

HLIB Research

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BUY (Maintain)

Target Price: **RM4.10**
Previously: **RM4.10**
Current Price: **RM3.53**

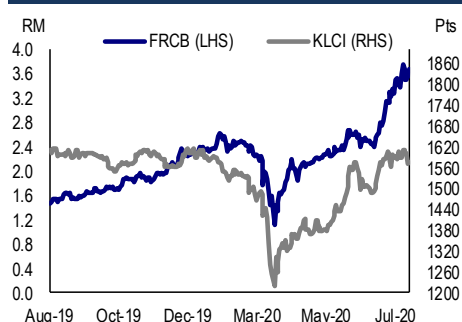
Capital upside 16.1%

Dividend yield 0.8%

Expected total return 16.9%

Sector coverage: Technology

Company description: Frontken is a leading surface engineering service provider in semiconductor and O&G markets.

Share price


Historical return (%)	1M	3M	12M
Absolute	40.8	67.0	146.0
Relative	38.8	47.2	151.4

Stock information

Bloomberg ticker	FRCB MK
Bursa code	0128
Issued shares (m)	1,048
Market capitalisation (RM m)	3,867
3-mth average volume ('000)	6,221
SC Shariah compliant	Yes

Major shareholders

Dazzle Clean	21.6%
Ooi Keng Thye	15.1%
Kenanga Unit Trust	3.7%

Earnings summary

	FY19	FY20f	FY21f
FYE (Dec)			
PATMI – core (RM m)	69.6	82.4	104.3
EPS – core (sen)	6.6	7.8	9.9
P/E (x)	53.4	45.1	35.7

Frontken Corporation

Back-to-back record breaking quarter

All-time high 3Q20 core net profit of RM22m (+7% QoQ, +21% YoY) matched our expectation. This outperformance was mainly driven by Taiwan semi business coupled with relentless vigilance in cost discipline despite O&G industrywide slowdown. New lines in Taiwan are expected to begin operation in Nov while it is planning to build new facility to cater for 3/2nm demand. Reiterate BUY with unchanged TP of RM4.10, pegged to 40x of mid-FY22 EPS. We like its unique exposure to leading-edge semiconductor frontend supply chain.

In line with HLIB but below street. Record-breaking 3Q20 core net profit of RM22m (+7% QoQ, +21% YoY) brought 9M20's sum to RM59m (+15% YoY) which matched HLIB expectation at 71% but missed consensus at 69%. 9M20 one-off adjustments include PPE disposal gain (RM1.5m), allowance for impairment losses on receivables (RM256k), forex loss (RM102k) and withholding tax (RM1m) imposed on the dividend declared by AGTC.

Dividend. None (3Q19: none). YTD DPS amounted to 1.2 sen (2Q19: 1.0 sen).

QoQ. Turnover inched up 8% mainly due to better performances from all subsidiaries (Philippines: +30%, Taiwan: +9%, Malaysia: +6% and Singapore: +2%) except unit in Indonesia (-47%) due to O&G drag. Core net profit expanded by 7% to RM22m as Indonesia unit swung back to losses. Semiconductor division unaudited profits was 20% better.

YoY. Revenue saw a solid growth of 9% driven by Taiwan (+32%) and Philippines (+6%) which fully offset the contractions in Singapore (-23%), Malaysia (-24%) and Indonesia (-20%) attributable to the slowdown in O&G. In spite of that and higher MI charge, core earnings rose at a quicker pace of 21% thanks to margin improvement resulting from continual efforts to elevate efficiency across the Group.

YTD. Top and bottom lines gained 7% and 15%, respectively for the same reasons stated above. We note that Taiwan revenue expanded by 27% with corresponding earnings growth of 49% on the back of margin improvement of 5ppt to 34%.

Semiconductor. Generated 86% (9M19: 78%) of group revenue in 9M20. Frontken is seeing advancement and deployment of new innovative technologies following global 5G rollout to benefit its business. It plans to expand Taiwan capacity by constructing a new state-of-the-art facility in anticipation of increase in demand for services related to tools involved in the most advanced node manufacturing. In the interim, AGTC has also added new production lines to better cope with the existing increasing demand. The lines are expected to be operational in Nov 2020.

O&G. Accounted for the remaining 14% of group turnover in 9M20. It noticed that new orders are trickling from various umbrella contracts for provision of manpower supply and also mechanical rotating equipment services and parts. While it hopes for more favourable 4Q20 and beyond, global oil demand and pandemic remain as key risks.

Forecast. Unchanged as results are in line.

Reiterate **BUY** with unchanged TP of **RM4.10**, pegged to 40x of mid-FY22 EPS. We justify this valuation based on its unique exposure to leading-edge semiconductor frontend supply chain which is currently in high demand on the back of national strategic and security interests. We like Frontken for its 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), and (4) strong balance sheet (net cash of RM263m or 25 sen per share) to supports its Taiwan expansion.

