate	22.7%	22.7%	22.7%	22.7%
Interest cover	NM	NM	NM	NM
Net debt/Equity	NM	NM	NM	NM
Net debt/EBITDA	NM	NM	NM	NM
ROCE	21.5%	23.8%	25.2%	27.1%
ROE	20.3%	22.5%	23.7%	25.6%
Valuation				
FCFF yield	3.3%	1.0%	2.0%	2.5%
Dividend yield	0.8%	0.7%	0.9%	1.1%
EV/Revenue	12.0	9.6	8.1	6.6
EV/EBITDA	33.4	26.6	21.8	17.3
Adj. P/E	41.6	48.4	39.4	31.0

Summary Investment Thesis and Valuation

A market leader in providing precision cleaning services in the region, particularly in the semiconductor industry with TSMC making up c.36% of FRCB's FY20 revenue. Investors can gain indirect exposure to front-end semi manufacturing without the associated high capex outlay (9% vs Foundries' average of 22%), in our view.

Valuation

Our Jun-22 PT of RM3.80 is derived by pegging the target P/E of 45x to FY22E EPS. We believe the premium multiple is justifiable for the following reasons: (1) FRCB is the only stock in Bursa Malaysia that has a sizable exposure to the front-end semiconductor space (85% of FY20 revenue) as the rest are more back-end related. We compared the largest front-end player and back-end player in semis manufacturing (TSMC and ASE), and noticed a valuation gap in favor of TSMC (front-end). Therefore, we apply the same logic and conclude that FRCB should trade at a premium to its back-end peers in Malaysia, e.g. Unisem. (2) Greater earnings certainty due to its volume-driven business with anchor customer TSMC, the world's largest foundry.

Performance Drivers

Market	7%
Region	6%
Macro	15%
Style	4%
Idiosyn.	66%

Factors	6M Corr	1Y Corr
Market: MSCI Asia Pac ex JP	0.09	0.24
Region: Malaysia	0.22	0.28
Macro:		
JPM China A-shares Sentiment	0.01	0.27
Citi Economic Surprise - EM	-0.26	-0.24
JPM EM Currency(EMCI) Fixing	-0.32	-0.19
Quant Styles:		
Size	-0.18	-0.16
LowVol	0.23	0.08
Growth	-0.16	0.06

Table 1: 2Q21 result summary

Rm mm	2Q21	2Q20	YoY	1Q21	QoQ	1H21	1H20	YoY
Revenue	108,625	87,620	24%	103,517	5%	212,142	172,491	23%
Operating Profit	34,469	27,801	24%	34,976	-1%	69,445	52,183	33%
EBITDA	38,233	30,680	25%	37,381	2%	75,614	57,443	32%
PBT	34,536	27,918	24%	35,056	-1%	69,592	52,641	32%
PATMI	24,738	20,329	22%	22,914	8%	47,653	37,336	28%
Core PATMI	25,404	20,278	25%	22,241	14%	47,646	36,614	30%
Margin			Chg in ppt		Chg in ppt			Chg in ppt
Gross profit	31.7%	31.7%	+0.0ppt	33.8%	-2.1ppt	32.7%	30.3%	+2.5ppt
EBITDA	35.2%	35.0%	+0.2ppt	36.1%	-0.9ppt	35.6%	33.3%	+2.3ppt
PBT	31.8%	31.9%	-0.1ppt	33.9%	-2.1ppt	32.8%	30.5%	+2.3ppt
PATMI	23.4%	23.1%	+0.2ppt	21.5%	+1.9ppt	22.5%	21.2%	+1.2ppt

Source: Company data.

Investment Thesis, Valuation and Risks

Frontken Corp (*Overweight; Price Target: RM3.80*)

Investment Thesis

FRCB is a market leader in providing precision cleaning services in the region, particularly in the semiconductor industry, with TSMC making up c.36% of FRCB's FY20 revenue. Investors can gain indirect exposure to front-end semi manufacturing without the associated high capex outlay (9% vs Foundries' average of 22%), in our view.

