

**HLIB Research**

PP 9484/12/2012 (031413)

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**BUY** (Maintain)

**Target Price:** **RM1.77**
**Previously:** **RM1.67**
**Current Price:** **RM1.56**

Capital upside	13.5%
Dividend yield	1.3%
Expected total return	14.8%

**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)	1,635
3-mth average volume ('000)	8,865
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	FY19i	FY20f
PATMI – core (RM m)	54.4	69.6	74.6
EPS – core (sen)	5.2	6.6	7.1
P/E (x)	30.2	23.6	22.0

# Frontken Corporation

## A solid quarter but better ones ahead

Frontken 1H19 core net profit of RM33m (+64% YoY) beat expectations as 2H19 is usually stronger. Declared first interim dividend of 1 sen per share. Despite the weaker QoQ and YoY top line, bottom line appeared to be stronger on the back of enhanced efficiency. Semiconductor sector may experience a strong recovery in 2H19. Similarly for O&G as some 2Q19 billings are carried over into 3Q19. Our upward forecast revisions have led to higher TP of RM1.77, pegged to 25x of FY20 EPS. Maintain BUY.

**Beat expectations.** 2Q19 core net profit of RM17m (+12% QoQ, +35% YoY) brings 1H19's total to RM33m (+64% YoY), accounting for 50% and 49% of HLIB and consensus full year forecasts, respectively. This is considered an outperformance as historically 1H only accounts for 37-40% of full year earnings. One-off adjustments include forex loss and withholding tax.

**Dividend.** Declared a first interim single tier dividend of 1 sen (2Q18: none) per share whereby entitlement and payment dates will be announced at a later date.

**QoQ.** Turnover moderated 4% attributable to lower contributions from Taiwan (-4%), Malaysia (-16%) and Philippines (-1%), offsetting the growth in Singapore (+4%). Nonetheless, core net profit gained 12% thanks to operational excellence, lower D&A and effective tax rate (2Q19 excluding withholding tax: 20% vs. 1Q19: 27%).

**YoY.** Top line's 2% decline was attributable to the similar weaknesses mentioned above with moderations registered in Taiwan (-5%), Malaysia (-3%) and Philippines (-8%) while partly mitigated by Singapore's growth (+10%). With better economies of scale and continuous operational excellence, core net profit jumped 35% to RM17m.

**YTD.** Revenue increased 7% to RM164m stimulated by Singapore (+21%), Malaysia (+23%) and Philippines (+2%), more than sufficient to equalize Taiwan's minor slip (-1%). However, core earnings strengthened 64% on the back of leaner operations and lower effective tax rate (excluding withholding tax, 1H19: 24% vs. 1H18: 25%), despite higher D&A

**Semiconductor.** Generated 78% of group revenue in 2Q19. One of its customers seems to indicate that the worst may be over and 2H orders likely to ramp significantly. The customer further added that this is mainly driven by demand from high-performance computing (HPC) and communication (5G) segments.

**O&G.** Accounted for the remaining 22% of group turnover in 2Q19 with sustainable profitability. We understand that O&G contribution could have been higher if not due to timing issue and some billings were carried forward into 3Q19. It also noticed that number of enquiries had picked up with high conversion rate into sales. We believe the growth story remains intact and this performance is sustainable going forward considering Brent crude price remains stable at current levels.

**Forecast.** Tweaked both semiconductor and O&G EBITDA margin assumptions. In turn, FY19-21 EPS are revised upward by 5-6%.

Reiterate **BUY** with a higher fair value of **RM1.77** from RM1.67, reflecting the earnings revision. Our TP is pegged to 25x of FY20 EPS. We expect Frontken to experience 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 RM151m or 14.3 sen per share).

