Shariah Compliant

Industrials

Malaysia

March 23, 2021

Maybank IB Research

Frontken Corp. Bhd (FRCB MK)

Sustainability efforts in place

BUY

Share Price	MYR 4.90
12m Price Target	MYR 5.85 (+20%)
Previous Price Target	*MYR 5.85*

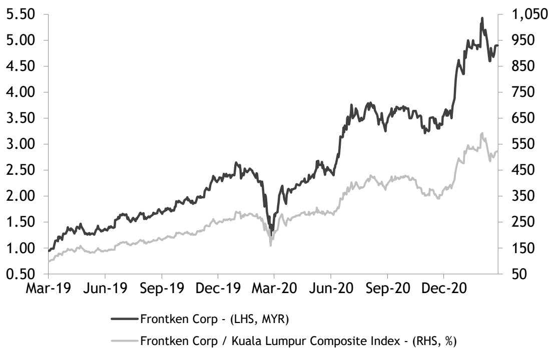
Company Description

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)	5.43/1.34
3m avg turnover (USDm)	5.9
Free float (%)	57.2
Issued shares (m)	1,053
Market capitalisation	MYR5.2B
	USD1.3B
Major shareholders:	
Dazzle Clean Ltd.	21.5%
OOI KENG THYE /FRONTKEN/	15.1%
Public Mutual Bhd.	3.5%

Price Performance



	-1M	-3M	-12M
Absolute (%)	1	45	238
Relative to index (%)	(3)	45	171

Source: FactSet

Maintain BUY

We remain upbeat on Frontken's growth outlook which is supported by the upcycle of the global semiconductor industry and increasing orders from its Taiwanese customers. On the ESG front, albeit limited disclosures on selected areas, we see Frontken's related risk factors to be relatively contained. Our earnings forecasts and MYR5.85 TP (47x FY22E PER, at +2SD) are intact. Maintain BUY in view of strong FY21-23E earnings prospects from the semiconductor segment.

Long-term sustainability goals with customers

Frontken is committed to uphold its sustainability efforts, which also extend to its customers. Via its continuous R&D efforts and technology offerings which are aligned with sustainability goals, the Group's key products and services would result in critical equipment/machinery parts (of its customers) lasting longer, performing better, are aesthetically pleasing and being recyclable. This, in turn, would contribute to long-term environmental and sustainability goals. Frontken considers itself aligned with 11 out of the 17 UN Sustainable Development Goals (SDGs).

Board composition to be improved

Overall, there were no notable governance issues or concerns, including related party transactions and purchases. Relating to Frontken's board composition, 2 of its 5 directors are independent and there were no female representatives. Nevertheless, we understand that Frontken has plans to improve its board composition regarding diversity and independence.

Positive earnings outlook

Frontken's positive earnings outlook is largely backed by the broad semiconductor industry's upcycle, which in turn, could result in improved volumes, particularly from its key Taiwanese customer. Consequently, Frontken is also planning to expand its Taiwanese facilities in 2021-2022 in anticipation of favourable business outlook, namely stronger demand for its products and services related to advanced chips' equipment.

FYE Dec (MYR m)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	340	368	514	578	610
EBITDA	114	122	177	211	237
Core net profit	69	81	108	130	149
Core EPS (sen)	6.6	7.7	10.3	12.4	14.2
Core EPS growth (%)	27.2	17.3	33.8	20.1	14.4
Net DPS (sen)	2.5	4.0	5.2	6.2	7.1
Core P/E (x)	34.7	45.9	47.4	39.4	34.5
P/BV (x)	6.4	8.5	10.5	9.3	9.1
Net dividend yield (%)	1.1	1.1	1.1	1.3	1.5
ROAE (%)	19.7	20.1	23.4	25.0	26.7
ROAA (%)	14.2	14.3	16.9	18.5	19.9
EV/EBITDA (x)	19.4	28.2	27.9	23.4	21.0
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	108	130	144
MKE vs. Consensus (%)	-	-	0.0	(0.0)	3.2

ESG
Tear Sheet Insert

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ESG

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Business Model & Industry Issues

- Frontken's key products and services include precision cleaning, servicing of high-speed rotating equipment and surface treatment. Frontken remains committed to align its sustainability efforts with its customers. With that, the Group conducts research, develops and builds advanced technologies which result in customers' critical equipment/machinery parts which last longer, perform better, are aesthetically pleasing and recyclable.
- We view that Frontken also strives to uphold various key sustainability goals, namely related to environmental protection and operating sustainable business models and related entities. Frontken considers itself aligned with 11 out of the 17 UN Sustainable Development Goals (SDGs).
- Board representation by independent and female directors are below recommended levels. However, responsible workplace and talent management strategies and policies are in place. Overall, we view Frontken's ESG risks as being contained.

