August 8, 2018

Maybank IB Research

Frontken Corp. Bhd (FRCB MK)

Expect a stronger 2H18

BUY

Share Price	MYR 0.64
12m Price Target	MYR 0.69 (+8%)
Previous Price Target	*MYR 0.63*

Maintain BUY

1H18 results were ahead of our forecast. We expect an even improved 2H18, fuelled by its key customer's production ramp-up. We raise our FY18-20 earnings forecasts by 7%-10% on higher work orders and margin improvement in Singapore. Correspondingly, our TP is raised by 10% to MYR0.69, pegged to an unchanged 15x FY19 EPS (0.5 SD above its 3-year mean). Maintain BUY.

2Q18 results positively surprise

Frontken's 2Q18 core net profit came in higher at MYR10.8m (+55% YoY, +60% QoQ), taking 1H18 core net profit to MYR17.5m (+26% YoY) on an improved topline and profit margin improvements from vigilance in cost management. This represents 48% of our full-year forecast – above our expectation as we had expected 1H18 earnings to make up 40-45% of our FY18 forecast. The beat was primarily from Frontken's Singapore segment, which saw higher-than-expected revenue and margin expansion. We opine this was due to its customer's stronger production of both DRAM and NAND memory in the 2QCY18 period.

Taiwan segment results in line

Frontken's Taiwan segment 2Q18 revenue was in line at MYR46m (+12.0% YoY, +5.4% QoQ). 1H18 revenue of MYR89.5m made up 46% of our full year forecast. We expect the contribution to continue to increase as revenues have reportedly improved thus far in the second half of the year. More new service orders will come as its key customer is expected to ramp-up production of 7nm process nodes as well as the mass production at existing and new capacity node of 10nm and above.

Raising our earnings forecasts

We raise FY18-20 net profit forecasts by 7%-10% after raising our Singapore revenue and EBIT projections to MYR59.5 and MYR9.6m (from MYR50.8m and MYR5.0m) on more new works and margin improvement. We also expect its effective tax rate to decline to our FY18 forecast of 28% from 33% currently, in the absence of withholding tax.

FYE Dec (MYR m)	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue	262	297	321	365	415
EBITDA	51	65	83	95	106
Core net profit	18	34	41	48	55
Core EPS (sen)	1.7	3.3	3.9	4.6	5.3
Core EPS growth (%)	202.2	92.7	17.8	18.8	15.0
Net DPS (sen)	0.0	0.5	0.8	0.9	1.1
Core P/E (x)	9.2	9.6	16.5	13.9	12.1
P/BV (x)	0.6	1.2	2.1	1.9	1.7
Net dividend yield (%)	0.0	1.6	1.2	1.4	1.7
ROAE (%)	8.0	11.0	13.6	14.5	14.8
ROAA (%)	4.5	8.2	9.1	10.0	10.4
EV/EBITDA (x)	2.7	6.3	6.7	5.4	4.4
Net gearing (%) (incl perps)	net cash	net cash	net cash	net cash	net cash
Consensus net profit	-	-	39	46	54
MKE vs. Consensus (%)	-	-	5.4	3.9	3.6

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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.

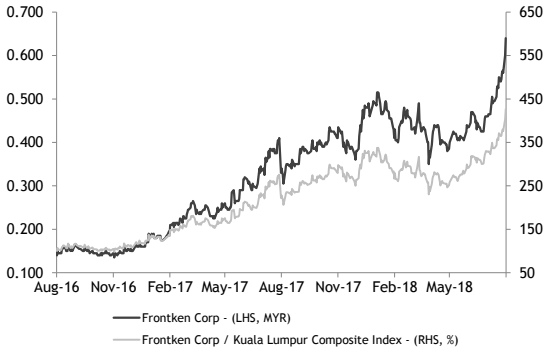
Statistics

52w high/low (MYR)	0.64/0.31
3m avg turnover (USDm)	0.8
Free float (%)	20.0
Issued shares (m)	1,053
Market capitalisation	MYR674.2M
	USD165M

Major shareholders:

Dazzle Clean Ltd.	27.8%
OOI KENG THYE /FRONTKEN/	14.5%
CIMB-Principal Asset Managament Bhd	5.8%

