

# Netlink NBN Trust (NETLINK SP)

## Delivering stable performance

### Noise from re-measurement loss; Maintain BUY

Netlink's consolidated 9MFY22 revenue at SGD282m (+1.9% YoY) and net profit at SGD62m (-12% YoY) marginally missed MIBG/Street estimates due to higher operating expenses impacted by a re-measurement loss of SGD12.4m relating to finance lease receivables. Excluding this loss, we expect stable EBITDA growth YoY. We continue to like NetLink as its 5.6% FY22E yield offers strong dividend visibility. Changes to its regulated returns (7% pre-tax WACC) are key risks. Maintain BUY and DDM-based TP (COE: 6.3%, LTG: 1.5%) of SGD1.13. We transfer coverage to Kelvin Tan.

### Within expectations

3QFY22 revenue grew to SGD282m (-0.9% YoY, -1.2% QoQ) driven by higher revenue from Non Building Address Point (NBAP) & Segment connection (+45.9% YoY, 9.0% QoQ), residential (+2.4% YoY, 1.7% QoQ) and Co-location (+4.1% YoY, 2% QoQ), though partially offset by competition in Non-Residential and Central Office revenue. While EBITDA and PAT came in lower by 6.2% and 5.2% respectively YoY, the decrease relates to a re-measurement loss from reduction in rental rates upon the renewal of the Central Office lease agreements with SingTel from Sep 2021. Management states that the reduction in rental rates is not expected to have a material cashflow impact in FY22 or subsequent years.

### Stable growth momentum boosted top line

NBAP and Segment recorded 21.8% YoY growth (+4.4% QoQ) in connections driven by the increase in base stations as Singapore remains on track in its 5G rollout plan, as well as government agencies' projects to digitalise outdoor locations. The NBAP segment is likely to see sustained growth momentum especially with Singapore smart nation initiatives. These trends will accelerate well with increasing P2P connections and more diversity connections from data centres come through. Nevertheless, residential revenue remains Netlink's core driver. Residential fibre connections have seen more modest growth to 1.458m (1.0% YoY, 0.5% QoQ). This is largely in line with the Group's focus of improving take-ups from first-time fibre users and connecting low-income households via IMDA's Home Access program.

### Safe haven for dividend play

Given resiliency of the business model, the Group continues to explore potential inorganic growth opportunities in telecoms infrastructure that are likely to generate a stable cashflow. With gross debt/EBITDA of 2.6x and cash balance of SGD113m (as of 31 Dec 21), we believe Netlink should have sufficient headroom to drive its acquisition ambition without compromising dividends. With 93% of revenue from recurring cashflow, we believe Netlink 5.6% dividend yield offers an attractive spread even as interest rates rise.

FYE Mar (SGD m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	370	368	384	388	396
EBITDA	253	261	273	276	282
Core net profit	78	92	104	103	105
Core EPS (cts)	2.0	2.4	2.7	2.7	2.7
Core EPS growth (%)	1.0	18.2	12.7	(0.8)	1.5
Net DPS (cts)	5.0	5.1	5.4	5.5	5.5
Core P/E (x)	45.1	39.8	36.5	36.8	36.2
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	3.2	3.8	3.9	4.1
ROAA (%)	1.8	2.2	2.6	2.6	2.7
EV/EBITDA (x)	15.9	16.0	15.7	15.6	15.3
Net gearing (%) (incl perps)	17.1	17.6	18.4	19.5	20.9
Consensus net profit	-	-	100	100	86
MKE vs. Consensus (%)	-	-	3.7	3.1	22.4

Kelvin Tan

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# BUY

Share Price	SGD 0.98
12m Price Target	SGD 1.13 (+16%)
Previous Price Target	SGD 1.13

### Company Description

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

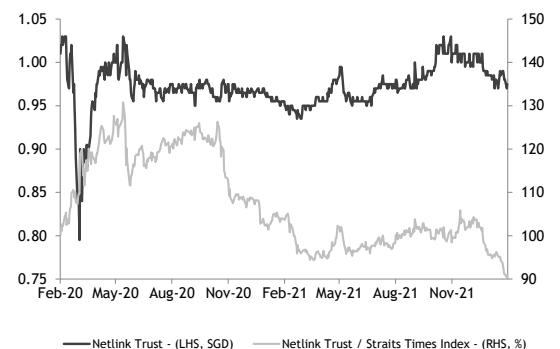
### Statistics

52w high/low (SGD)	1.03/0.94
3m avg turnover (USDm)	4.8
Free float (%)	75.2
Issued shares (m)	3,897
Market capitalisation	SGD3.8B
	USD2.8B

### Major shareholders:

Singapore Telecommunications Ltd.	24.8%
Mathews International Capital Managemen	2.7%
The Vanguard Group, Inc.	2.0%

