July 18, 2019

Maybank IB Research

Frontken Corp. Bhd (FRCB MK)

Increasing demand for its services

BUY

Share Price	MYR 1.58
12m Price Target	MYR 1.85 (+17%)
Previous Price Target	*MYR 1.85*

Still in a secular uptrend. Maintain BUY

We see good works visibility into 2H19 and FY20 due to: (i) the acceleration in 5G wireless network deployment and AI applications; (ii) increasing adoption of Customer X's 7nm by high performance computing applications; and (iii) the ramp-up in local O&G activities. We make no changes to our estimates and our TP of MYR1.85. Our valuation is based on an unchanged FY20 PER of 23.5x (+1.5std above its 5-year mean to reflect strong EPS growth outlook). Maintain BUY.

Expect another stronger core net profit in 2Q19

2Q19 results are expected to be announced by end of this month or early August. We expect core net profit to be stronger YoY/QoQ at MYR16m-19m (vs. 1Q19: MYR16.1m and 2Q18: MYR10.8m) with 1H19 core net profit making up 47%-49% of our FY19 estimate of MYR69.3m.

Twin growth engine continues

We believe the revenue contribution from its semiconductor segment could still increase YoY in 2Q19 despite weak general semiconductor demand amid trade tensions. The growth would be propelled by: (i) strong orders for cleaning Customer X's 7nm due to improving foundry utilisation; (ii) more orders from Customer L, possibly because of the production of newly launched 10nm processors; and (iii) sustained work orders from its memory customer. We also view that the growth could continue to come from refurbishment works for its Customer F's new O&G equipment and more repair and maintenance for its O&G customers in East Malaysia.

No changes to our earnings estimates

We leave our estimates unchanged as we have already factored in the above factors. We expect Frontken's work orders in 2H19 to remain resilient. We understand its Customer X's 7nm has already been fully booked, and 7nm+ is in production, which is to be used in AMD's third-gen Ryzen processor, Huawei's Kirin 985 and Apple's A13 chipsets. We also see better works visibility from its memory customer in view of increasing demand for 3D NAND memory chips due to 5G wireless network and AI applications.

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	23.9	20.0	17.3
P/BV (x)	1.7	2.3	4.4	3.8	3.3
Net dividend yield (%)	1.1	2.1	1.3	1.5	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	12.9	11.0	9.5
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.

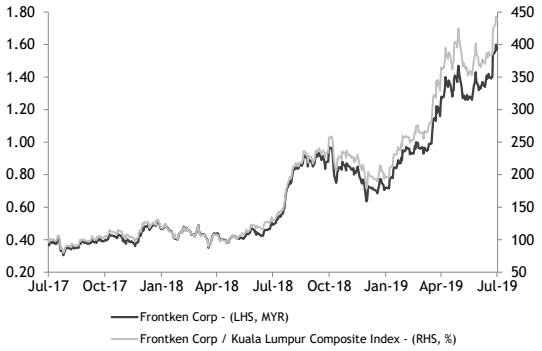
Statistics

52w high/low (MYR)	1.60/0.50
3m avg turnover (USDm)	3.0
Free float (%)	47.6
Issued shares (m)	1,053
Market capitalisation	MYR1.7B
	USD405M

Major shareholders:

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

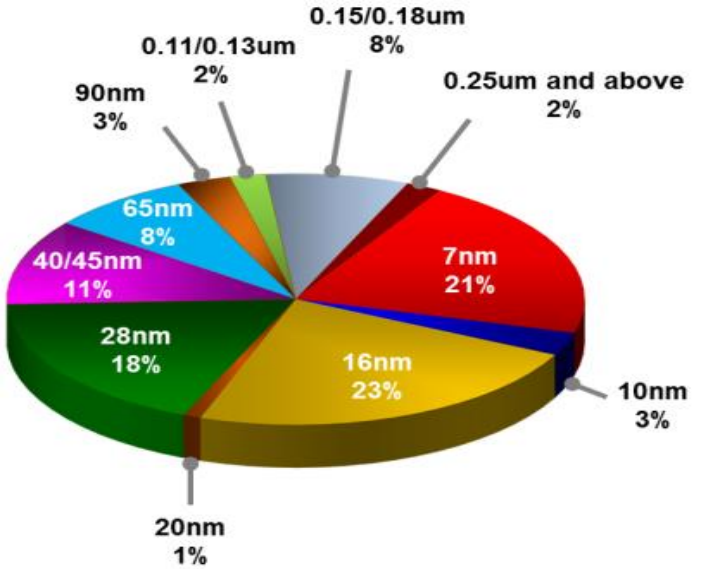
Price Performance



	-1M	-3M	-12M
Absolute (%)	20	23	219
Relative to index (%)	19	21	238

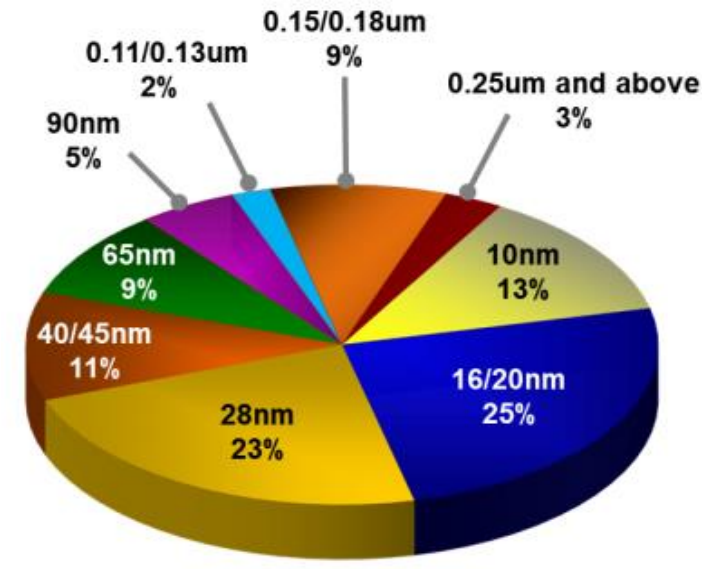
Source: FactSet

Fig 1: Customer X's 2Q19 revenue by technology



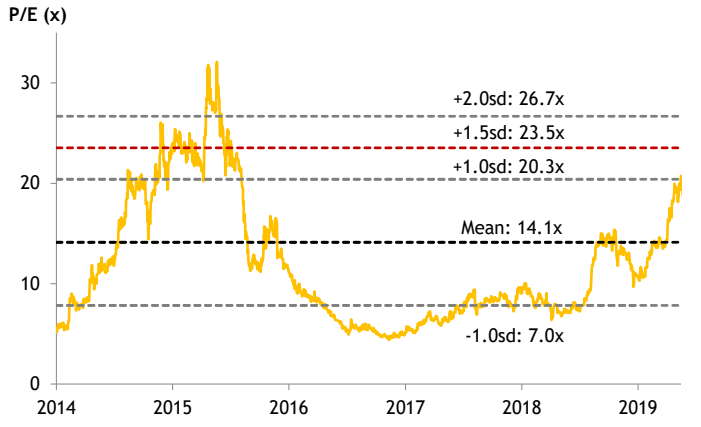
Source: Customer X's website

Fig 2: Customer X's 2Q18 revenue by technology



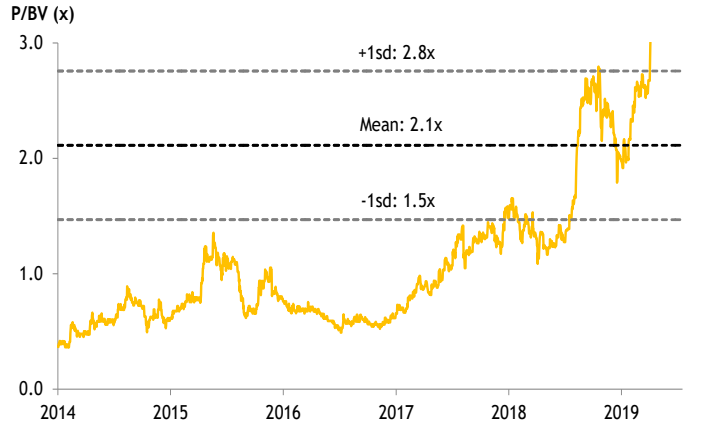
Source: Customer X's website

Fig 3: 1-year forward PER



Source: Bloomberg, Company data, Maybank Kim Eng

Fig 4: 1-year forward PBV

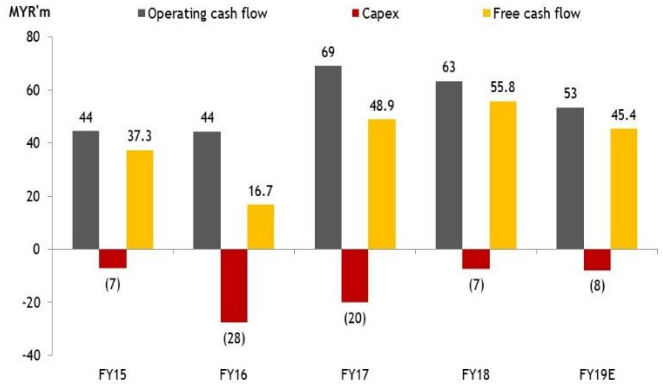


Source: Bloomberg, Company data, Maybank Kim Eng

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, through better profit margins.

