

HLIB Research

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Tan J Young
jt看@hlib.hongleong.com.my

(603) 2083 1721

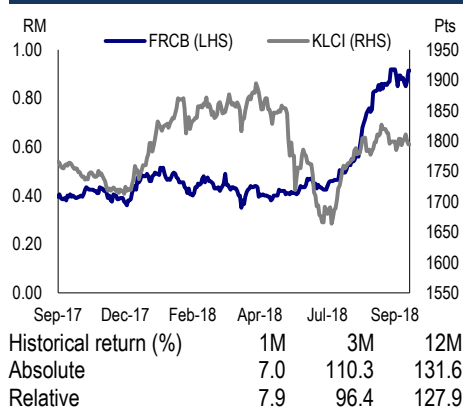
BUY (Maintain)

Target Price: **RM1.05**
Previously: **RM0.84**
Current Price: **RM0.915**

Capital upside	14.8%
Dividend yield	2.4%
Expected total return	17.2%

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)	959
3-mth average volume ('000)	17,990
SC Shariah compliant	Yes

Major shareholders

Dazzle Clean	27.8%
Ooi Keng Thye	14.5%
CIMB Group Holdings Bhd	5.2%

Earnings summary

	FY17	FY18f	FY19f
FYE (Dec)			
PATMI – core (RM m)	34.3	45.5	55.0
EPS – core (sen)	3.3	4.3	5.2
P/E (x)	28.1	21.2	17.5

Frontken Corporation

Aspired to go the distance

We gathered that Frontken's business prospect is very favourable and 2H18 is expected to be stronger. Semiconductor outlook continues to be bullish while investment remains robust. 7nm technology is now proven and demand will be solid thanks to its key differentiating factor. O&G recovery is crystalizing supported by higher oil price. Reiterate BUY with higher TP of RM1.05

Too conservative. In a recent meeting with management, we gathered that industry landscapes in both semiconductor and O&G are very favourable to Frontken. Based on those facts, 2H18 is likely to outperform 1H18 implying that our forecasts appear to be too reserved.

Bullish semiconductor outlook. Global sales has gone through the roof with 7M18 turnover surging 19.3% YoY to USD267.2bn, on track to achieve another record year. As a result, WSTS revised their 2018 growth forecast upward for the sixth consecutive time, from 12.4% to 15.7% to reach all-time high of RM477.1bn revenue. In its August press release, WSTS expected all products to expand while Asia Pacific region is projected to experience above-industry growth of 16.3%. This bodes well for Frontken who services all major foundries in this region.

Robust investment. In Aug, purely-play foundry Powerchip Tech has disclosed plans to construct 2 new 12-inch wafer fabs in Taiwan with total investment of USD9.1bn. This will add on to the existing strong pipeline of fab constructions and will continue to spur equipment expenditures. As more equipment exists in the supply chain, there will be more demand for such cleaning services from Frontken to ensure uninterrupted production in a cost-effective manner.

7nm is proven. The newly-introduced three iPhone models are all equipped with A12 Bionic chip, an industry-first 7nm CPU with 6.9bn transistors. With its technological leadership, we believe that Frontken plays an important role in the 7nm supply chain. 7nm/+ will be the major nodes like 16nm and 28nm. TSMC is projecting 7nm wafer revenue contribution to jump and the ramp will be stronger than any node they had in history.

A key differentiator. It was reported that going forward, AMD will focus its entire product portfolio on TSMC's 7nm process, including Vega 20 (workstation-class GPU), Zen 2-based (next generation CPU architecture) Epyc, Navi (GPU architecture) and Polaris. These 7nm products are believed to grant AMD an upper hand against its oldest rival, Intel who is reportedly still struggling with the 10nm migration. If AMD successfully win market share from Intel, demand for Frontken's cleaning services will be further boosted.

O&G recovery. Brent crude price have reached USD81/bbl, the highest level since end-2014 underpinned by continuous tightening of oil supply coupled with reluctance of OPEC producers to hike production aggressively. The oil prices rally, in our view, will boost oil majors' confidence to sanction more projects which eventually will heat up the entire value chain. Frontken, being the maintenance player is likely to ride on the recovery of the sector to receive more jobs.