Material E issues

- Regarding environmental aspects, Frontken strives to conduct its businesses in socially responsible manners and also align its sustainability goals with its customers.
- Frontken is committed to complying with all regulatory requirements and preventing pollution (i.e. water). Meanwhile, Frontken's R&D initiatives also prioritise reduction of environmental impact.
- In FY19, total output grew +4% YoY and the unit production (average; based on per part produced) resulted in: (i) power usage of 11.20 kWh (FY18: 11.91 kWh), (ii) water usage of 0.12 cubic (FY18: 0.14 cubic), and (iii) produced waste of 0.37kg (FY18: 0.43kg).
- Green power in FY19 (via solar) was optimised further to 384,128 kWh, from 268,242 kWh in FY18.
- 2 major waste reduction projects were implemented in FY19, where total water consumption fell 5.8% YoY, saving 54,443 tons of water, and 54 tons of waste was recycled.

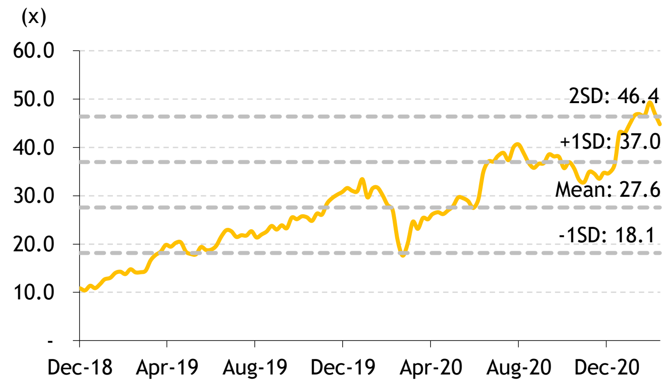
Material S issues

- As part of its R&D effort to develop and improve coating and cleanings processes, Frontken has replaced dangerous steps and processes which are detrimental to employees' overall health, in terms of both physical (i.e. injury) and mental (i.e. lengthy, repetitive processes).
- Frontken strives to manage its talent recruitment, and in a fair and open manner. Meanwhile, Frontken also develops and manages its talent pool via continuous training, emplacing work-life balance and upholding employee wellness and safety. Frontken has invested over 9,664 hours to train its employees.
- FY19: Employee retention rate was 98.94% (FY18: 99.18%) and injury rate was only 0.01 hour per 100 employees (FY18: 0.03).
- Frontken aims to be proactive in corporate social responsibility (CSR), such as by providing education opportunities and various public services by its employees. Consequently, Frontken and its volunteers have contributed a total of 5,282 hours in FY19.

Key G metrics and issues

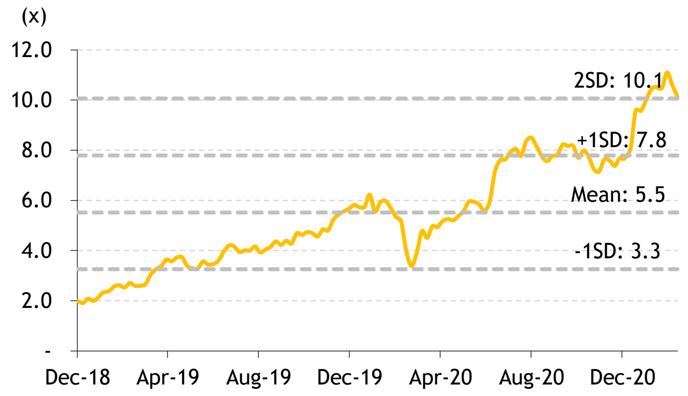
- The board comprises of 5 directors. 2 are executive directors, 1 a non-independent non-executive director and 2 are independent non-executive directors.
- The composition of independent directors is in accordance with the Main Market Listing Requirements of Bursa Securities of at least 1/3 of the board. However, it is below MCCG's (Malaysian Code on Corporate Governance) recommendation for large companies' (MYR2b market cap and above) board to have majority independent directors.
- While it appears to be a very experience-diversified board, all current board members are male.
- There are plans to improve the board's composition of independent directors and gender diversity.
- Ng Wai Pin holds a dual role as the Board Chairman and Chief Executive Officer – a departure from MCCG's practices. The board is in opinion that there is no concentration of power and authority by any individuals, while majority of the board comprises of Non-Executive Directors.
- As at 29 Apr 2020, Ng Wai Pin has a direct interest in Frontken with 6,932,900 ordinary shares (c.0.7%). Meanwhile, Tay Kiang meng, an executive director, has direct interest of 9,404,808 ordinary shares (c.0.9%).
- By virtue of Ng Wai Pin's direct substantial shareholding in Dazzle Clean Ltd, his indirect interest was 290,991,473 ordinary shares (c.22%).
- The CEO/directors' total remuneration of MYR6.4m/MYR8.2m for FY19 accounted for 8.6%/ 11.1% of the Group's net profit of MYR74.2m.
- Frontken has been audited by Crowe Malaysia PLT since FY09. Frontken has also appointed BDO Governance Advisory Sdn Bhd as the Group's internal auditor (excluding Taiwan operations).
- Frontken does not have a dividend payout policy but DPS has been increasing YoY since FY17.
- No notable related party transaction or M&A activities in in the recent years.

