

# Netlink NBN Trust (NETLINK SP)

# **Defensive results**

# FY21 net profit met expectations; maintain BUY

FY21 net profit of SGD94.8m was in line with MKE/ consensus estimates. Results were driven by higher EBITDA margin of 73.3% due to increased government grants and a favourable sales mix (more connectivity revenue). DPU of SGD0.0255 was declared, bringing FY21 DPU to SGD0.0508, meeting MKE/street estimates. With this, we raised our FY22-FY24E core profit by 11% to account for lower finance cost. As a result, our DDM-based (COE 6.3%, long-term growth 1.5%) TP is raised to SGD1.13 as we roll forward valuations to FY22E. Maintain BUY. Negative revisions to its regulatory regime are the key risk to our call.

### Results in line

Revenue dipped 0.5% to SGD368.5m as growth in residential (+2.5% to SGD238m) and the (Non-Building Address Point (NBAP) & segment (+22.5% to SGD8.9m) was offset by lower installation-relation revenue (-19% to SGD16.6m) and diversion (-23.2% to SGD8.5m) due to fewer orders amid Covid-19, as well as lower availability of contractors from Apr to Aug last year. That said, EBITDA margin expanded to 73.3% (+3.5ppt) due to higher government grants arising from Job Support Schemes and property taxes, as well as favourable shift in its sales mix towards higher-margin connectivity services. 2HFY21 DPU of SGD0.0255 was declared, which brings FY21 DPU to SGD0.0508, meeting MKE/street estimates and translates to a FY21 DPU yield of 5.2%.

# Acquisitions more in focus for FY22E

Moving into FY22E, Netlink's virtual monopoly in residential connections will continue to help it expand its residential network in new housing estates such as Tengah and Punggol. In terms of non-residential connections, the group will also continue to work proactively with telco players to acquire new non-residential and NBAP customers to support digitalisation projects and 5G rollout plan. NetLink will also be exploring opportunities to invest in telecom infrastructure business overseas to generate stable cashflow. No target has been identified yet and NetLink is making preliminary assessments of potential deals.

### No shortage of foreign workers

NetLink does not foresee any manpower shortages, despite stricter import of migrant workers amid the emergent of more virulent Covid variants. With a naturally defensive residential fibre monopoly business and 5.4% FY22E yield, we continue to believe NetLink provides a haven as compared to many yield plays despite rising risk of Covid resurgence.

FYE Mar (SGD m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	370	368	384	388	396
EBITDA	253	261	272	275	282
Core net profit	78	95	104	105	108
Core EPS (cts)	2.0	2.4	2.7	2.7	2.8
Core EPS growth (%)	1.0	21.4	10.1	0.2	3.3
Net DPS (cts)	5.0	5.1	5.4	5.5	5.6
Core P/E (x)	45.1	38.8	36.4	36.3	35.1
P/BV (x)	1.2	1.3	1.4	1.5	1.5
Net dividend yield (%)	5.5	5.4	5.5	5.6	5.7
ROAE (%)	2.6	3.3	3.8	4.0	4.3
ROAA (%)	1.8	2.3	2.6	2.7	2.8
EV/EBITDA (x)	15.9	16.0	15.8	15.6	15.3
Net gearing (%) (incl perps)	17.1	17.7	18.7	19.9	21.3
Consensus net profit	-	-	98	103	na
MKE vs. Consensus (%)	-	-	6.9	1.3	na

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# **BUY**

Share Price SGD 0.98

12m Price Target SGD 1.13 (+16%)

Previous Price Target SGD 1.11

#### **Company Description**

NetLink NBN Trust designs, builds, owns and operates the passive fibre network infrastructure of Singapore's Next Gen NBN.

#### Statistics

52w high/low (SGD)	1.03/0.94
3m avg turnover (USDm)	6.9
Free float (%)	75.2
Issued shares (m)	3,897
Market capitalisation	SGD3.8B
	USD2.9B

#### Major shareholders:

Singapore Telecommunications Ltd.	24.8%
Matthews International Capital Managemen	2.6%
The Vanguard Group, Inc.	1.7%

#### Price Performance



Netlink Trust - (LHS, SGD)	

	-1M	-3M	-12M
Absolute (%)	2	2	(3)
Relative to index (%)	4	(4)	(20)