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Risks to Rating and Price Target

Key risks include 1) Semi inventory correction in 2022. 2) Customer concentration risk as TSMC makes up c.36% of revenue. 3) TSMC's share loss to Samsung given zero exposure to the latter.

Frontken Corp: Summary of Financials

Income Statement						Cash Flow Statement					
	FY19A	FY20A	FY21E	FY22E	FY23E		FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	340	368	457	537	649	Cash flow from operating activities	115	120	119	139	168
COGS	(192)	(203)	(246)	(279)	(327)	o/w Depreciation & amortization	18	18	19	20	21
Gross profit	148	165	212	257	322	o/w Changes in working capital	21	11	(13)	(20)	(29)
SG&A	(26)	(32)	(49)	(60)	(76)	Cash flow from investing activities	(12)	(12)	(65)	(34)	(34)
Adj. EBITDA	114	132	166	200	249	o/w Capital expenditure	(7)	(8)	(65)	(35)	(35)
D&A	(18)	(18)	(19)	(20)	(21)	as % of sales	2.1%	2.1%	14.2%	6.5%	5.4%
Adj. EBIT	96	114	146	180	228	Cash flow from financing activities	(34)	(34)	(37)	(45)	(58)
Net Interest	0	1	1	2	2	o/w Dividends paid	(20)	(29)	(37)	(45)	(58)
Adj. PBT	96	114	148	181	230	o/w Shares issued/(repurchased)	0	0	0	0	0
Tax	(22)	(26)	(34)	(41)	(52)	o/w Net debt issued/(repaid)	(11)	(1)	0	0	0
Minority Interest	(5)	(6)	(7)	(9)	(11)	Net change in cash	71	80	18	59	76
Adj. Net Income	70	83	107	131	167	Adj. Free cash flow to firm	108	114	53	102	131
Reported EPS	0.07	0.08	0.07	0.08	0.11	y/y Growth	89.9%	5.5%	(53.1%)	92.1%	28.4%
Adj. EPS	0.07	0.08	0.07	0.08	0.11						
DPS	0.02	0.03	0.02	0.03	0.04						
Payout ratio	27.1%	34.2%	34.5%	34.5%	34.5%						
Shares outstanding	1,048	1,048	1,572	1,572	1,572						
Balance Sheet						Ratio Analysis					
	FY19A	FY20A	FY21E	FY22E	FY23E		FY19A	FY20A	FY21E	FY22E	FY23E
Cash and cash equivalents	197	290	308	367	443	Gross margin	43.6%	44.9%	46.3%	47.9%	49.6%
Accounts receivable	86	103	118	138	167	EBITDA margin	33.4%	35.9%	36.3%	37.3%	38.3%
Inventories	15	20	21	24	28	EBIT margin	28.2%	30.9%	32.0%	33.5%	35.1%
Other current assets	109	131	146	170	203	Net profit margin	20.5%	22.5%	23.4%	24.5%	25.7%
Current assets	334	443	477	559	668	ROE	19.8%	20.3%	22.5%	23.7%	25.6%
PP&E	126	122	171	189	207	ROA	14.3%	14.6%	16.2%	17.6%	19.4%
LT investments	-	-	-	-	-	ROCE	20.7%	21.5%	23.8%	25.2%	27.1%
Other non current assets	56	54	51	49	46	SG&A/Sales	7.7%	8.7%	10.7%	11.2%	11.8%
Total assets	516	618	698	796	921	Net debt/Equity	NM	NM	NM	NM	NM
Short term borrowings	1	0	0	0	0	Net debt/EBITDA	NM	NM	NM	NM	NM
Payables	17	19	22	25	29	Sales/Assets (x)	0.7	0.6	0.7	0.7	0.8
Other short term liabilities	84	120	120	120	120	Assets/Equity (x)	1.4	1.4	1.4	1.4	1.3
Current liabilities	102	138	141	144	148	Interest cover (x)	NM	NM	NM	NM	NM
Long-term debt	0	0	0	0	0	Operating leverage	669.0%	224.8%	118.4%	132.0%	127.5%
Other long term liabilities	15	13	13	13	13	Tax rate	22.9%	22.7%	22.7%	22.7%	22.7%
Total liabilities	117	151	154	157	161	Revenue y/y Growth	3.9%	8.4%	24.1%	17.4%	21.0%
Shareholders' equity	377	440	510	596	705	EBITDA y/y Growth	21.7%	16.4%	25.4%	20.6%	24.4%
Minority interests	22	27	35	44	55	EPS y/y Growth	34.5%	18.9%	(14.0%)	22.9%	26.9%
Total liabilities & equity	516	618	698	796	921						
BVPS	0.36	0.42	0.32	0.38	0.45	Valuation					
y/y Growth	16.0%	16.7%	(22.7%)	16.9%	18.3%		FY19A	FY20A	FY21E	FY22E	FY23E
Net debt/(cash)	(196)	(290)	(308)	(367)	(443)	P/E (x)	49.5	41.6	48.4	39.4	31.0
						P/BV (x)	9.1	7.8	10.1	8.7	7.3
						EV/EBITDA (x)	39.7	33.4	26.6	21.8	17.3
						Dividend Yield	0.5%	0.8%	0.7%	0.9%	1.1%

