Frontken Corp. Bhd (FRCB MK)

Steady and on course

Strong work order growth ahead. Maintain BUY

2Q19 core net profit (+60% YoY; 14% QoQ) was in-line with our/consensus estimates and 1H19 equaled 47% of our/consensus 2019E. We make no estimate revisions; The next growth leg remains intact, factored into our estimates, driven by: (i) increasing adoption of its Customer X's 7/7nm+ in 2H19 and 5G deployment into FY20; and (ii) better local O&G activities in 2H19. We reiterate BUY with an unchanged TP of MYR1.85, pegged to an unchanged 23.5x PER (+1.5SD of 5-year mean to reflect the positive earnings growth outlook).

Within our and consensus expectations

Excluding one-off items, Frontken's 2Q19 core net profit was MYR17.2m (+60% YoY), which took its 1H19 core net profit to MYR32.4m (85% YoY). The growth was attributable to the: (i) Profit margin improvement from vigilance in cost management; and ii) Improved topline from its Singapore segment at MYR16.9m (+10% YoY, +4% QoQ) and possibly contribution from its Customer X's 7nm (as we had highlighted in our previous report). We posit overall topline growth decreased 2.0% YoY and 4.4% QoQ due to lower contributions from other semiconductor customers and Customer X's matured nodes. The Group declared a first single tier DPS of 1sen, representing a 50% DPR and meeting our full-year estimate as well.

Strong demand for smaller node to boost work orders

Frontken is well placed to gain from the growing demand for its Customer X's continuous advancement in cutting-edge process and capacity expansion. As the rapid 5G deployment globally will generate a tremendous amount of data to process, it would spur demand for: (i) its Customer X's 7/7nm+ and upcoming 5nm chips in 2020 that can deliver greater power efficiency and faster processing capability; and (ii) its memory customer's 3D NAND chips. With the growing complexity in the chipmaking process equipment to produce these advanced chips, it will boost more high value work orders for Frontken.

No changes to earnings estimates

We leave our FY19E-20E earnings forecasts unchanged, having imputed the above factors. We expect an even improved 2H19 on: (i) more high value work orders fuelled by its Customer X's production ramp-up of 7/7nm+ process nodes; and (ii) sustainable work orders from its major O&G customers.

FYE Dec (MYR m)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	297	327	390	441	483
EBITDA	65	92	117	136	157
Core net profit	36	53	69	83	96
Core EPS (sen)	3.4	5.1	6.6	7.9	9.1
Core EPS growth (%)	98.8	50.0	29.9	19.3	15.8
Net DPS (sen)	0.5	1.5	2.0	2.4	2.7
Core P/E (x)	13.6	13.8	24.9	20.9	18.1
P/BV (x)	1.7	2.3	4.6	4.0	3.5
Net dividend yield (%)	1.1	2.1	1.2	1.4	1.7
ROAE (%)	11.0	17.2	19.8	20.5	20.6
ROAA (%)	8.5	12.0	14.5	15.7	16.3
EV/EBITDA (x)	6.3	6.7	13.5	11.6	9.9
Net gearing (%) (incl perps)	net cash				
Consensus net profit	-	-	67	77	86
MKE vs. Consensus (%)	-	-	2.9	8.1	12.0

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Maybank IB Research

BUY

Share Price	MYR 1.65
12m Price Target	MYR 1.85 (+12%)
Previous Price Target	MYR 1.85

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)	1.66/0.55
3m avg turnover (USDm)	2.9
Free float (%)	47.6
Issued shares (m)	1,053
Market capitalisation	MYR1.7B
	USD421M
Major shareholders:	
Dazzle Clean Ltd	27.8%
Ooi Keng Thye	14.5%
CIMB-Principal Asset Management	5.2%

Price Performance



	-1M	-3M	-12M
Absolute (%)	23	20	206
Relative to index (%)	25	20	229
Source: FactSet			