Source: FactSet



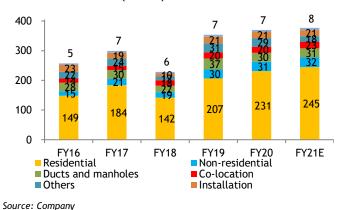
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# **Value Proposition**

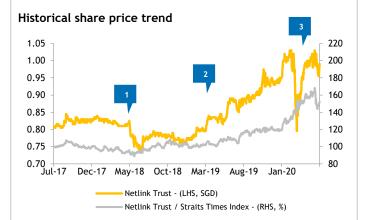
- Netlink operates the sole passive backbone for Singapore's nationwide fibre network with a mandated 100% of homes passed.
- As it has a virtual monopoly, EBITDA margin is high at 70%.
- More than 90% of revenue falls under a return on asset base (RAB) tariff regime based on a 7% pre-tax WACC. Tariffs are set over a five-year period with the current rate lasting until Dec 2022.
- Residential connection revenue, which follows regulated rate structure, represents the bulk (~62.5%) of the business.
- Non-residential, NBAP, and ducts and manholes services (under RAB framework) are the next largest revenue components at 18.6% combined.

#### Revenue breakdown (SGD m) - residential matters most



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# **Price Drivers**



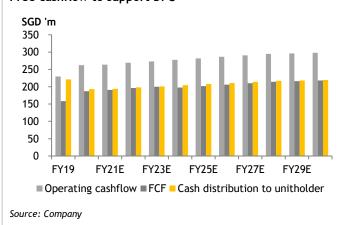
Source: Company, Maybank Kim Eng

- 1. 4QFY18 profit was 6% below prospectus estimate due to shortfall in installation revenue.
- 2. FY19 profit above prospectus forecasts.
- 3. Share price plunged due to market sell-down amid COVID-19 outbreak.

# **Financial Metrics**

- Healthy balance sheet and free cashflow can support 100% payout of its cash available for distribution.
- Following capex of SGD76m in FY20, management guided FY21E capex is at the lower range of SGD70-80m. We assume SGD73m per year until FY22E.

### Free cashflow to support DPU



# **Swing Factors**

# Upside

- Stronger-than-expected demand may enable NetLink to increase its regulated capex, which in turn provides additional guaranteed returns.
- Acceleration of office decentralisation from CBD area could provide growth in non-residential connections. Higher-than-expected residential household broadband penetration rate.
- Market risk-aversion could boost investment interest in NetLink given its defensive and stable business.
- Low interest rate environment could cause yield compression for NetLink.

### Downside

- Reduction in the regulated returns for the next review period would impact long-term fair value.
- Pricing competition in non-residential segment.
- Rising interest rate cycle would reduce the attractiveness of dividend-yielding stocks such as NetLink.

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# **Business Model & Industry Issues**

- NetLink provides fibre network services. This exposes it to environmental risks. In particular, energy is consumed to provide power to co-location rooms but NetLink has no direct control over energy consumed by its customers' equipment.
- Additionally, its densification of network within data centres also exposes it to environmental risks, as many data centres in Singapore, in the middle of its lifespan, were designed without sustainability and energy conservation in mind.
- The National Climate Secretariat under the Prime Minister's Office laid out a roadmap in 2014 to improve data centre sustainability by improving energy efficiency. SS564 aims to benchmark energy efficiency of data centres and provide the best practices for the industry. BCA-IDA Green Mark has also been implemented. It is a rating system to encourage the adoption of energy efficient data centre design.
- Likewise, NetLink will continue to roll out initiatives at its end to improve energy efficiency.
- In terms of governance, NetLink is adopting industry best practices, evidenced by its "Most Transparent REITs & Business Trust" award. Its constant disclosure and engagement with stakeholders helped the market to understand its opportunities and risks perception.

# Material E issues

- Generated and disposed an average of 0.44% of fibre scraps (excess fibre too short to be reused) against fibre cables issued. This is below its 2.5% FY21 target.
- Recovered 391.4 tonnes of fibre cables from cable diversion. These recovered fibre cables cannot be reused and will be disposed of at National Environment Agency approved facility for incineration.
- In FY20, NetLink invested SGD0.85m to replace fan coil units in co-location rooms to improve energy efficiency of cooling system by 30%.
- Going forward, more initiatives will be rolled out across its co-location rooms to reduce energy consumption. One example is "blanking" project - reduce power consumed for cooling based on containment concept. This will be gradually implemented across all co-location rooms.
- Motion sensor/LED lights were also introduced in suitable rooms in central offices.