Financial Forecast

All items in (RM m) unless otherwise stated

Income statement

FYE Dec	FY18	FY19	FY20f	FY21f	FY22f
Revenue	327.2	339.9	376.8	447.2	469.6
COGS	(234.7)	(226.2)	(251.4)	(293.8)	(308.5)
EBITDA	92.6	113.7	125.4	153.4	161.1
D&A	(17.3)	(17.8)	(16.0)	(15.2)	(14.7)
EBIT	75.3	95.9	109.4	138.1	146.3
Net Interest Income	0.3	0.4	1.3	1.8	2.3
Associates	0.0	0.0	0.0	0.0	0.0
PBT	75.6	96.3	110.8	139.9	148.6
Tax	(18.6)	(22.0)	(23.3)	(29.4)	(31.2)
Net Profit	57.0	74.2	87.5	110.5	117.4
MI	(4.7)	(5.1)	(5.1)	(6.3)	(5.8)
PATAMI	52.3	69.2	82.4	104.3	111.6
Exceptionals	2.2	0.5	0.0	0.0	0.0
Adj PATAMI	54.4	69.6	82.4	104.3	111.6
Basic Shares (m)	1,053.0	1,053.0	1,053.0	1,053.0	1,053.0
Rep EPS (sen)	5.0	6.6	7.8	9.9	10.6
Adj EPS (sen)	5.2	6.6	7.8	9.9	10.6
Adj FD EPS (sen)	5.2	6.6	7.8	9.9	10.6

Balance sheet

FYE Dec	FY18	FY19	FY20f	FY21f	FY22f
Cash	133.0	197.2	257.6	328.8	407.3
Receivables	106.8	86.3	95.7	113.5	119.2
Inventories	13.7	15.1	16.8	19.6	20.6
Investment	0.0	0.0	0.0	0.0	0.0
PPE	140.4	145.5	139.5	134.2	129.5
Intangibles	33.8	33.8	33.8	33.8	33.8
Other Assets	27.4	37.9	37.9	37.9	37.9
Total Assets	455.1	515.7	581.3	667.9	748.3
Payables	82.4	84.0	93.4	109.1	114.6
ST borrowings	3.9	0.8	0.8	0.8	0.8
LT borrowings	7.5	0.0	0.0	0.0	0.0
Other Liabilities	16.5	32.1	32.1	32.1	32.1
Total liabilities	110.4	117.0	126.3	142.1	147.6
Shareholders' Funds	325.0	377.0	428.0	492.6	561.8
MI	19.6	21.8	26.9	33.1	38.9
Total S/H Equity	344.6	398.7	454.9	525.8	600.7
Ttl Liab&S/H Funds	455.1	515.7	581.3	667.9	748.3

Cashflow Analysis

FYE Dec	FY18	FY19	FY20f	FY21f	FY22f
EBITDA	92.6	113.7	125.4	153.4	161.1
Tax Paid	(14.2)	(19.8)	(23.3)	(29.4)	(31.2)
WC Changes	(14.6)	21.3	(1.7)	(4.9)	(1.2)
Other	(0.4)	(0.3)	1.3	1.8	2.3
CFO	63.3	114.9	101.8	120.8	130.9
FCF	55.8	107.9	91.8	110.8	120.9
CAPEX (CF)	(7.5)	(7.0)	(10.0)	(10.0)	(10.0)
Acquisitions	(7.1)	(2.6)	0.0	0.0	0.0
Other	7.5	(2.4)	0.0	0.0	0.0
CFI	(7.1)	(12.1)	(10.0)	(10.0)	(10.0)
Dividend	(10.0)	(18.9)	(31.3)	(39.7)	(42.5)
Debt changes	(16.7)	(10.7)	0.0	0.0	0.0
Other	(1.1)	(4.2)	0.0	0.0	0.0
CFF	(27.8)	(33.7)	(31.3)	(39.7)	(42.5)
Net Cashflow	28.4	69.1	60.5	71.2	78.5

