July 13, 2021

Maybank IB Research

Frontken Corp. Bhd (FRCB MK)

Taiwan remains as key catalyst

BUY

Share Price	MYR 3.13
12m Price Target	MYR 3.90 (+26%)
Previous Price Target	*MYR 3.90*

Maintain BUY

Post recent management meeting, we remain upbeat on Frontken's growth outlook, namely on their resilient job order flows and expansion in Taiwan. Our earnings forecasts are intact. Maintain BUY with unchanged TP of MYR3.90, pegged to 47x FY22E PER at about +2SD – mainly attributed to earnings growth prospects from their semiconductor segment.

Taiwan, the key growth country

Frontken is targeting to complete the purchase of its new Taiwanese facility soon, followed by renovation/modification works in the coming month(s). Meanwhile, Frontken is planning for the new plant's full operations to go in tandem with the commercial production of the 3nm advanced chips by its key customer. At this juncture, this is expected to take place around mid-2022. All in all, we remain positive on this expansion plan as it could potentially double Frontken's output in Taiwan in the long-term. We have not factored in significant earnings impact from the upcoming plant in our FY22-23E forecasts.

Front-end semiconductor industry remains solid

We expect near-term outlook remains bright for Frontken, due to the global semiconductor industry's upcycle which leads to increase in equipment and equipment spending. We note that Frontken has most front-end semiconductor companies as its customers (within their operating countries). Meanwhile, SEMI, the global industry association, mentioned that a total of 29 new high-volume fabrication facilities will complete in 2021-2022 – i.e. 8 in China and Taiwan, respectively. This entails an estimated >USD140b in equipment spending over the next few years.

Earnings unchanged

Our FY21-23E earnings forecasts are intact, pending further operational updates and/or earning releases. Our earnings growths are primarily anchored by the semiconductor segment. Meanwhile, we believe the recovery of the O&G sector could also serve as additional near-term growth catalysts.

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)	4.4	5.1	6.9	8.3	9.5
Core EPS growth (%)	27.2	17.3	33.8	20.1	14.4
Net DPS (sen)	1.7	2.7	3.4	4.1	4.7
Core P/E (x)	34.8	46.0	45.5	37.9	33.1
P/BV (x)	6.4	8.5	10.1	8.9	8.8
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)	19.5	28.2	26.7	22.4	20.1
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	108	131	149
MKE vs. Consensus (%)	-	-	0.8	(0.4)	0.0

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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.

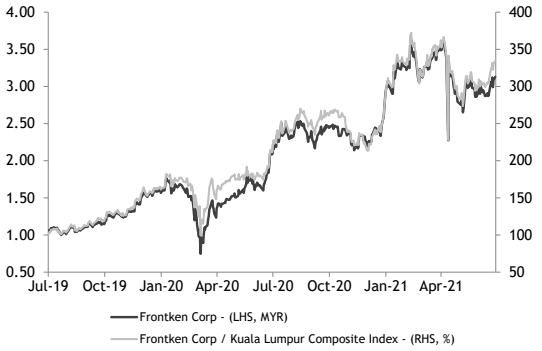
Statistics

52w high/low (MYR)	3.62/2.09
3m avg turnover (USDm)	4.2
Free float (%)	58.4
Issued shares (m)	1,575
Market capitalisation	MYR4.9B
	USD1.2B

Major shareholders:

Dazzle Clean Ltd.	20.3%
OOI KENG THYE /FRONTKEN/	15.1%
Public Mutual Bhd.	3.5%

Price Performance



	-1M	-3M	-12M
Absolute (%)	9	(11)	49
Relative to index (%)	13	(6)	56

Source: FactSet

ESG@MKE
Tear Sheet Insert

ESG@MKE

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Risk Rating & Score[1]	42.0 (Severe)
Score Momentum[2]	0.3
Last Updated	1 Jul 2021
Controversy Score[3] (Updated: 09 Feb 2019)	0 - No reported incidents

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 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 FY20, despite increased in output and production capacity, resources management has remained stable, i.e.: (i) power usage of 10.16kWh (FY19: 11.20 kWh), (ii) water usage of 0.12 cubic (unchanged YoY), and (iii) produced waste of 0.4kg (FY19: c.0.4kg).
- Accumulated 1,021,294 KW of green power (via solar) since 2018.
- Increased 24% of environmentally friendly chemical use in kg per unit of production, in FY20.