# Material S issues

- Achieved 5,413 learning hours with an average of 15.4 learning hours per employee.
- Zero incidents of discrimination during FY19.
- Zero work-related incidents resulting in fatalities or permanent disabilities.
- Staff turnover rate of 17.7% is higher than high-tech industry's norm of 15.9%.
- NetLink aims to achieve annual employee turnover rate lower than industry norm in FY21 by investing in employees' skills development and building internal capabilities.
- 71:29 male to female employee ratio. Females make up 36% of "managers and executive" category.
- 64% of workforce is between 30 and 50 years old.

# Key G metrics and issues

- Awarded "Most Transparent REITs & Business Trust" by SIAS 20th Investors' Choice Awards in 2019.
- The board consists of eight directors, of which one is executive director (CEO), one is non-executive, non-independent director and six are independent (75%). Two directors are female (25%).
- The nominating, audit and remuneration committees are chaired by independent directors.
- Seven directors have served on the board since 2017 and one since 2018.
- Professional background of independent directors includes accounting, banking, consultancy and law.
- Total remuneration of CEO and top five key management personnel amounts to SGD4.3m, or 5.5% of FY20 PAT and 15.5% of staff cost.
- Independent auditor is Deloitte & Touche LLP since listing in 2017.
- No material contracts were entered into by NetLink or subsidiaries that involved the CEO, any directors or controlling shareholders.

# 1. Focus charts

Fig 1: MKE vs consensus estimate

(end-Mar, SGD m)	FY22E	FY23E	FY23E
Revenue (MKE)	384	388	396
EBITDA (MKE)	272	276	282
Core profit (MKE)	105	105	108
TP (SGD / unit)	1.13		
Revenue (cons)	385	343	390
EBITDA (cons)	276	246	276
Core profit (cons)	97	100	110
TP (SGD / unit)	1.14		
MKE vs cons (Revenue)	-0.4%	13.2%	1.6%
MKE vs cons (EBITDA)	-1.1%	11.9%	2.2%
MKE vs cons (core profit)	8.2%	4.3%	-1.6%
MKE vs cons (TP)	0.9%		

Source: Bloomberg, Maybank Kim Eng

Fig 2: Forecast revisions

	FY22E	FY23E	FY24E
Revised revenue	384	388	396
Revised EBITDA	273	276	282
Revised core profit	104	105	108
Revised TP	1.13		
Previous revenue	388	392	401
Previous EBITDA	267	277	284
Previous core profit	94	94	98
Previous TP	1,11		
Change in revenue	-1.2%	-1.0%	-1.2%
Change in EBITDA	2.0%	-0.5%	-0.7%
Change in core profit	11.0%	11.3%	10.3%
Change in TP	1.8%		

Source: Maybank Kim Eng

Fig 3: Quarterly income statement breakdown

(end-Mar, SGD m)	4QFY20	1QFY21	2QFY21	3QFY21	4QFY21	QoQ	YoY	% of MKE FY21E	% of cons FY21E
Revenue									
Ducts and manholes	7.3	7.4	7.2	7.2	6.9	-4%	-6%	93%	
Central office	4.1	4.8	4.7	4.3	4.3	0%	4%	<b>99</b> %	
Connection revenue - Residential	59.0	59.2	59.3	59.7	59.8	0%	1%	98%	
Connection revenue - Non- residential	7.9	7.4	7.9	7.4	7.7	3%	-3%	94%	
Connection revenue - NBAP and segment	1.8	1.9	2.1	2.4	2.5	1%	36%	117%	
Co-location	5.0	4.8	4.7	4.8	4.8	0%	-2%	93%	
Installation	3.7	2.1	4.8	5.0	4.7	-6%	27%	101%	
Diversion	3.6	1.4	1.8	3.9	1.4	-66%	-63%	123%	
Total revenue	92.4	89.0	92.5	94.8	92.2	-3%	0%	98%	99%
EBITDA	51.6	68.8	70.9	70.2	60.3	-14%	17%	101%	
Core profit	12.5	23.5	21.3	24.7	25.3	2%	103%	105%	100%