Forecast. After taking into consideration of all the positive indications above, we raise FY18-20 EPS by 13%, 11% and 12%, respectively.

Reiterate **BUY** with higher TP of **RM1.05** reflecting the upward earnings revision as well as higher price multiple of 20x (previously 18x) of FY19 EPS. We think Frontken deserves a higher PE valuation given its (1) compelling multiyear growth; (2) leading edge technology; (3) O&G recovery; and (4) strong balance sheet.

Financial Forecast

All items in (RM m) unless otherwise stated

Income statement

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Revenue	261.8	296.6	331.7	374.4	402.8
COGS	(210.9)	(231.9)	(248.7)	(278.8)	(299.3)
EBITDA	50.9	64.7	83.0	95.5	103.5
D&A	(17.2)	(18.5)	(17.2)	(16.4)	(15.7)
EBIT	33.7	46.2	65.8	79.1	87.8
Net Interest Income	(0.4)	(0.1)	0.0	0.3	0.5
Associates	0.0	0.0	0.0	0.0	0.0
PBT	33.3	46.1	65.9	79.4	88.3
Tax	(6.1)	(9.7)	(15.5)	(18.7)	(20.8)
Net Profit	27.3	36.4	50.4	60.7	67.6
MI	(7.2)	(6.6)	(4.9)	(5.7)	(6.2)
PATAMI	20.0	29.9	45.5	55.0	61.4
Exceptionals	(2.2)	4.4	0.0	0.0	0.0
Adj PATAMI	17.8	34.3	45.5	55.0	61.4
Basic Shares (m)	1,053.0	1,053.0	1,053.0	1,053.0	1,053.0
Rep EPS (sen)	1.9	2.8	4.3	5.2	5.8
Adj EPS (sen)	1.7	3.3	4.3	5.2	5.8
Adj FD EPS (sen)	1.7	3.3	4.3	5.2	5.8

Balance sheet

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Cash	88.7	119.3	145.4	180.1	219.5
Receivables	96.1	91.7	109.0	123.1	132.4
Inventories	11.0	13.5	13.6	15.3	16.4
Investment	2.0	2.0	2.0	2.0	2.0
PPE	152.1	150.0	142.9	136.5	130.8
Intangibles	33.8	33.8	33.8	33.8	33.8
Other Assets	24.1	20.8	20.8	20.8	20.8
Total Assets	407.8	431.1	467.5	511.5	555.7
Payables	73.5	79.8	88.6	99.3	106.6
ST borrowings	8.5	21.9	21.9	21.9	21.9
LT borrowings	20.3	11.5	11.5	11.5	11.5
Other Liabilities	10.1	11.8	11.8	11.8	11.8
Total liabilities	112.4	125.1	133.9	144.6	151.9
Shareholders' Funds	261.6	281.6	304.3	331.8	362.5
MI	33.8	24.4	29.3	35.0	41.2
Total S/H Equity	295.4	306.0	333.6	366.9	403.8
Ttl Liab&S/H Funds	407.8	431.1	467.5	511.5	555.7

Cashflow Analysis

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
EBITDA	50.9	64.7	83.0	95.5	103.5
Tax Paid	(6.7)	(7.9)	(15.5)	(18.7)	(20.8)
WC Changes	1.1	6.9	(8.7)	(4.9)	(3.2)
Other	(0.9)	5.3	0.0	0.3	0.5
CFO	44.4	69.0	58.8	72.2	80.1
FCF	16.7	48.9	48.8	62.2	70.1
CAPEX (CF)	(27.7)	(20.2)	(10.0)	(10.0)	(10.0)
Acquisitions	(7.4)	(13.3)	0.0	0.0	0.0
Other	0.1	1.3	0.0	0.0	0.0
CFI	(35.0)	(32.1)	(10.0)	(10.0)	(10.0)
Dividend	0.0	(5.2)	(22.7)	(27.5)	(30.7)
Debt changes	(14.4)	0.0	0.0	0.0	0.0
Other	(4.1)	(3.2)	0.0	0.0	0.0
CFF	(18.5)	(8.4)	(22.7)	(27.5)	(30.7)
Net Cashflow	(9.1)	28.6	26.1	34.7	39.4