## Financial Forecast

All items in (RM m) unless otherwise stated

### Income statement

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Revenue	296.6	327.2	358.2	376.1	394.9
COGS	(231.9)	(234.7)	(247.1)	(259.5)	(272.5)
EBITDA	64.7	92.6	111.0	116.6	122.4
D&A	(18.5)	(17.3)	(16.5)	(15.8)	(15.2)
EBIT	46.2	75.3	94.5	100.8	107.3
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	95.3	102.1	109.1
Tax	(9.7)	(18.6)	(20.1)	(21.5)	(23.0)
Net Profit	36.4	57.0	75.2	80.5	86.0
MI	(6.6)	(4.7)	(5.6)	(5.9)	(6.2)
PATAMI	29.9	52.3	69.6	74.6	79.9
Exceptionals	4.4	2.2	0.0	0.0	0.0
Adj PATAMI	34.3	54.4	69.6	74.6	79.9
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	6.6	7.1	7.6
Adj EPS (sen)	3.3	5.2	6.6	7.1	7.6
Adj FD EPS (sen)	3.3	5.2	6.6	7.1	7.6

### Balance sheet

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Cash	119.3	133.0	188.6	250.2	315.1
Receivables	91.7	106.8	117.8	123.6	129.8
Inventories	13.5	13.7	13.5	14.2	14.9
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
<b>Total Assets</b>	<b>431.1</b>	<b>455.1</b>	<b>514.9</b>	<b>577.3</b>	<b>643.9</b>
Payables	79.8	82.4	88.0	92.4	97.0
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
<b>Total liabilities</b>	<b>125.1</b>	<b>110.4</b>	<b>116.0</b>	<b>120.4</b>	<b>125.0</b>
Shareholders' Funds	281.6	325.0	373.7	425.8	481.6
MI	24.4	19.6	25.2	31.1	37.3
Total S/H Equity	306.0	344.6	398.9	456.9	518.9
<b>Ttl Liab&amp;S/H Funds</b>	<b>431.1</b>	<b>455.1</b>	<b>514.9</b>	<b>577.3</b>	<b>643.9</b>

### Cashflow Analysis

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
EBITDA	64.7	92.6	111.0	116.6	122.4
Tax Paid	(7.9)	(14.2)	(20.1)	(21.5)	(23.0)
WC Changes	6.9	(14.6)	(5.2)	(2.2)	(2.3)
Other	5.3	(0.4)	0.8	1.3	1.8
<b>CFO</b>	<b>69.0</b>	<b>63.3</b>	<b>86.6</b>	<b>94.2</b>	<b>98.9</b>
<b>FCF</b>	<b>48.9</b>	<b>55.8</b>	<b>76.6</b>	<b>84.2</b>	<b>88.9</b>
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
<b>CFI</b>	<b>(32.1)</b>	<b>(7.1)</b>	<b>(10.0)</b>	<b>(10.0)</b>	<b>(10.0)</b>
Dividend	(5.2)	(10.0)	(21.0)	(22.5)	(24.1)
Debt changes	0.0	(16.7)	0.0	0.0	0.0
Other	(3.2)	(1.1)	0.0	0.0	0.0
<b>CFF</b>	<b>(8.4)</b>	<b>(27.8)</b>	<b>(21.0)</b>	<b>(22.5)</b>	<b>(24.1)</b>
<b>Net Cashflow</b>	<b>28.6</b>	<b>28.4</b>	<b>55.6</b>	<b>61.7</b>	<b>64.9</b>

### Quarterly financial summary

FYE Dec	2Q18	3Q18	4Q18	1Q19	2Q19
Revenue	81.8	85.9	88.7	83.8	80.1
COGS	(58.0)	(61.2)	(60.2)	(56.5)	(52.5)
EBITDA	23.8	24.7	28.5	27.4	27.7
D&A	(4.3)	(4.2)	(4.3)	(4.8)	(4.6)
EBIT	19.5	20.5	24.2	22.6	23.0
Net Interest Income	0.0	0.2	0.2	(0.0)	0.1
Associates	0.0	0.0	0.0	0.0	0.0
PBT	19.5	20.6	24.4	22.5	23.1
Tax	(6.2)	(4.1)	(4.4)	(6.2)	(5.3)
Net Profit	13.3	16.5	20.0	16.3	17.8
MI	(1.2)	(1.3)	(1.3)	(0.9)	(1.3)
PATAMI	12.1	15.2	18.7	15.4	16.5
Exceptionals	0.7	(0.2)	0.9	(0.0)	0.8
Adj PATAMI	12.8	15.0	19.6	15.4	17.3
Basic Shares (m)	1,053.0	1,053.0	1,053.0	1,053.0	1,053.0
Rep EPS (sen)	1.1	1.4	1.8	1.5	1.6
Adj EPS (sen)	1.2	1.4	1.9	1.5	1.6
Adj FD EPS (sen)	1.2	1.4	1.9	1.5	1.6