Quarterly financial summary

FYE Dec	3Q19	4Q19	1Q20	2Q20	3Q20
Revenue	87.0	88.9	84.9	87.6	94.8
COGS	(56.4)	(60.9)	(55.8)	(55.2)	(60.0)
EBITDA	30.6	28.0	29.1	32.4	34.8
D&A	(4.6)	(3.8)	(4.7)	(4.6)	(4.6)
EBIT	26.0	24.3	24.4	27.8	30.3
Net Interest Income	0.1	0.2	0.3	0.1	0.1
Associates	0.0	0.0	0.0	0.0	0.0
PBT	26.1	24.5	24.7	27.9	30.3
Tax	(5.6)	(4.9)	(6.5)	(6.1)	(7.3)
Net Profit	20.5	19.6	18.2	21.8	23.0
MI	(1.4)	(1.4)	(1.2)	(1.5)	(1.7)
PATAMI	19.0	18.2	17.0	20.3	21.3
Exceptionals	(1.0)	0.7	(0.7)	0.0	0.5
Adj PATAMI	18.0	18.9	16.3	20.3	21.8
Basic Shares (m)	1,053.0	1,053.0	1,053.0	1,053.0	1,053.0
Rep EPS (sen)	1.8	1.7	1.6	1.9	2.0
Adj EPS (sen)	1.7	1.8	1.6	1.9	2.1
Adj FD EPS (sen)	1.7	1.8	1.6	1.9	2.1

Valuation Ratios

FYE Dec	FY18	FY19	FY20f	FY21f	FY22f
PER (x)	71.1	53.7	45.1	35.7	33.3
Core PER (x)	68.3	53.4	45.1	35.7	33.3
FD PER (x)	68.3	53.4	45.1	35.7	33.3
DPS (sen)	1.5	2.5	3.0	3.8	4.0
Net DY (%)	0.4	0.7	0.8	1.1	1.1
Book/share (sen)	30.9	35.8	40.6	46.8	53.4
P/Book (x)	11.4	9.9	8.7	7.5	6.6
FCF/share (sen)	5.3	10.2	8.7	10.5	11.5
FCF yield (%)	1.5	2.9	2.5	3.0	3.3
Mkt Cap	3,717.1	3,717.1	3,717.1	3,717.1	3,717.1
Net Cash(Debt)	121.5	196.3	256.8	328.0	406.4
EV	3,595.5	3,520.8	3,460.3	3,389.1	3,310.7
EV/EBITDA (x)	38.8	31.0	27.6	22.1	20.6
ROE (%)	16.7	18.5	19.3	21.2	19.9
Current Ratio (x)	2.9	3.5	3.9	4.2	4.7
Quick Ratio (x)	2.8	3.3	3.7	4.0	4.6
Interest Cover (x)	132.5	126.8	4,321.0	5,455.7	5,779.7

Other Ratios

FYE Dec	FY18	FY19	FY20f	FY21f	FY22f
Sales Growth (%)		3.9	10.9	18.7	5.0
EBITDA Growth (%)		22.8	10.3	22.3	5.0
EBIT Growth (%)		27.4	14.1	26.3	5.9
PBT Growth (%)		27.3	15.1	26.3	6.2
Net Profit Growth (%)		30.2	17.9	26.3	6.2
EBITDA Margin (%)	28.3	33.4	33.3	34.3	34.3
EBIT Margin (%)	23.0	28.2	29.0	30.9	31.2
PBT Margin (%)	23.1	28.3	29.4	31.3	31.6
Net Profit Margin (%)	17.4	21.8	23.2	24.7	25.0
Net Debt/Equity (%)	Cash	Cash	Cash	Cash	Cash
CAPEX/Sales (%)	2.3	2.1	2.7	2.2	2.1

Figure #1 **Quarterly results comparison**

FYE Dec (RM m)	3Q19	2Q20	3Q20	QoQ	YoY	9M19	9M20	YoY
Revenue	87.0	87.6	94.8	8.2	8.9	251.0	267.3	6.5
EBITDA	30.6	32.4	34.8	7.5	13.8	85.6	96.3	12.5
EBITDA Margin	35.2	37.0	36.8			34.1	36.0	
EBIT	26.0	27.8	30.3	8.9	16.3	71.6	82.4	15.2
PBT	26.1	27.9	30.3	8.6	16.1	71.8	83.0	15.6
PAT	20.5	21.8	23.0	5.3	12.3	54.6	63.1	15.4
Reported PATMI	19.0	20.3	21.3	5.0	12.0	51.0	58.7	15.1
Core PATMI	18.0	20.3	21.8	7.1	21.0	50.7	58.5	15.3
Reported EPS (sen)	1.8	1.9	2.0	5.0	12.0	4.8	5.6	15.1
Core EPS (sen)	1.7	1.9	2.1	7.1	21.0	4.8	5.6	15.3

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BUY	Expected absolute return of +10% or more over the next 12 months.
HOLD	Expected absolute return of -10% to +10% 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.
NOT RATED	Stock is not or no longer within regular coverage.

Sector rating guidelines

OVERWEIGHT	Sector expected to outperform the market over the next 12 months.
NEUTRAL	Sector expected to perform in-line with the market over the next 12 months.
UNDERWEIGHT	Sector expected to underperform the market over the next 12 months.

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