Source: Bloomberg, Maybank Kim Eng

Fig 4: Revenue breakdown by segments

Revenue breakdown	4QFY 20	1QF Y21	2QFY21	3QFY2 1	4QF Y21
Return on asset base (RAB) regulated revenue					
Residential	63.8%	66.5 %	64.1%	63.0%	64.8 %
Ducts and manholes	7.9%	8.3%	7.8%	7.6%	7.5%
Non-residential	8.6%	8.3%	8.5%	7.9%	8.3%
NBAP / Segment fibre	2.0%	2.1%	2.3%	2.6%	2.7%
Sub-total	82%	85%	83%	81%	83%
Non-RAB regulated					
revenue					
Co-location	5.4%	5.4%	5.1%	5.1%	5.3%
Installation	4.0%	2.4%	5.1%	5.3%	5.1%
Sub-total	9.4%	7.8 %	10.3%	10.4%	10.4 %
Non-regulated					
revenue					
Central office	4%	5%	5%	5%	5%
Diversion	4%	2%	2%	4%	1%
Total	100%	100 %	100%	100%	100 %

Source: Company data

Fig 5: Operating statistics

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Fibre connections	4Q FY2 0	1Q FY2 1	2Q FY2 1	3QFY21	4Q FY2 1	Qo Q	Yo Y
Residential end- users (m)	1.4 27	1.4 28	1.4 37	1.443	1.4 47	0%	1%
Non-residential end-users (m)	0.0 48	0.0 47	0.0 48	0.048	0.0 48	1%	1%
NBAP	1,6 79	1,7 72	1,8 47	1,884	1,9 96	6%	19%

Source: Company data



# 2. Valuation and risks

Fig 6: DDM valuation

(end-Mar, SGD m)	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E
Cash distribution paid	210	213	217	221	225	228	232	236	240	243
PV of cash distribution	210	188	181	173	165	158	151	144	138	131
Total PV of cash distribution	1,508									
Terminal value	5,047									
PV of Terminal Value	2,904									
Equity value	4,411									
Equity value / share (SGD)	1.13									

Source: Maybank Kim Eng

Fig 7: DDM parameters

Parameter	
Risk Free Rate (%)	2.5%
Market risk premium (%)	6.5%
Beta (x)	0.59
Cost of Equity (%)	6.3%
Terminal Growth (%)	1.5%

Source: Maybank Kim Eng

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FYE 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
Key Metrics	45.4	20.7	27.4	24.2	25.4
P/E (reported) (x)	45.1	39.7	36.4	36.3	35.1
Core P/E (x) P/BV (x)	45.1 1.2	38.8 1.3	36.4 1.4	36.3 1.5	35.1 1.5
P/NTA (x)	1.2	1.3	1.4	1.5	1.5
Net dividend yield (%)	5.5	5.4	5.5	5.6	5.7
FCF yield (%)	5.3	5.4	5.3	5.4	5.4
EV/EBITDA (x)	15.9	16.0	15.8	15.6	15.3
EV/EBIT (x)	47.4	44.9	42.1	42.1	40.9
INCOME STATEMENT (SGD m)					
Revenue	370.2	368.5	383.5	388.2	396.4
EBITDA	252.6	260.7	272.3	275.4	281.9
Depreciation	(167.8)	(167.8)	(170.2)	(173.1)	(176.0)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	84.8	93.0	102.1	102.3	105.8
Net interest income /(exp)	(20.5)	(11.3)	(11.3)	(11.3)	(11.3)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	7.5	10.0	7.5	7.5	7.5
Pretax profit	71.9	91.6	98.4	98.6	102.1
Income tax	6.2	3.2	6.0	6.0	6.0
Minorities	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	78.1	94.8	104.4	104.6	108.1
Core net profit	78.1	94.8	104.4	104.6	108.1
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	168.6	168.4	159.0	150.6	136.5
Accounts receivable	73.4	73.1	76.1	77.0	78.6
Inventory	4.3	4.3	4.5	4.5	4.6
Property, Plant & Equip (net)	3,026.7	2,919.1	2,821.9	2,721.8	2,625.7
Intangible assets	843.5	843.5	843.5	843.5	843.5
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	92.3	92.3	92.3	92.3	92.3
Total assets	4,208.8	4,100.7	3,997.2	3,889.6	3,781.2
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	58.5	53.6	55.3	56.1	57.0
LT interest bearing debt	664.8	664.8	664.8	664.8	664.7
Other liabilities	579.0	579.0	579.0	579.0	579.0
Total Liabilities	1,301.8	1,296.9	1,298.7	1,299.4	1,300.2
Shareholders Equity	2,906.9	2,803.7	2,698.5	2,590.2	2,480.9
Minority Interest  Total shareholder equity	0.0 <b>2,906.9</b>	0.0 <b>2,803.7</b>	0.0 <b>2,698.5</b>	0.0 <b>2,590.2</b>	0.0 <b>2,480.9</b>
Total liabilities and equity	4,208.8	4,100.7	3,997.2	3,889.6	3,781.2
CASH FLOW (SGD m)					
Pretax profit	71.9	91.6	98.4	98.6	102.1
Depreciation & amortisation	167.8	167.8	170.2	173.1	176.0
Adj net interest (income)/exp	19.6	11.3	11.3	11.3	11.3
Change in working capital	4.8	(4.5)	(1.4)	(0.2)	(0.8)
Cash taxes paid	3.2	6.0	6.0	6.0	6.0
Other operating cash flow	(22.5)	(14.1)	(11.3)	(11.3)	(11.3)
Cash flow from operations	258.8	258.1	273.1	277.5	283.3
Capex	(75.5)	(60.2)	(73.0)	(73.0)	(80.0)
Free cash flow	187.0	197.8	200.1	204.5	203.3
Dividends paid	(193.3)	(198.0)	(209.6)	(212.9)	(217.3)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	30.0	0.0	0.0	0.0	0.0
Other invest/financing cash flow	0.0	0.0	0.0	0.0	0.0
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
J	20.0	(0.2)	(9.4)	(8.4)	(14.1)