### Valuation Ratios

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
PER (x)	55.0	31.4	23.6	22.0	20.6
Core PER (x)	48.0	30.2	23.6	22.0	20.6
FD PER (x)	48.0	30.2	23.6	22.0	20.6
DPS (sen)	0.5	1.5	2.0	2.1	2.3
Net DY (%)	0.3	1.0	1.3	1.4	1.5
Book/share (sen)	26.7	30.9	35.5	40.4	45.7
P/Book (x)	5.8	5.1	4.4	3.9	3.4
FCF/share (sen)	4.6	5.3	7.3	8.0	8.4
FCF yield (%)	3.0	3.4	4.7	5.1	5.4
Mkt Cap	1,642.7	1,642.7	1,642.7	1,642.7	1,642.7
Net Cash/Debt	85.8	121.5	177.1	238.8	303.6
EV	1,556.8	1,521.1	1,465.6	1,403.9	1,339.0
EV/EBITDA (x)	24.1	16.4	13.2	12.0	10.9
ROE (%)	12.2	16.7	18.6	17.5	16.6
Current Ratio (x)	2.2	2.9	3.5	4.0	4.6
Quick Ratio (x)	2.1	2.8	3.3	3.9	4.4
Interest Cover (x)	49.7	132.5	275.2	293.5	312.3

### Other Ratios

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Sales Growth (%)		10.3	9.5	5.0	5.0
EBITDA Growth (%)		43.1	20.0	5.0	5.0
EBIT Growth (%)		62.8	25.6	6.6	6.4
PBT Growth (%)		63.9	26.1	7.1	6.9
Net Profit Growth (%)		56.6	31.9	7.1	6.9
EBITDA Margin (%)	21.8	28.3	31.0	31.0	31.0
EBIT Margin (%)	15.6	23.0	26.4	26.8	27.2
PBT Margin (%)	15.6	23.1	26.6	27.1	27.6
Net Profit Margin (%)	12.3	17.4	21.0	21.4	21.8
Net Debt/Equity (%)	N Cash	N Cash	N Cash	N Cash	N Cash
CAPEX/Sales (%)	6.8	2.3	2.8	2.7	2.5

**Figure #1**      **Quarterly results comparison**

<b>FYE Dec (RM m)</b>	<b>2Q18</b>	<b>1Q19</b>	<b>2Q19</b>	<b>QoQ</b>	<b>YoY</b>	<b>1H18</b>	<b>1H19</b>	<b>YoY</b>
Revenue	81.8	83.8	80.1	(4.4)	(2.0)	152.7	164.0	7.4
EBITDA	23.8	27.4	27.7	1.0	16.1	39.4	55.0	39.7
EBITDA Margin	29.1	32.6	34.5			25.8	33.6	
EBIT	19.5	22.6	23.0	2.0	18.2	30.6	45.6	49.0
PBT	19.5	22.5	23.1	2.5	18.4	30.5	45.7	49.5
PAT	13.3	16.3	17.8	9.1	34.2	20.5	34.2	67.0
Reported PATMI	12.1	15.4	16.5	7.2	36.7	18.4	31.9	73.6
Core PATMI	12.8	15.4	17.3	12.4	34.8	19.9	32.7	64.4
Reported EPS (sen)	1.1	1.5	1.6	7.2	36.7	1.7	3.0	73.6
Core EPS (sen)	1.2	1.5	1.6	12.4	34.8	1.9	3.1	64.4

*Bursa, HLIB Research*

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<b>BUY</b>	Expected absolute return of +10% or more over the next 12 months.
<b>HOLD</b>	Expected absolute return of -10% to +10% over the next 12 months.
<b>SELL</b>	Expected absolute return of -10% or less over the next 12 months.
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