Fig 1: Results summary

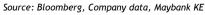
			Quarterly				Cumulative	
FYE Dec (MYR'm)	2Q19	2Q18	%YoY	1Q19	%QoQ	1H19	1H18	%YoY
Revenue	80.1	81.8	(2.0)	83.8	(4.4)	164.0	152.7	7.4
EBITDA	27.7	23.8	16.4	27.4	1.0	55.0	37.0	48.6
Depreciation	(4.6)	(4.3)	6.8	(4.8)	(3.7)	(9.5)	(8.8)	7.2
Other income	0.3	1.0	(70.6)	1.0	(71.1)	1.3	2.3	(46.0)
EBIT	23.0	19.4	18.5	22.6	2.0	45.6	30.5	49.2
Finance income	0.3	0.2	46.0	0.2	22.5	0.5	0.4	50.0
Finance costs	(0.2)	(0.2)	27.0	(0.2)	(18.9)	(0.4)	(0.4)	14.0
Associate profit/loss	0.0	0.1	nm	0.0	nm	0.0	0.0	nm
PBT	23.1	19.5	18.4	22.5	2.5	45.7	30.5	49.5
Tax expense	(5.3)	(6.2)	(15.3)	(6.2)	(14.9)	(11.5)	(10.1)	13.9
Headline PATAMI	16.5	12.1	36.7	15.4	7.2	31.9	18.4	73.6
Core PATAMI	17.2	10.8	60.3	15.2	13.8	32.4	17.5	85.2
Basic EPS (sen)	1.58	1.15	37.4	1.47	7.5	3.05	1.75	74.3
Margin (%)	2Q19	2Q18	+/- ppt	1Q19	+/- ppt	1H19	1H18	+/- ppt
EBITDA	34.5	29.0	5.5	32.6	1.9	33.6	24.3	9.3
EBIT	28.7	23.7	5.0	26.9	1.8	27.8	20.0	7.8
PBT	28.8	23.9	5.0	26.9	1.9	27.8	20.0	7.8
Core net profit	21.5	13.2	8.4	18.1	3.4	19.8	11.5	8.3
Net gearing (x)	net cash	net cash	nm	net cash	nm	net cash	net cash	nm
Segmental revenue (MYR'm)	2Q19	2Q18	%YoY	1Q19	%QoQ	1H19	1H18	%YoY
Taiwan	43.7	46.0	(5.0)	45.2	(3.5)	88.9	89.5	(0.7)
Singapore	16.9	15.4	9.8	16.3	3.9	33.2	27.4	21.1
Malaysia	15.1	15.6	(3.1)	18.0	(15.9)	33.2	27.0	22.6
Philippines	4.1							
Indonesia	7.1	4.5	(8.4)	4.2	(1.3)	8.3	8.2	
	0.3	4.5 0.3	(8.4) 9.7	4.2 0.1	(1.3) 143.8	8.3 0.4	8.2 0.6	2.0
Segmental EBIT (MYR'm)								2.0 (21.4)
Segmental EBIT (MYR'm) Taiwan	0.3	0.3	9.7	0.1	143.8	0.4	0.6	2.0 (21.4) %YoY
	0.3 2Q19	0.3 2Q18	9.7 %YoY	0.1 1Q19	143.8 %QoQ	0.4 1H19	0.6 1H18	2.0 (21.4) %YoY 14.9
Taiwan	0.3 2Q19 13.0	0.3 2Q18 11.6	9.7 %YoY 12.5	0.1 1Q19 12.4	143.8 %QoQ 5.5	0.4 1H19 25.4	0.6 1H18 22.1	2.0 (21.4) %YoY 14.9 109.2
Taiwan Singapore	0.3 2Q19 13.0 5.9	0.3 2Q18 11.6 5.7	9.7 %YoY 12.5 3.2	0.1 1Q19 12.4 5.0	143.8 %QoQ 5.5 18.5	0.4 1H19 25.4 10.9	0.6 1H18 22.1 5.2	2.0 (21.4) %YoY 14.9 109.2 209.4