Quarterly financial summary

FYE Dec	2Q17	3Q18	4Q17	1Q18	2Q18
Revenue	70.5	78.6	80.4	70.9	81.8
COGS	(55.8)	(60.8)	(62.0)	(55.3)	(58.0)
EBITDA	14.7	17.8	18.4	15.6	23.8
D&A	(4.5)	(4.8)	(4.7)	(4.5)	(4.3)
EBIT	10.2	13.0	13.7	11.1	19.5
Net Interest Income	0.0	(0.1)	(0.1)	(0.1)	0.0
Associates	0.0	0.0	0.0	0.0	0.0
PBT	10.3	12.9	13.6	11.0	19.5
Tax	(2.4)	(2.1)	(2.4)	(3.8)	(6.2)
Net Profit	7.9	10.8	11.3	7.2	13.3
MI	(2.1)	(1.6)	(1.4)	(0.9)	(1.2)
PATAMI	5.8	9.2	9.8	6.3	12.1
Exceptionals	1.0	0.8	0.9	0.8	0.7
Adj PATAMI	6.8	10.0	10.7	7.1	12.8
Basic Shares (m)	1,053.0	1,053.0	1,053.0	1,053.0	1,053.0
Rep EPS (sen)	0.6	0.9	0.9	0.6	1.1
Adj EPS (sen)	0.6	0.9	1.0	0.7	1.2
Adj FD EPS (sen)	0.6	0.9	1.0	0.7	1.2

Valuation Ratios

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
PER (x)	48.1	32.3	21.2	17.5	15.7
Core PER (x)	54.1	28.1	21.2	17.5	15.7
FD PER (x)	54.1	28.1	21.2	17.5	15.7
DPS (sen)	0.0	0.5	2.2	2.6	2.9
Net DY (%)	0.0	0.5	2.4	2.9	3.2
Book/share (sen)	24.8	26.7	28.9	31.5	34.4
P/Book (x)	3.7	3.4	3.2	2.9	2.7
FCF/share (sen)	1.6	4.6	4.6	5.9	6.7
FCF yield (%)	1.7	5.1	5.1	6.5	7.3
Mkt Cap	963.5	963.5	963.5	963.5	963.5
Net Cash(Debt)	60.0	85.8	111.9	146.6	186.0
EV	903.5	877.7	851.6	816.9	777.5
EV/EBITDA (x)	17.7	13.6	10.3	8.6	7.5
ROE (%)	6.8	12.2	14.9	16.6	16.9
Current Ratio (x)	2.4	2.2	2.4	2.6	2.9
Quick Ratio (x)	2.3	2.1	2.3	2.5	2.7
Interest Cover (x)	29.4	49.7	70.7	85.0	94.3

Other Ratios

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Sales Growth (%)		13.3	11.8	12.9	7.6
EBITDA Growth (%)		27.1	28.3	15.1	8.3
EBIT Growth (%)		37.1	42.4	20.2	10.9
PBT Growth (%)		38.4	42.7	20.5	11.3
Net Profit Growth (%)		33.4	38.4	20.5	11.3
EBITDA Margin (%)	19.4	21.8	25.0	25.5	25.7
EBIT Margin (%)	12.9	15.6	19.9	21.1	21.8
PBT Margin (%)	12.7	15.6	19.9	21.2	21.9
Net Profit Margin (%)	10.4	12.3	15.2	16.2	16.8
Net Debt/Equity (%)	N Cash	N Cash	N Cash	N Cash	N Cash
CAPEX/Sales (%)	10.6	6.8	3.0	2.7	2.5

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Hong Leong Investment Bank Berhad (10209-W)

Level 28, Menara Hong Leong,

No. 6, Jalan Damanlela,

Bukit Damansara,

50490 Kuala Lumpur

Tel: (603) 2083 1800

Fax: (603) 2083 1766

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BUY	Expected absolute return of +10% or more over the next 12 months.
HOLD	Expected absolute return of -10% to +15% over the next 12 months.
SELL	Expected absolute return of -10% or less over the next 12 months.
UNDER REVIEW	Rating on the stock is temporarily under review which may or may not result to a change from the previous rating.
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OVERWEIGHT	Sector expected to outperform the market over the next 12 months.
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