Source: Company reports and J.P. Morgan estimates.

Note: RM in millions (except per-share data). Fiscal year ends Dec. o/w - out of which

Other Companies Discussed in This Report (all prices in this report as of market close on 29 July 2021)
TSMC(2330.TW/NT\$583.0/OW)

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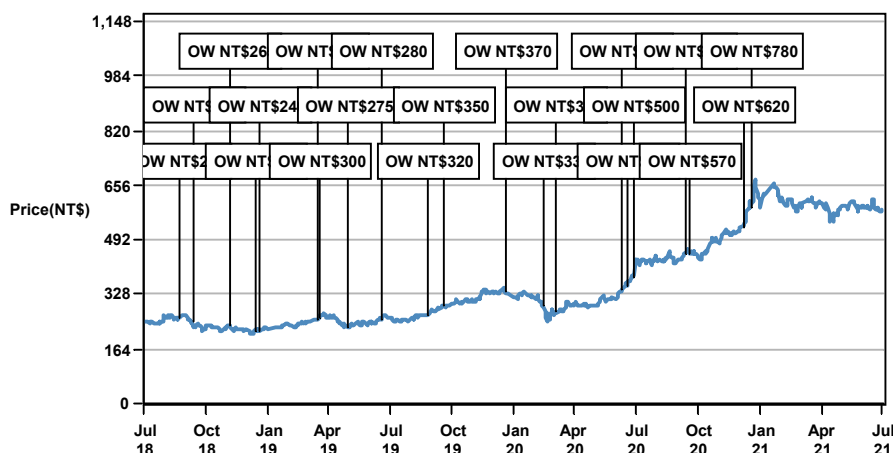
Frontken Corp (FRNK.KL, FRCB MK) Price Chart



Source: Bloomberg Finance L.P. and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Jun 21, 2021. All share prices are as of market close on the previous business day.

Date	Rating	Price (RM)	Price Target (RM)
22-Jun-21	OW	2.92	3.8

TSMC (2330.TW, 2330 TT) Price Chart



Source: Bloomberg Finance L.P. and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Apr 28, 2002. All share prices are as of market close on the previous business day.

Date	Rating	Price (NT\$)	Price Target (NT\$)
20-Sep-18	OW	258.0	290
11-Oct-18	OW	244.0	285
05-Dec-18	OW	234.0	265
11-Jan-19	OW	216.0	245
17-Jan-19	OW	217.5	240
15-Apr-19	OW	252.0	280
18-Apr-19	OW	261.5	300
28-May-19	OW	231.0	275
18-Jul-19	OW	252.0	280
25-Sep-19	OW	265.0	320
18-Oct-19	OW	293.5	350
17-Jan-20	OW	334.5	370
13-Mar-20	OW	294.0	335
01-Apr-20	OW	274.0	325
09-Jul-20	OW	341.0	355
17-Jul-20	OW	357.5	375
24-Jul-20	OW	381.5	500
11-Oct-20	OW	453.0	550
16-Oct-20	OW	453.0	570
04-Jan-21	OW	530.0	620
15-Jan-21	OW	592.0	780

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

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