Price Performance



	-1M	-3M	-12M
Absolute (%)	39	66	94
Relative to index (%)	30	71	94

Source: FactSet

Fig 1: Summary results table

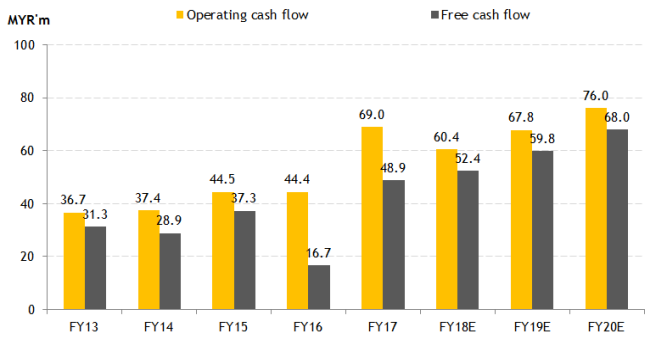
FYE Dec (MYR'm)	Quarterly					Cumulative		
	2Q18	2Q17	%YoY	1Q18	%QoQ	6M18	6M17	%YoY
Revenue	**81.8**	**70.5**	***16.0***	**70.9**	***15.3***	**152.7**	**137.6**	***11.0***
EBITDA	**22.8**	**13.8**	***65.0***	**14.2**	***60.3***	**37.0**	**26.6**	***39.3***
Depreciation	(4.3)	(4.5)	*(3.4)*	(4.5)	*(2.8)*	**(8.8)**	**(8.9)**	*(1.4)*
Other income	1.0	1.0	*(2.3)*	1.4	*(30.2)*	2.3	2.0	*16.6*
EBIT	**19.4**	**10.3**	***88.5***	**11.1**	***74.5***	**30.5**	**19.6**	***55.6***
Finance income	0.2	0.2	*(19.8)*	0.2	*30.3*	0.4	0.5	*(24.4)*
Finance costs	(0.2)	(0.2)	*(31.2)*	(0.2)	*(32.7)*	(0.4)	(0.4)	*(11.3)*
Associate profit/loss	0.1	(0.1)	*>-100*	(0.0)	*>-100*	0.0	(0.1)	*>-100*
PBT	**19.5**	**10.3**	***90.1***	**11.0**	***76.9***	**30.5**	**19.6**	***55.9***
Tax expense	(6.2)	(2.4)	*161.9*	(3.8)	*62.0*	(10.1)	(5.2)	*92.8*
Headline net profit	**12.1**	**5.8**	***>100***	**6.3**	***91.7***	**18.4**	**10.8**	***69.5***
Core net profit	**10.8**	**6.9**	***55.1***	**6.7**	***59.8***	**17.5**	**13.9**	***25.6***
Basic EPS (sen)	1.15	0.56	***>100***	0.60	***91.7***	1.75	1.03	*69.9*
Margin (%)	**2Q18**	**2Q17**	**+/- ppt**	**1Q18**	**+/- ppt**	**6M18**	**6M17**	**+/- ppt**
EBITDA	27.9	19.6	*8.3*	20.1	*7.8*	24.3	19.3	*4.9*
EBIT	23.7	14.6	*9.1*	15.7	*8.0*	20.0	14.3	*5.7*
PBT	23.9	14.6	*9.3*	15.6	*8.3*	20.0	14.2	*5.8*
Core net profit	14.8	8.3	*6.5*	9.5	*(3.0)*	11.5	10.1	*1.3*
Net gearing (x)	**net cash**	**net cash**	**nm**	**net cash**	**nm**	**net cash**	**net cash**	**nm**
Segmental revenue (MYR'm)	**2Q18**	**2Q17**	**%YoY**	**1Q18**	**%QoQ**	**6M18**	**6M17**	**%YoY**
Taiwan	46.0	41.0	*12.0*	43.6	*5.4*	89.5	76.4	*17.1*
Singapore	15.4	12.5	*23.6*	12.0	*28.4*	27.4	25.7	*6.5*
Malaysia	15.6	12.6	*24.5*	11.4	*37.0*	27.0	26.0	*4.0*
Philippines	4.5	4.2	*8.0*	3.7	*23.0*	8.2	9.0	*(9.1)*
Indonesia	0.3	0.3	*(2.4)*	0.3	*3.2*	0.6	0.5	*22.6*
Segmental EBIT (MYR'm)	**2Q18**	**2Q17**	**%YoY**	**1Q18**	**%QoQ**	**6M18**	**6M17**	**%YoY**
Taiwan	11.6	9.2	*25.9*	10.5	*10.4*	22.1	16.4	*34.9*
Singapore	5.7	0.5	*>100*	(0.5)	*>100*	5.2	0.8	*>100*
Malaysia	1.5	0.1	*>100*	1.0	*47.9*	2.6	1.7	*53.1*
Philippines	0.8	0.7	*9.4*	0.6	*40.4*	1.4	1.6	*(15.1)*
Indonesia	(0.2)	(0.3)	*(30.2)*	(0.5)	*(48.9)*	(0.7)	(0.8)	*(14.0)*