Fig 1: 1-year forward PER



Source: Bloomberg, Company data, Maybank KE

Fig 2: 1-year forward PBV



Source: Bloomberg, Company data, Maybank KE

Risk statement

There are several risk factors for our earnings estimates, target price and rating for Frontken. A sharp downturn in the global markets for electronics and/or oil & gas will affect the demand for Frontken's services. Additionally, forex volatility, especially USD/MYR, will also affect Frontken's earnings, as about 1/5 of the Group's revenue is denominated in USD.

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Metrics					
P/E (reported) (x)	22.0	36.8	47.4	39.4	34.5
Core P/E (x)	34.7	45.9	47.4	39.4	34.5
P/BV (x)	6.4	8.5	10.5	9.3	9.1
P/NTA (x)	6.4	9.9	11.7	10.5	9.2
Net dividend yield (%)	1.1	1.1	1.1	1.3	1.5
FCF yield (%)	5.4	3.3	0.3	2.0	2.9
EV/EBITDA (x)	19.4	28.2	27.9	23.4	21.0
EV/EBIT (x)	23.0	30.3	32.0	26.6	23.4
INCOME STATEMENT (MYR m)					
Revenue	339.9	368.3	513.8	577.9	609.9
EBITDA	113.7	122.3	177.4	211.5	237.3
Depreciation	(17.8)	(18.4)	(22.7)	(25.6)	(24.5)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	95.9	113.7	154.7	185.9	212.8
Net interest income /(exp)	0.4	0.6	0.9	0.9	0.9
Associates & JV	0.0	0.0	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	96.3	114.3	155.6	186.8	213.7
Income tax	(22.0)	(25.9)	(35.8)	(43.0)	(49.2)
Minorities	(5.1)	(6.4)	(11.4)	(13.7)	(15.6)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	69.2	82.0	108.4	130.2	148.9
Core net profit	69.1	81.0	108.4	130.2	148.9
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	225.4	312.2	226.5	233.6	203.3
Accounts receivable	93.7	110.7	139.6	156.1	164.4
Inventory	15.1	20.0	21.5	23.7	23.9
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	125.7	121.7	224.1	276.6	309.1
Intangible assets	33.8	33.8	33.8	33.8	33.8
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	22.0	19.8	19.5	19.1	19.1
Total assets	**515.7**	**618.1**	**665.0**	**742.8**	**753.5**
ST interest bearing debt	0.8	0.0	0.0	0.0	0.0
Accounts payable	84.0	118.0	124.7	130.6	130.9
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	11.9	9.5	1.3	1.3	1.3
Other liabilities	20.0	24.0	18.0	18.0	18.0
Total Liabilities	**117.0**	**151.1**	**144.1**	**150.0**	**150.3**
Shareholders Equity	377.0	440.0	488.2	553.3	562.7
Minority Interest	21.8	27.0	32.7	39.6	40.5
Total shareholder equity	**398.7**	**467.0**	**520.9**	**592.9**	**603.2**
Total liabilities and equity	**515.7**	**618.1**	**665.0**	**742.8**	**753.5**
CASH FLOW (MYR m)					
Pretax profit	96.3	114.3	155.6	186.8	213.7
Depreciation & amortisation	17.8	18.4	22.7	25.6	24.5
Adj net interest (income)/exp	(0.4)	(0.6)	(0.9)	(0.9)	(0.9)
Change in working capital	20.9	12.1	(23.8)	(12.8)	(8.2)
Cash taxes paid	(19.8)	(22.9)	(35.8)	(43.0)	(49.2)
Other operating cash flow	(0.1)	(0.6)	0.0	0.0	0.0
Cash flow from operations	135.8	131.8	117.8	155.7	180.0
Capex	(7.0)	(7.7)	(102.4)	(52.5)	(32.5)
Free cash flow	128.8	124.1	15.4	103.2	147.5
Dividends paid	(19.9)	(29.1)	(59.9)	(71.9)	(82.3)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	(13.0)	(5.7)	0.0	0.0	0.0
Other invest/financing cash flow	(5.8)	(4.8)	0.9	0.9	0.9
Effect of exch rate changes	1.7	6.2	0.0	0.0	2.0
Net cash flow	91.7	90.8	(43.6)	32.2	68.1