### Price Performance



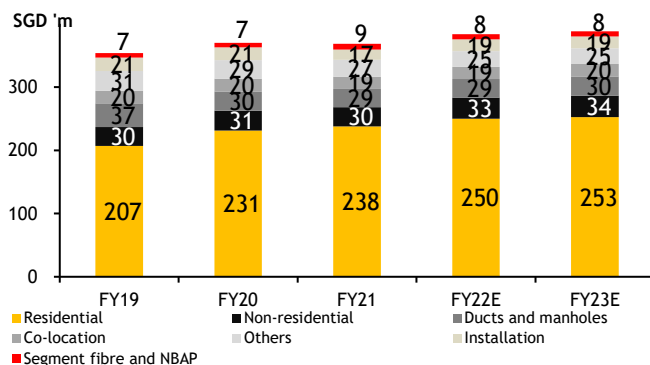
	-1M	-3M	-12M
Absolute (%)	(1)	(5)	2
Relative to index (%)	(5)	(10)	(13)

Source: FactSet

## 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

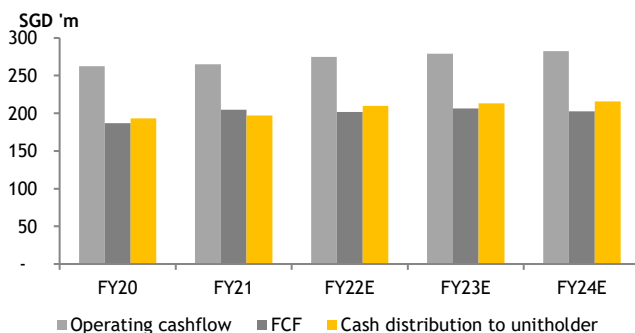


Source: Company

## 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.

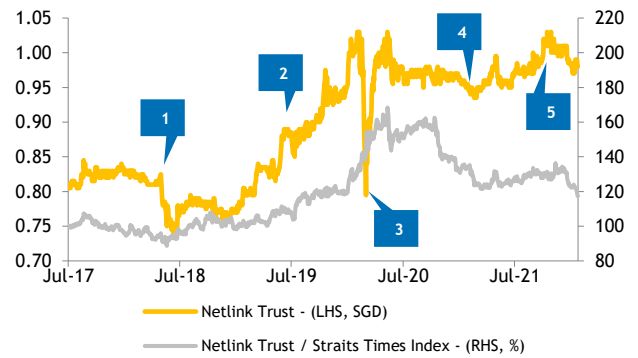
### Free cashflow to support DPU



Source: Company

## Price Drivers

### Historical share price trend



Source: Company, Maybank IBG Research

- FY18 profit was 6% below prospectus estimate due to shortfall in installation revenue.
- FY19 profit above prospectus forecasts.
- Share price plunged due to market sell-down amid COVID-19 outbreak.
- Q4FY20 EBITDA declined 11.2% following a one-time write-off of capitalised project cost from a discontinued IT system replacement project, market responded with a sell off
- Share price has appreciated 6% in the past three months, likely on the back of resilient top-line, good cost control and attractive dividend yield on a low interest rate environment

## 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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Risk Rating & Score <sup>1</sup>	27.7 (Medium)
Score Momentum <sup>2</sup>	-0.4
Last Updated	11 Jan 2022
Controversy Score <sup>3</sup> (Updated: 28 May 2018)	0 - No reported incident

## 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.
- Its densification of network within data centres exposes it to data centres’ environmental risks, as many Singapore data centres, in the middle of its lifespan, were designed without sustainability and energy conservation in mind. That said, NetLink has no direct control over its customers’ power consumption.
- 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. S564 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

<sup>1</sup>**Risk Rating & Score** - derived by Sustainalytics and assesses the company’s exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company’s enterprise value, respectively, from ESG-driven financial impacts. <sup>2</sup>**Score Momentum** - indicates changes to the company’s score since the last update - a **negative** integer indicates a company’s improving risk score; a **positive** integer indicates a deterioration. <sup>3</sup>**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

## Focus Charts

Fig 1: Quarterly income statement

(end-Mar, SGD m)	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	QoQ	YoY	YTD % of MIBG FY22E	YTD % of cons FY22E
Revenue									
Ducts and manholes	7	7	7	7	7	2.2%	-1.0%		
Central office	4	4	4	4	4	2.2%	-4.8%		
Connection revenue - Residential	60	60	60	61	60	1.7%	2.4%		
Connection revenue - Non-residential	7	8	8	8	8	2.2%	-2.2%		
Connection revenue - NBAP and segment	2	2	3	3	3	9.0%	45.9%		
Co-location	5	5	5	5	5	2.2%	4.1%		
Installation	5	5	5	5	5	-1.7%	1.9%		
Diversion	4	1	2	2	2	22.6%	24.3%		
Total revenue	95	92	93	95	94	-1.2%	-0.9%	74%	73%
EBITDA	70	60	69	58	70	20.7%	-0.2%	72%	71%
Core profit	25	25	24	13	25	96.2%	1.2%	59%	62%
EBITDA margin	74.0%	65.3%	74.7%	61.0%	74.5%				

