

HLIB Research

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BUY (Maintain)

Target Price: **RM4.10**
Previously: **RM4.10**
Current Price: **RM3.68**

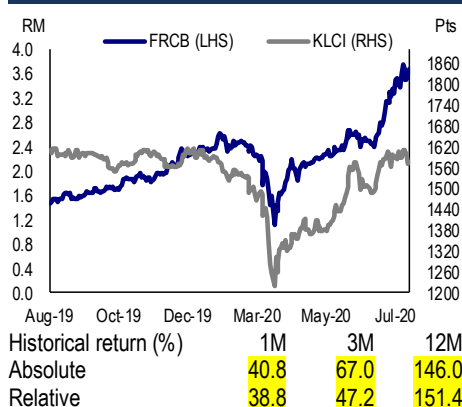
Capital upside 11.4%

Dividend yield 0.8%

Expected total return 12.2%

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)	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

FYE (Dec)	FY19	FY20f	FY21f
PATMI – core (RM m)	69.6	82.4	104.3
EPS – core (sen)	6.6	7.8	9.9
P/E (x)	55.5	46.9	37.1

Frontken Corporation

From strength to strength

The briefing validates our bullishness and expect another all-time high quarterly earnings. Taiwan's order is so robust till it has finally embarked on capacity expansion and is technologically ready to support the upcoming 3/2nm. SG's semi is expected to see flat volume but lifted by strong margin. O&G's prospect is not favourable but still expect to be profitable. Reiterate BUY with unchanged TP of RM4.10, pegged to 40x of mid-FY22 EPS. We like its unique exposure to world's leading-edge semiconductor frontend supply chain.

Post briefing, we remain optimistic of Frontken's business outlook and expect it to achieve another record high quarterly performance. Key takeaways as below:

Taiwan. Expect higher volume from one of its main customers who is advancing to 4nm or 5nm+ equivalent. 3nm is expected to be a long node with higher density and see up to 30% less power consumption vs 5nm. 3nm risk production is planned for next year followed by volume production in 2H22. Currently, AGTC has 3 months order visibility and still robust supported by unexpected high volume from 5nm. Price reduction roadmap is already in place although pricing pressure has subsided when customer's margin is high. Efficiency improved significantly when handling same parts (process familiarity) with volume. Thus, 5nm margin is better than in the past. AGTC is securing few pieces of land near exiting facility for expansion. Expansion size has yet to be determined. Construction is targeted to commence next year in line with 3nm commercial production and will also support 2nm. The new plant will begin with small capacity and more automation to yield consistent high-end results. Existing facility is equipped with semi-automation (for 7/5nm), Class 10 cleanroom and can support up to 1nm. Some orders that previously lost due to pricing have returned, as peers were not able to meet the required quality. ALD tool handling turnaround time has improved significantly (previously 1 month) supported by 4 teams despite complex process which require multiple steps.

Singapore's semi. Qualified for new parts for MNC with fab in China. Logistic issue during pandemic lockdown period and early Oct due to Golden Week holiday. Output was impacted by labor shortage and now it is partly mitigated after bringing staff back from Malaysia. Volume is flat but lifted by strong margin. Memory customer will continue to expand despite volatile and dismal memory prices.

SMIC blacklist. Negligible impact as volume is extremely small only require coating.

Ultra Clean's establishment in Penang is to support Lam Research and not expected to compete in cleaning business.

O&G. Prospect is not favorable and continue to lag but still expect it to be profitable (<FY19). Frontken will go ahead to develop a workshop in Pengerang.

Travel curtailments has halted several project developments including anodization and new parts cleaning/degreasing (now on ad-hoc basis). M&A is also delayed.

Forecast. Unchanged.

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 world's 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 RM247m or 23.4 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	2Q19	3Q19	4Q19	1Q20	2Q20
Revenue	80.1	87.0	88.9	84.9	87.6
COGS	(52.5)	(56.4)	(60.9)	(55.8)	(55.2)
EBITDA	27.7	30.6	28.0	29.1	32.4
D&A	(4.6)	(4.6)	(3.8)	(4.7)	(4.6)
EBIT	23.0	26.0	24.3	24.4	27.8
Net Interest Income	0.1	0.1	0.2	0.3	0.1
Associates	0.0	0.0	0.0	0.0	0.0
PBT	23.1	26.1	24.5	24.7	27.9
Tax	(5.3)	(5.6)	(4.9)	(6.5)	(6.1)
Net Profit	17.8	20.5	19.6	18.2	21.8
MI	(1.3)	(1.4)	(1.4)	(1.2)	(1.5)
PATAMI	16.5	19.0	18.2	17.0	20.3
Exceptionals	0.8	(1.0)	0.7	(0.7)	0.0
Adj PATAMI	17.3	18.0	18.9	16.3	20.3
Basic Shares (m)	1,053.0	1,053.0	1,053.0	1,053.0	1,053.0
Rep EPS (sen)	1.6	1.8	1.7	1.6	1.9
Adj EPS (sen)	1.6	1.7	1.8	1.6	1.9
Adj FD EPS (sen)	1.6	1.7	1.8	1.6	1.9

Valuation Ratios

FYE Dec	FY18	FY19	FY20f	FY21f	FY22f
PER (x)	74.0	55.9	46.9	37.1	34.6
Core PER (x)	71.0	55.5	46.9	37.1	34.6
FD PER (x)	71.0	55.5	46.9	37.1	34.6
DPS (sen)	1.5	2.5	3.0	3.8	4.0
Net DY (%)	0.4	0.7	0.8	1.0	1.1
Book/share (sen)	30.9	35.8	40.6	46.8	53.4
P/Book (x)	11.9	10.3	9.0	7.8	6.9
FCF/share (sen)	5.3	10.2	8.7	10.5	11.5
FCF yield (%)	1.4	2.8	2.4	2.9	3.1
Mkt Cap	3,864.5	3,864.5	3,864.5	3,864.5	3,864.5
Net Cash/Debt	121.5	196.3	256.8	328.0	406.4
EV	3,743.0	3,668.2	3,607.7	3,536.5	3,458.1
EV/EBITDA (x)	40.4	32.3	28.8	23.1	21.5
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

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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.

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OVERWEIGHT	Sector expected to outperform the market over the next 12 months.
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