Source: Company data

Value Proposition

- Frontken is a leading service provider of cleaning and coating of high-tech equipment in Malaysia and Taiwan.
- Group earnings have reached an inflection point with growth to pick up from increasing demand for chips and the recovery of O&G industries.
- High barriers to entry for precision cleaning services due to stringent customer compliance that require in-depth knowledge, skills and expertise.
- Highly cash generative with operating cash flow last year of MYR69m against net profit of MYR34m (depreciation MYR18m) and FCF MYR49m (FCF yield 10.9%).
- ROE has continued to improve from 4.3% in FY15 to 13.4% in FY17, through better profit margins.

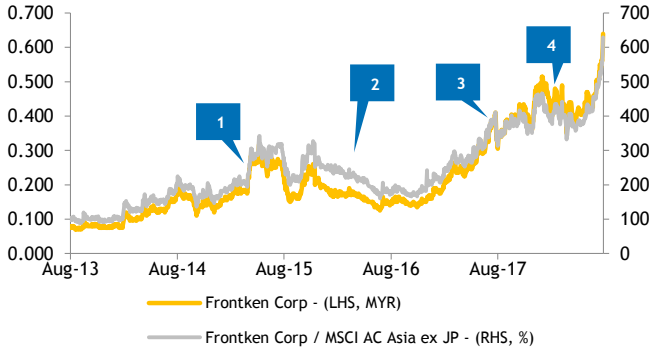
Sustainable FCF and OCF



Source: Company, Maybank KE

Price Drivers

Historical share price trend



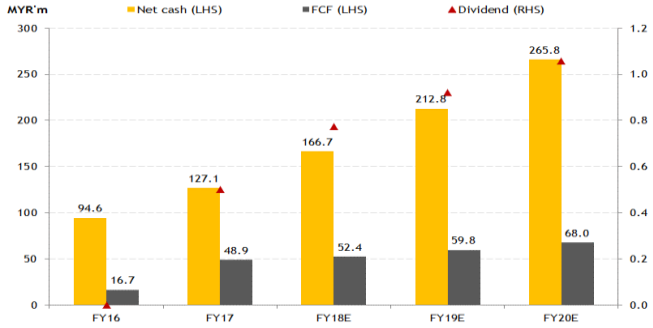
Source: Company, FactSet, Maybank Kim Eng

1. Achieved higher revenue due to the ramp-up in semiconductor business in Taiwan and recognition of one-off EPCC project, which was ATB project at Tanjung Bin.
2. Slump in oil and gas price naturally affected production and maintenance activities, coupled with unfortunate cost overrun in its ATB project.
3. The global semiconductor market grew at an impressive rate throughout 2017 (+21.6% YoY), posting highest-ever annual sales.
4. The start of a slowdown in global sales of smartphones to end users.

Financial Metrics

- We expect Frontken's revenue to continue to grow in the next three years on increasing demand for chips.
- Higher profit margins due to better services fees for handling complex process of advance wafer fabrication process (nodes).
- Net cash position (10sen/sh) in FY17 on low borrowings and strong cash flow.
- The Group resumed a dividend last year of 0.5sen, equal to a 17.5% payout ratio. We forecast a 20% payout ahead, supported by strong FCF and an increasing net cash position in FY18E-20E.

Net cash and strong FCF to support higher dividend payout



Source: Company data, Maybank KE

Swing Factors

Upside

- Higher utilisation rate of wafer fabrication equipment and capacity expansion of logic foundry and memory companies.
- Higher-than-expected chip demand from other markets, such as automotive, artificial intelligence etc.
- Rally in oil prices and higher CAPEX that can spur O&G activities.