Source: FactSet, Bloomberg

Fig 2: Quarterly operating statistics

Fibre connections	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	QoQ	YoY
Residential end-users (m)	1.443	1.447	1.449	1.451	1.458	0.50%	1.00%
Non-residential end-users (m)	0.048	0.048	0.049	0.049	0.05	1.40%	3.70%
NBAP	1,884	1,996	2,101	2,197	2,294	4.40%	21.80%

Revenue breakdown	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22
<b>Return on asset base (RAB) regulated revenue</b>					
Residential	63.00%	64.90%	64.20%	63.80%	64.00%
Ducts and manholes	7.60%	7.50%	7.50%	7.50%	7.50%
Non-residential	7.90%	8.40%	8.10%	8.10%	8.20%
NBAP / Segment fibre	2.60%	2.70%	3.00%	3.20%	3.30%
NBAP					
<b>Sub-total</b>	<b>81.00%</b>	<b>83.50%</b>	<b>82.80%</b>	<b>82.60%</b>	<b>83.00%</b>
<b>Non-RAB regulated revenue</b>					
Co-location	5.10%	5.30%	5.20%	5.20%	5.20%
Installation	5.30%	5.10%	5.30%	5.10%	5.20%
<b>Sub-total</b>	<b>10.40%</b>	<b>10.40%</b>	<b>10.50%</b>	<b>10.30%</b>	<b>10.40%</b>
<b>Non-regulated revenue</b>					
Central office	4.50%	4.70%	4.70%	4.70%	4.30%
Diversion	4.20%	1.50%	2.00%	2.40%	2.30%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: Factset, Bloomberg

Fig 3: Maybank IBG vs consensus

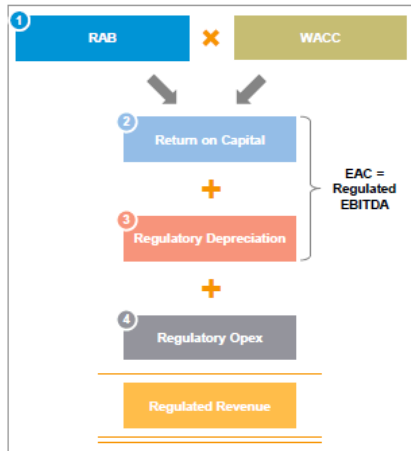
(end-Mar, SGD m)	FY22E	FY23E	FY24E
Revenue (MIBG)	384	388	396
EBITDA (MIBG)	273	276	282
Core profit (MIBG)	104	103	105
TP (SGD / unit)	1.13		
Revenue (cons)	388	386	394
EBITDA (cons)	277	277	278
Core profit (cons)	100	104	104
TP (SGD / unit)	1.14		
MIBG vs cons (Revenue)	-1.2%	0.7%	0.6%
MIBG vs cons (EBITDA)	-1.3%	-0.4%	1.3%
MIBG vs cons (core profit)	4.0%	-0.7%	0.7%
MIBG vs cons (TP)	-0.9%		

Source: Factset, Bloomberg, Maybank IBG Research

Fig 4: Framework for RAB based pricing model

**NetLink Trust's pricing for its services**

**Framework for RAB Based Pricing Model**



**Methodology for RAB based pricing model**

1 Cost Base for RAB	<ul style="list-style-type: none"> <li>Base year of the RAB is 2012</li> <li>Assets purchased up to 2012 are valued at 2012 prices</li> <li>Assets purchased after 2012 are valued at actual cost</li> </ul>
2 Return on Capital <sup>(1)</sup>	<ul style="list-style-type: none"> <li>Nominal pre-tax WACC of 7.0% for the current review period</li> <li>Derived using the capital asset pricing model</li> <li>Nominal Pre-tax WACC = <math>\text{Cost of equity} \times \frac{(1 - \text{gearing})}{(1 - \text{tax})} + \text{Cost of debt} \times \text{gearing}</math></li> </ul>
3 Regulatory Depreciation	<ul style="list-style-type: none"> <li>Based on Annuity Method of Depreciation</li> <li>Useful life of assets:               <ul style="list-style-type: none"> <li>Ducts and manholes: 35 years</li> <li>Fibre and related Infrastructure: 25 years</li> </ul> </li> </ul>
4 Regulatory Opex	<ul style="list-style-type: none"> <li>NLT is allowed to recover a portion of its operating expenditure spent as part of the RAB</li> </ul>