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Ratios					
Growth ratios (%)					
Revenue growth	3.9	8.4	39.5	12.5	5.5
EBITDA growth	22.9	7.6	45.0	19.2	12.2
EBIT growth	27.5	18.6	36.1	20.2	14.5
Pretax growth	27.3	18.7	36.2	20.1	14.4
Reported net profit growth	32.4	18.5	32.3	20.1	14.4
Core net profit growth	27.2	17.3	33.8	20.1	14.4
Profitability ratios (%)					
EBITDA margin	33.4	33.2	34.5	36.6	38.9
EBIT margin	28.2	30.9	30.1	32.2	34.9
Pretax profit margin	28.3	31.0	30.3	32.3	35.0
Payout ratio	37.9	51.1	50.0	50.0	50.0
DuPont analysis					
Net profit margin (%)	20.3	22.3	21.1	22.5	24.4
Revenue/Assets (x)	0.7	0.6	0.8	0.8	0.8
Assets/Equity (x)	1.4	1.4	1.4	1.3	1.3
ROAE (%)	19.7	20.1	23.4	25.0	26.7
ROAA (%)	14.2	14.3	16.9	18.5	19.9
Liquidity & Efficiency					
Cash conversion cycle	(18.6)	(22.9)	(32.9)	(22.0)	(20.6)
Days receivable outstanding	109.8	99.9	87.7	92.1	94.6
Days inventory outstanding	27.0	25.8	24.9	24.6	25.7
Days payables outstanding	155.4	148.5	145.5	138.8	140.9
Dividend cover (x)	2.6	2.0	2.0	2.0	2.0
Current ratio (x)	3.3	3.2	2.8	2.8	2.7
Leverage & Expense Analysis					
Asset/Liability (x)	4.4	4.1	4.6	5.0	5.0
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)	na	na	na	na	na
Debt/EBITDA (x)	0.1	0.1	0.0	0.0	0.0
Capex/revenue (%)	2.1	2.1	19.9	9.1	5.3
Net debt/ (net cash)	(212.6)	(302.7)	(225.1)	(232.2)	(201.9)

Source: Company; Maybank

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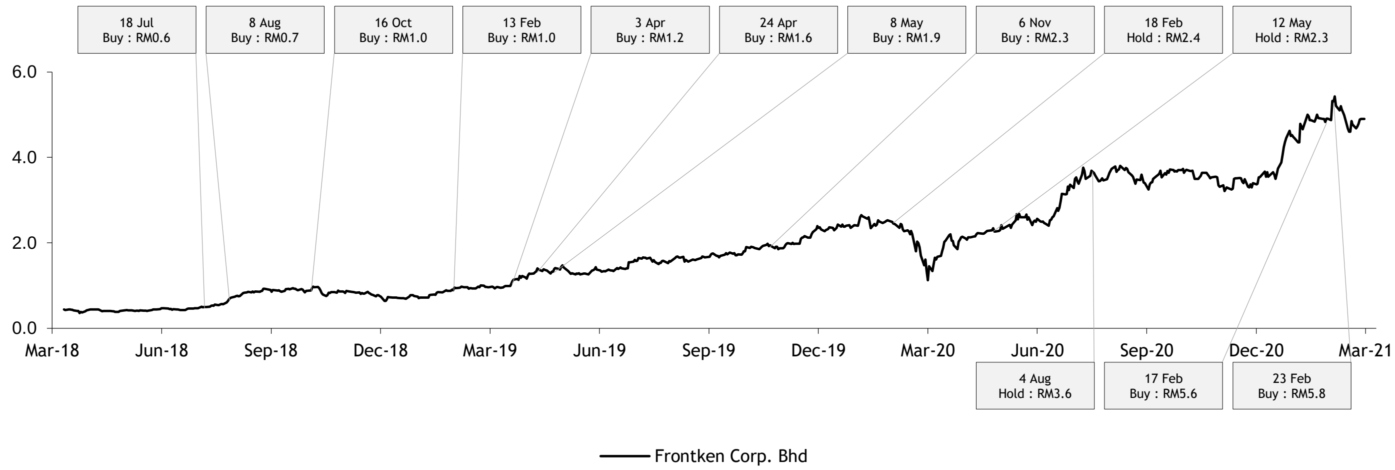
Historical recommendations and target price: Frontken Corp. Bhd (FRCB MK)



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