Downside

- Lower utilisation rate on tapering demand for smartphones and electronic devices.
- Lack of development in other markets and investment on new advanced technological nodes.
- Sharp fall in oil prices and industry CAPEX lead to lower O&G sector demand for services.

FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Metrics					
P/E (reported) (x)	8.3	11.1	16.5	13.9	12.1
Core P/E (x)	9.2	9.6	16.5	13.9	12.1
P/BV (x)	0.6	1.2	2.1	1.9	1.7
P/NTA (x)	nm	nm	nm	nm	nm
Net dividend yield (%)	0.0	1.6	1.2	1.4	1.7
FCF yield (%)	10.1	14.8	7.8	8.9	10.1
EV/EBITDA (x)	2.7	6.3	6.7	5.4	4.4
EV/EBIT (x)	4.1	8.8	8.6	6.7	5.3
INCOME STATEMENT (MYR m)					
Revenue	261.8	296.6	321.4	365.4	414.5
Gross profit	78.5	104.8	137.5	161.7	183.8
EBITDA	51.0	64.8	83.0	95.0	106.2
Depreciation	(17.2)	(18.5)	(18.5)	(18.5)	(18.5)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	33.8	46.3	64.5	76.4	87.7
Net interest income /(exp)	(0.4)	(0.1)	(0.4)	(0.3)	(0.3)
Associates & JV	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
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	33.3	46.1	64.0	76.0	87.4
Income tax	(6.1)	(9.7)	(18.2)	(21.7)	(24.9)
Minorities	(7.2)	(6.6)	(5.2)	(6.2)	(7.1)
Perpetual securities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	20.0	29.9	40.6	48.2	55.5
Core net profit	17.9	34.5	40.6	48.2	55.5
Preferred Dividends	0.0	0.0	0.0	0.0	0.0
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	102.5	129.3	169.0	215.1	268.0
Accounts receivable	101.2	97.0	95.3	108.3	122.9
Inventory	11.0	13.5	11.6	12.8	14.5
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	152.1	150.0	139.5	129.0	118.5
Intangible assets	33.8	33.8	33.8	33.8	33.8
Investment in Associates & JVs	2.0	2.0	1.9	1.9	1.8
Other assets	5.3	5.5	5.5	5.5	5.5
Total assets	**407.8**	**431.1**	**456.5**	**506.3**	**565.0**
ST interest bearing debt	8.7	16.9	15.1	13.6	12.2
Accounts payable	73.3	79.6	71.6	80.4	91.4
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	20.6	11.7	10.4	9.4	8.4
Other liabilities	10.0	17.0	17.0	17.0	17.0
Total Liabilities	**112.4**	**125.1**	**113.9**	**120.2**	**128.9**
Shareholders Equity	261.6	281.6	314.1	352.7	397.0
Minority Interest	33.8	24.4	28.5	33.4	39.1
Total shareholder equity	**295.4**	**306.0**	**342.6**	**386.1**	**436.1**
Perpetual securities	0.0	0.0	0.0	0.0	0.0
Total liabilities and equity	**407.8**	**431.1**	**456.5**	**506.3**	**565.0**
CASH FLOW (MYR m)					
Pretax profit	33.3	46.1	64.0	76.0	87.4
Depreciation & amortisation	17.2	18.5	18.5	18.5	18.5
Adj net interest (income)/exp	0.4	0.1	0.4	0.3	0.3
Change in working capital	1.1	6.9	(4.3)	(5.5)	(5.3)
Cash taxes paid	(6.7)	(7.9)	(18.2)	(21.7)	(24.9)
Other operating cash flow	(0.9)	5.4	0.1	0.1	0.1
Cash flow from operations	44.4	69.0	60.4	67.8	76.0
Capex	(27.7)	(20.2)	(8.0)	(8.0)	(8.0)
Free cash flow	16.7	48.9	52.4	59.8	68.0
Dividends paid	(2.2)	(7.2)	(9.2)	(10.9)	(12.5)
Equity raised / (purchased)	(0.1)	0.0	0.0	0.0	0.0
Perpetual securities	0.0	0.0	0.0	0.0	0.0
Change in Debt	(15.1)	(0.2)	(3.2)	(2.5)	(2.3)
Perpetual securities distribution	0.0	0.0	0.0	0.0	0.0
Other invest/financing cash flow	(8.5)	(12.9)	(0.4)	(0.3)	(0.3)
Effect of exch rate changes	3.3	2.0	0.0	0.0	0.0
Net cash flow	(5.7)	30.6	39.7	46.1	53.0

FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Ratios					
Growth ratios (%)					
Revenue growth	(6.7)	13.3	8.4	13.7	13.5
EBITDA growth	46.5	26.9	28.2	14.4	11.8
EBIT growth	102.7	36.8	39.3	18.5	14.8
Pretax growth	108.4	38.4	38.7	18.8	15.0
Reported net profit growth	400.1	49.0	36.0	18.8	15.0
Core net profit growth	204.4	92.7	17.8	18.8	15.0
Profitability ratios (%)					
EBITDA margin	19.5	21.8	25.8	26.0	25.6
EBIT margin	12.9	15.6	20.1	20.9	21.2
Pretax profit margin	12.7	15.6	19.9	20.8	21.1
Payout ratio	0.0	17.5	20.0	20.0	20.0
DuPont analysis					
Net profit margin (%)	7.7	10.1	12.6	13.2	13.4
Revenue/Assets (x)	0.6	0.7	0.7	0.7	0.7
Assets/Equity (x)	1.6	1.5	1.5	1.4	1.4
ROAE (%)	8.0	11.0	13.6	14.5	14.8
ROAA (%)	4.5	8.2	9.1	10.0	10.4
Liquidity & Efficiency					
Cash conversion cycle	19.1	(0.3)	(15.8)	(12.6)	(12.3)
Days receivable outstanding	133.6	120.3	107.7	100.3	100.4
Days inventory outstanding	22.4	23.0	24.5	21.6	21.3
Days payables outstanding	136.8	143.5	148.0	134.4	134.0
Dividend cover (x)	nm	5.7	5.0	5.0	5.0
Current ratio (x)	2.5	2.2	2.8	3.2	3.5
Leverage & Expense Analysis					
Asset/Liability (x)	3.6	3.4	4.0	4.2	4.4
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)	89.6	nm	147.4	nm	nm
Debt/EBITDA (x)	0.6	0.4	0.3	0.2	0.2
Capex/revenue (%)	10.6	6.8	2.5	2.2	1.9
Net debt/ (net cash)	(73.1)	(100.7)	(143.5)	(192.1)	(247.4)

Source: Company; Maybank

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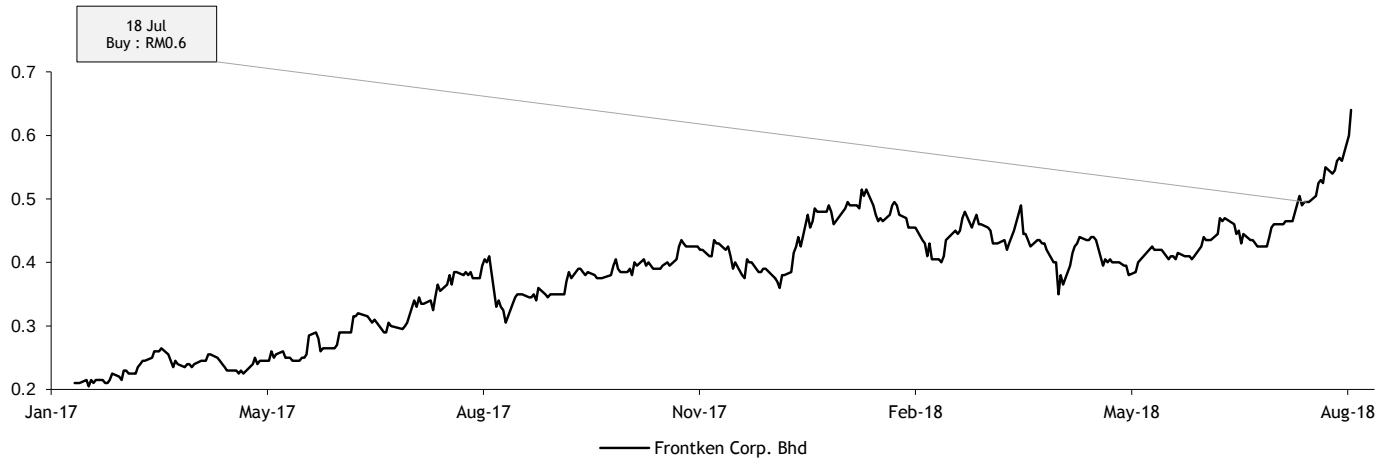

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