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FYE 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
Key Ratios					
Growth ratios (%)					
Revenue growth	4.7	(0.5)	4.1	1.2	2.1
EBITDA growth	2.6	3.2	4.4	1.2	2.3
EBIT growth	(0.7)	9.6	9.8	0.2	3.4
Pretax growth	3.0	27.5	7.3	0.2	3.5
Reported net profit growth	1.0	21.4	10.1	0.2	3.3
Core net profit growth	1.0	21.4	10.1	0.2	3.3
Profitability ratios (%)					
EBITDA margin	68.2	70.8	71.0	71.0	71.1
EBIT margin	22.9	25.2	26.6	26.4	26.7
Pretax profit margin	19.4	24.9	25.7	25.4	25.8
Payout ratio	247.2	208.6	200.6	203.3	200.9
DuPont analysis					
Net profit margin (%)	21.1	25.7	27.2	26.9	27.3
Revenue/Assets (x)	0.1	0.1	0.1	0.1	0.1
Assets/Equity (x)	1.4	1.5	1.5	1.5	1.5
ROAE (%)	2.6	3.3	3.8	4.0	4.3
ROAA (%)	1.8	2.3	2.6	2.7	2.8
Liquidity & Efficiency					
Cash conversion cycle	nm	nm	nm	nm	nm
Days receivable outstanding	72.6	71.6	70.0	71.0	70.7
Days inventory outstanding	nm	nm	nm	nm	nm
Days payables outstanding	nm	nm	nm	nm	nm
Dividend cover (x)	0.4	0.5	0.5	0.5	0.5
Current ratio (x)	2.7	2.8	2.7	2.6	2.5
Leverage & Expense Analysis					
Asset/Liability (x)	3.2	3.2	3.1	3.0	2.9
Net gearing (%) (incl perps)	17.1	17.7	18.7	19.9	21.3
Net gearing (%) (excl. perps)	17.1	17.7	18.7	19.9	21.3
Net interest cover (x)	4.1	8.2	9.1	9.1	9.4
Debt/EBITDA (x)	2.6	2.5	2.4	2.4	2.4
Capex/revenue (%)	20.4	16.4	19.0	18.8	20.2
Net debt/ (net cash)	496.2	496.4	505.8	514.2	528.2

Source: Company; Maybank

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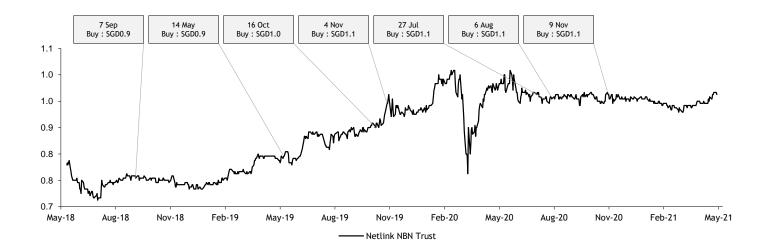
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