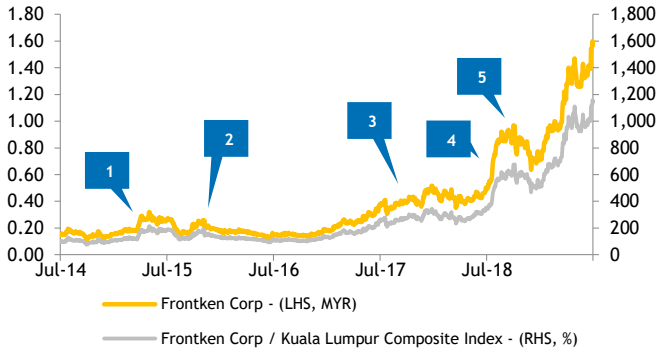
Sustainable FCF and OCF



Source: Company, Maybank KE

Price Drivers

Historical share price trend



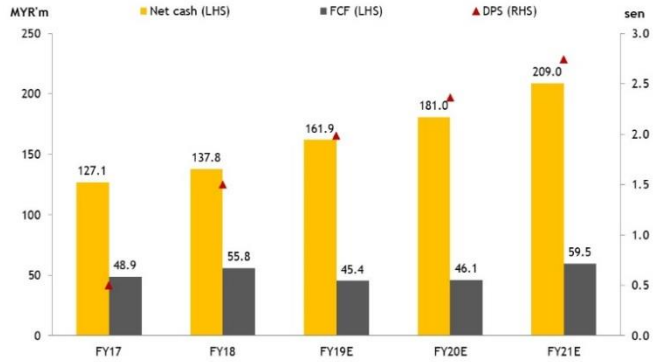
Source: Company, FactSet, Maybank Kim Eng

1. Achieved higher revenue 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	23.9	20.0	17.3
Core P/E (x)	13.6	13.8	23.9	20.0	17.3
P/BV (x)	1.7	2.3	4.4	3.8	3.3
P/NTA (x)	1.7	2.3	5.2	4.4	3.8
Net dividend yield (%)	1.1	2.1	1.3	1.5	1.7
FCF yield (%)	10.1	7.6	2.7	2.8	3.6
EV/EBITDA (x)	6.3	6.7	12.9	11.0	9.5
EV/EBIT (x)	8.8	8.3	15.1	12.6	10.7
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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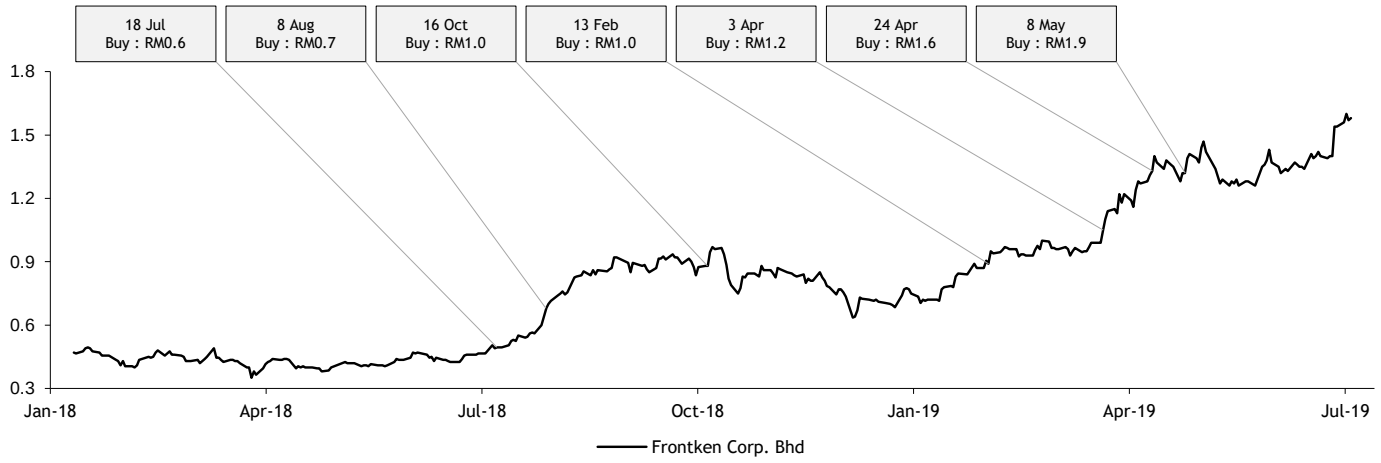

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