Taiwan Singapore Malaysia	0.3 2Q19 13.0 5.9 3.4	0.3 2Q18 11.6 5.7 1.5	9.7 %YoY 12.5 3.2 119.1	0.1 1Q19 12.4 5.0 4.6	143.8 %QoQ 5.5 18.5 (26.8)	0.4 1H19 25.4 10.9 7.9	0.6 1H18 22.1 5.2 2.6	2.0 (21.4) %YoY 14.9 109.2 209.4 6.6
Taiwan Singapore Malaysia Philippines	0.3 2Q19 13.0 5.9 3.4 0.7	0.3 2Q18 11.6 5.7 1.5 0.8	9.7 %YoY 12.5 3.2 119.1 (9.4)	0.1 1Q19 12.4 5.0 4.6 0.7	143.8 %QoQ 5.5 18.5 (26.8) (1.5)	0.4 1H19 25.4 10.9 7.9 1.5	0.6 1H18 22.1 5.2 2.6 1.4	2.0 (21.4) %YoY 14.9 109.2 209.4 6.6 (81.7)
Taiwan Singapore Malaysia Philippines Indonesia	0.3 2Q19 13.0 5.9 3.4 0.7 (0.0)	0.3 2Q18 11.6 5.7 1.5 0.8 (0.2)	9.7 %YoY 12.5 3.2 119.1 (9.4) (92.9)	0.1 1Q19 12.4 5.0 4.6 0.7 (0.1)	143.8 %QoQ 5.5 18.5 (26.8) (1.5) (84.8)	0.4 1H19 25.4 10.9 7.9 1.5 (0.1)	0.6 1H18 22.1 5.2 2.6 1.4 (0.7)	2.0 (21.4) %YoY 14.9 109.2 209.4 6.6 (81.7) +/- ppt
Taiwan Singapore Malaysia Philippines Indonesia Segmental EBIT margin (%)	0.3 2Q19 13.0 5.9 3.4 0.7 (0.0) 2Q19	0.3 2Q18 11.6 5.7 1.5 0.8 (0.2) 2Q18	9.7 %YoY 12.5 3.2 119.1 (9.4) (92.9) +/- ppt	0.1 1Q19 12.4 5.0 4.6 0.7 (0.1) 1Q19	143.8 %QoQ 5.5 18.5 (26.8) (1.5) (84.8) +/- ppt	0.4 1H19 25.4 10.9 7.9 1.5 (0.1) 1H19	0.6 1H18 22.1 5.2 2.6 1.4 (0.7) 1H18	2.0 (21.4) %YoY 14.9 109.2 209.4 6.6 (81.7) +/- ppt 3.9
Taiwan Singapore Malaysia Philippines Indonesia Segmental EBIT margin (%) Taiwan	0.3 2Q19 13.0 5.9 3.4 0.7 (0.0) 2Q19 29.9	0.3 2Q18 11.6 5.7 1.5 0.8 (0.2) 2Q18 25.2	9.7 %YoY 12.5 3.2 119.1 (9.4) (92.9) +/- ppt 4.6	0.1 1Q19 12.4 5.0 4.6 0.7 (0.1) 1Q19 27.3	143.8 %QoQ 5.5 18.5 (26.8) (1.5) (84.8) +/- ppt 2.6	0.4 1H19 25.4 10.9 7.9 1.5 (0.1) 1H19 28.6	0.6 1H18 22.1 5.2 2.6 1.4 (0.7) 1H18 24.7	2.0 (21.4) %YoY 14.9 109.2 209.4 6.6 (81.7) +/- ppt 3.9 13.8
Taiwan Singapore Malaysia Philippines Indonesia Segmental EBIT margin (%) Taiwan Singapore	0.3 2Q19 13.0 5.9 3.4 0.7 (0.0) 2Q19 29.9 34.9	0.3 2Q18 11.6 5.7 1.5 0.8 (0.2) 2Q18 25.2 37.2	9.7 %YoY 12.5 3.2 119.1 (9.4) (92.9) +/- ppt 4.6 (2.2)	0.1 1Q19 12.4 5.0 4.6 0.7 (0.1) 1Q19 27.3 30.6	143.8 %QoQ 5.5 18.5 (26.8) (1.5) (84.8) +/- ppt 2.6 4.3	0.4 1H19 25.4 10.9 7.9 1.5 (0.1) 1H19 28.6 32.8	0.6 1H18 22.1 5.2 2.6 1.4 (0.7) 1H18 24.7 19.0	2.0 (21.4) %YoY 14.9 109.2 209.4 6.6 (81.7) +/- ppt 3.9 13.8 14.5 0.8