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 14,479 hours in FY20 to train its employees (+21% YoY).
- FY20: Employee retention rate was >95% (FY19: 99%) and injury rate was only 0.04 hour per 100 employees (FY19: 0.01).
- 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 4,422 hours in FY20.

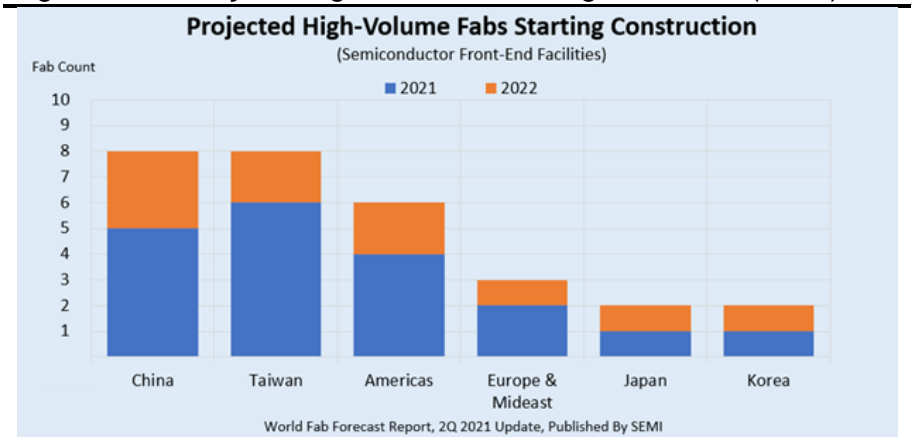
Key G metrics and issues

- The board comprises of 5 directors: 2 executive directors, 1 non-independent non-executive director and 2 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 31 Dec 2020, Ng Wai Pin has a direct interest in Frontken with 6,712,900 ordinary shares (c.0.6%). 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 213,891,473 ordinary shares (c.20%; 31 Dec 2020).
- The CEO/directors' total remuneration of MYR7.1m/MYR9.1m for FY20 accounted for 8.7%/11.1% of the Group's net profit of MYR82.0m.
- 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.

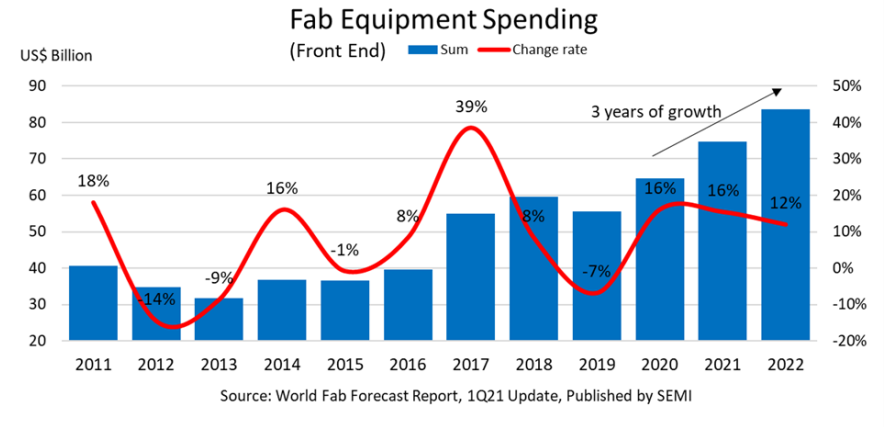
[1]***Risk Rating & Score*** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. [2]***Score Momentum*** - indicates changes to the company's score since the last update - a negative integer indicates a company's improving risk score; a positive integer indicates a deterioration. [3]***Controversy Score*** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Figure 1: SEMI: Projected high-volume fabs starting construction (Global)



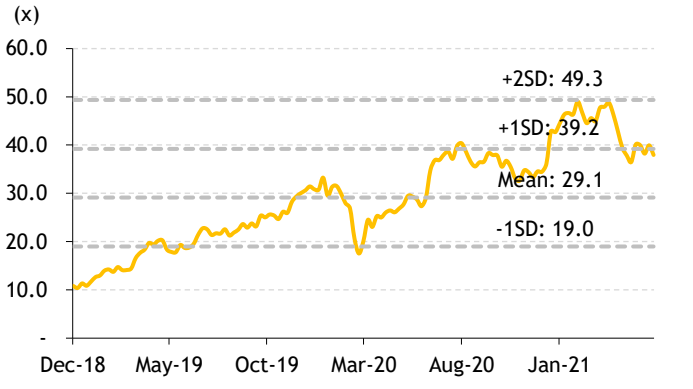
Source: SEMI (Jun 2021)