Source: Company data



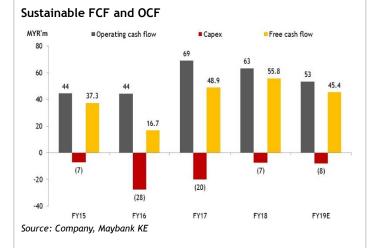
Source: Bloomberg, Company data, Maybank KE





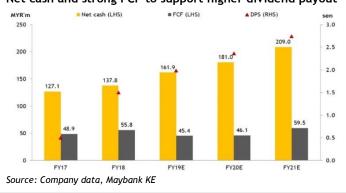
Value Proposition

- 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 advanced 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 in FY18 of MYR63.3m against net profit of MYR52.3m (depreciation MYR17.3m) and FCF of MYR55.8m.
- ROE has continued to improve from 4.3% in FY15 to 17.2% in FY18, and 19.8% in FY19E through wider profit margins.



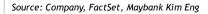
Financial Metrics

- We expect Frontken's revenue to continue to grow in the next three years on increasing demand for advanced chips and improving O&G industries outlook.
- Higher profit margins due to better services fees for handling complex equipment of advanced wafer fabrication process from 7nm and beyond.
- Net cash position (13sen/sh) in FY18 on low borrowings and strong cash flow.
- The Group paid a higher dividend in FY18 of 1.5sen vs. 0.5sen in FY17), equal to a 30.1% payout ratio. We forecast a 30% payout ahead, supported by strong FCF and an increasing net cash position in FY19E-21E.



Net cash and strong FCF to support higher dividend payout





- 1. Achieved higher revenue from the semiconductor business in Taiwan and recognition of one-off EPCC project, which was the 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 higher core net profit of 99% YoY for Frontken.
- 4. CEO of Frontken, Ng Wai Pin emerged as the largest shareholder after an indirect acquisition of 27.77% was made via Dazzle Clean Ltd in Aug 2018.
- 5. Negative sentiment on the start of a slowdown in global sales of smartphones to end users.

Swing Factors Upside

- Higher utilisation rate of wafer fabrication equipment and capacity expansion of logic foundry and memory companies.
- Higher-than-expected work orders from new advanced technological nodes.
- 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	FY17A	FY18A	FY19E	FY20E	FY21
Key Metrics					
P/E (reported) (x)	11.1	12.0	24.9	20.9	18
Core P/E (x)	13.6	13.8	24.9	20.9	18
P/BV (x)	1.7	2.3	4.6	4.0	3
P/NTA (x)	1.7	2.3	5.4	4.6	4
Net dividend yield (%)	1.1	2.1	1.2	1.4	1
FCF yield (%)	10.1	7.6	2.6	2.7	3
EV/EBITDA (x)	6.3	6.7	13.5	11.6	9
EV/EBIT (x)	8.8	8.3	15.8	13.2	11
NCOME STATEMENT (MYR m)					
Revenue	296.6	327.2	390.3	441.2	483
Gross profit	104.8	126.6	160.1	182.5	205
BITDA	64.8	92.5	117.4	136.2	156
epreciation	(18.5)	(17.3)	(16.7)	(17.0)	(17.
mortisation	0.0	0.0	0.0	0.0	Č C
BIT	46.3	75.2	100.7	119.1	139
let interest income /(exp)	(0.1)	0.3	0.1	0.1	0
ssociates & JV	(0.1)	0.1	0.0	0.0	C
xceptionals	(0.1)	0.1	0.0	0.0	(
Other pretax income	0.0	0.0	0.0	0.0	(
retax profit	46.1	75.6	100.8	119.3	139
ncome tax	(9.7)	(18.6)	(25.1)	(28.6)	(33
Ainorities	(6.6)	(4.7)	(6.3)	(8.0)	(10
Discontinued operations	0.0	0.0	0.0	0.0	(
Reported net profit	29.9	52.3	69.3	82.7	95
Core net profit	35.6	53.4	69.3	82.7	95
SALANCE SHEET (MYR m)					
ash & Short Term Investments	129.3	149.9	174.0	193.1	221
ccounts receivable	97.0	113.6	147.2	185.3	229
nventory	13.5	13.7	14.3	18.5	23
leinsurance assets	0.0	0.0	0.0	0.0	(
Property, Plant & Equip (net)	150.0	140.4	127.5	118.5	109
ntangible assets	33.8	33.8	33.8	33.8	33
nvestment in Associates & JVs	2.0	0.0	0.0	0.0	(
Other assets	5.5	3.7	3.7	3.7	3
Total assets	431.1	455.1	500.5	552.8	619
	16.9	4.8	2.7	2.7	2
T interest bearing debt					
Accounts payable	79.6	81.6	76.9	65.7	58
nsurance contract liabilities	0.0	0.0	0.0	0.0	(
T interest bearing debt	11.7	8.9	8.1	8.1	8
Other liabilities	17.0	15.0	15.0	15.0	15
otal Liabilities	125.1	110.4	103.0	91.8	84
hareholders Equity	281.6	325.0	373.6	431.4	498
Ainority Interest	24.4	19.6	24.0	29.6	36
Total shareholder equity	306.0	344.6	397.6	461.0	535
otal liabilities and equity	431.1	455.1	500.5	552.8	619
CASH FLOW (MYR m)					
Pretax profit	46.1	75.6	100.8	119.3	139
Depreciation & amortisation	18.5	17.3	16.7	17.0	17
dj net interest (income)/exp	0.1	(0.3)	(0.1)	(0.1)	(0.
hange in working capital	6.9	(15.9)	(38.9)	(53.5)	(55
ash taxes paid	(7.9)	(14.2)	(25.1)	(28.6)	(33
ther operating cash flow	5.4		0.0	0.0	
		(0.4)			(
ash flow from operations	69.0	63.3	53.4	54.1	67
apex	(20.2)	(7.5)	(8.0)	(8.0)	(8.
ree cash flow	48.9	55.8	45.4	46.1	59
Dividends paid	(7.2)	(10.0)	(22.7)	(27.2)	(31
quity raised / (purchased)	0.0	0.0	0.0	0.0	C
hange in Debt	(0.2)	(17.3)	(1.9)	0.0	(
Other invest/financing cash flow	(12.9)	(0.2)	0.1	0.1	C
ffect of exch rate changes	(6.4)	0.3	0.1	0.0	C

FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Key Ratios					
Growth ratios (%)					
Revenue growth	13.3	10.3	19.3	13.0	9.5
EBITDA growth	26.9	42.8	26.9	16.0	14.9
EBIT growth	36.8	62.4	33.9	18.3	16.7
Pretax growth	38.4	63.9	33.2	18.4	16.7
Reported net profit growth	49.0	75.0	32.7	19.3	15.8
Core net profit growth	98.8	50.0	29.9	19.3	15.8
Profitability ratios (%)					
EBITDA margin	21.8	28.3	30.1	30.9	32.4
EBIT margin	15.6	23.0	25.8	27.0	28.8
Pretax profit margin	15.6	23.1	25.8	27.0	28.8
Payout ratio	17.5	30.1	30.0	30.0	30.0
DuPont analysis					
Net profit margin (%)	10.1	16.0	17.8	18.7	19.8
Revenue/Assets (x)	0.7	0.7	0.8	0.8	0.8
Assets/Equity (x)	1.5	1.4	1.3	1.3	1.2
ROAE (%)	11.0	17.2	19.8	20.5	20.6
ROAA (%)	8.5	12.0	14.5	15.7	16.3
Liquidity & Efficiency					
Cash conversion cycle	(0.3)	(4.4)	18.2	59.2	100.7
Days receivable outstanding	120.3	115.8	120.3	135.7	154.5
Days inventory outstanding	23.0	24.4	21.9	22.8	27.0
Days payables outstanding	143.5	144.6	123.9	99.2	80.8
Dividend cover (x)	5.7	3.3	3.3	3.3	3.3
Current ratio (x)	2.2	2.8	3.7	5.0	6.5
Leverage & Expense Analysis					
Asset/Liability (x)	3.4	4.1	4.9	6.0	7.3
Net gearing (%) (incl perps)	net cash				
Net gearing (%) (excl. perps)	net cash				
Net interest cover (x)	nm	na	na	na	na
	0.4	0.1	0.1	0.1	0.1
Debt/FBITDA (x)					
Debt/EBITDA (x) Capex/revenue (%)	6.8	2.3	2.0	1.8	1.7

Source: Company; Maybank

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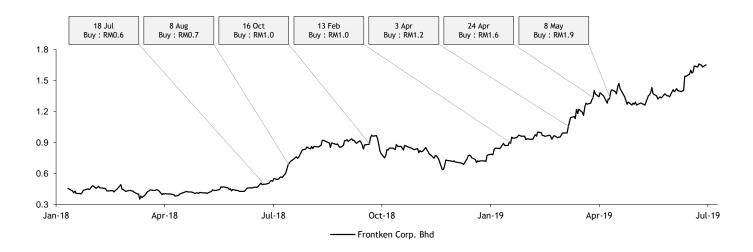
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