Figure 2: SEMI: Fab equipment spending



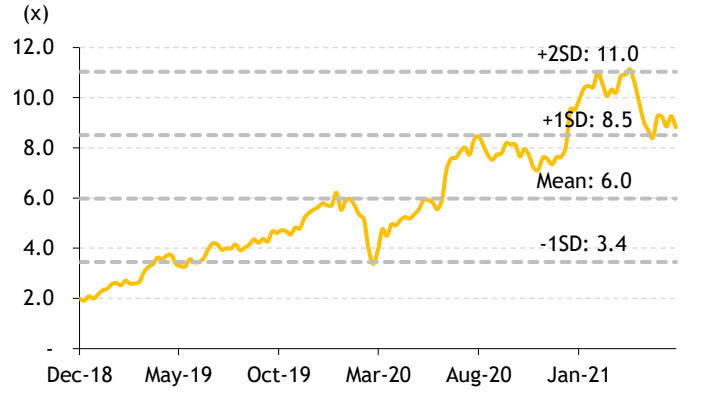
Source: SEMI (Mar 2021)

Figure 3: 1-year forward PER



Source: Bloomberg, Company data, Maybank KE

Figure 4: 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	45.5	37.9	33.1
Core P/E (x)	34.8	46.0	45.5	37.9	33.1
P/BV (x)	6.4	8.5	10.1	8.9	8.8
P/NTA (x)	7.0	9.2	10.8	9.5	9.3
Net dividend yield (%)	1.1	1.1	1.1	1.3	1.5
FCF yield (%)	5.4	3.3	0.3	2.1	3.0
EV/EBITDA (x)	19.5	28.2	26.7	22.4	20.1
EV/EBIT (x)	23.1	30.4	30.6	25.5	22.4
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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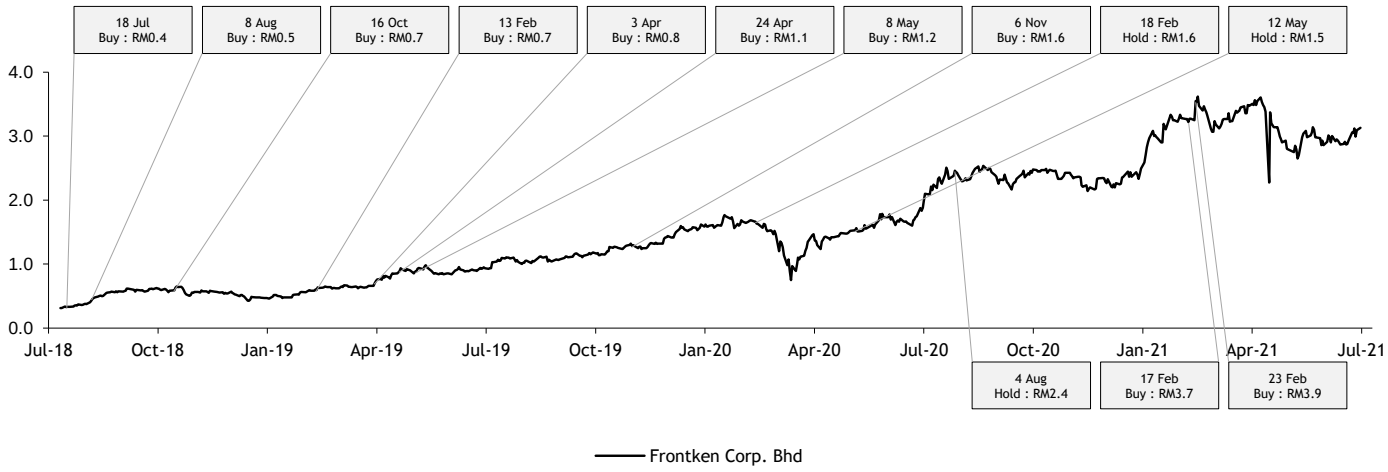

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