1. IMA may change the rate of applicable pre-tax WACC in future review period

Source: Company data

FYE 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Key Metrics</b>					
P/E (reported) (x)	45.1	40.8	36.5	36.8	36.2
Core P/E (x)	45.1	39.8	36.5	36.8	36.2
P/BV (x)	1.2	1.3	1.4	1.5	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	5.6	5.3	5.4	5.3
EV/EBITDA (x)	15.9	16.0	15.7	15.6	15.3
EV/EBIT (x)	47.4	46.1	42.6	43.1	41.7

**INCOME STATEMENT (SGD m)**

Revenue	370.2	368.5	383.5	388.2	396.4
EBITDA	252.6	260.7	273.5	275.6	282.0
Depreciation	(167.8)	(170.3)	(172.7)	(175.6)	(178.5)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	84.8	90.4	100.8	100.0	103.5
Net interest income / (exp)	(20.5)	(11.3)	(10.3)	(10.3)	(12.3)
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	89.1	98.0	97.2	98.7
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	92.3	104.0	103.2	104.7
Core net profit	78.1	92.3	104.0	103.2	104.7
Preferred Dividends	0.0	0.0	0.0	0.0	1.0

**BALANCE SHEET (SGD m)**

Cash & Short Term Investments	168.6	170.5	162.4	155.4	142.1
Accounts receivable	73.4	70.4	73.3	74.2	75.8
Inventory	4.3	5.2	5.4	5.4	5.6
Property, Plant & Equip (net)	3,026.7	2,927.4	2,827.7	2,725.1	2,626.5
Intangible assets	843.5	864.0	864.0	864.0	864.0
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	92.3	85.9	85.9	85.9	86.9
<b>Total assets</b>	<b>4,208.8</b>	<b>4,123.5</b>	<b>4,018.7</b>	<b>3,910.0</b>	<b>3,800.9</b>
ST interest bearing debt	0.0	0.0	0.0	0.0	1.0
Accounts payable	58.5	58.7	59.9	61.3	62.3
LT interest bearing debt	664.8	664.7	664.7	664.7	664.7
Other liabilities	579.0	596.0	572.0	572.0	572.0
<b>Total Liabilities</b>	<b>1,301.8</b>	<b>1,319.8</b>	<b>1,296.3</b>	<b>1,297.7</b>	<b>1,299.6</b>
Shareholders Equity	2,906.9	2,803.7	2,722.4	2,612.3	2,501.2
Minority Interest	0.0	0.0	0.0	0.0	0.0
<b>Total shareholder equity</b>	<b>2,906.9</b>	<b>2,803.7</b>	<b>2,722.4</b>	<b>2,612.3</b>	<b>2,501.2</b>
<b>Total liabilities and equity</b>	<b>4,208.8</b>	<b>4,123.5</b>	<b>4,018.7</b>	<b>3,910.0</b>	<b>3,800.9</b>

**CASH FLOW (SGD m)**

Pretax profit	71.9	89.1	98.0	97.2	98.7
Depreciation & amortisation	167.8	170.3	172.7	175.6	178.5
Adj net interest (income)/exp	19.6	11.3	10.3	10.3	12.3
Change in working capital	4.8	2.3	(1.8)	0.4	(0.7)
Cash taxes paid	3.2	6.0	6.0	6.0	6.0
Other operating cash flow	(22.5)	(14.1)	(10.3)	(10.3)	(11.3)
Cash flow from operations	258.8	264.9	274.9	279.3	283.6
Capex	(75.5)	(60.2)	(73.0)	(73.0)	(80.0)
Free cash flow	187.0	204.8	201.9	206.3	202.6
Dividends paid	(193.3)	(197.2)	(210.0)	(213.4)	(215.9)
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	1.0
<b>Net cash flow</b>	<b>20.0</b>	<b>7.5</b>	<b>(8.1)</b>	<b>(7.1)</b>	<b>(11.3)</b>

FYE 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
Revenue growth	4.7	(0.5)	4.1	1.2	2.1
EBITDA growth	2.6	3.2	4.9	0.8	2.3
EBIT growth	(0.7)	6.6	11.4	(0.8)	3.5
Pretax growth	3.0	24.0	10.0	(0.8)	1.5
Reported net profit growth	1.0	18.2	12.7	(0.8)	1.5
Core net profit growth	1.0	18.2	12.7	(0.8)	1.5
<b>Profitability ratios (%)</b>					
EBITDA margin	68.2	70.8	71.3	71.0	71.2
EBIT margin	22.9	24.5	26.3	25.8	26.1
Pretax profit margin	19.4	24.2	25.6	25.0	24.9
Payout ratio	247.2	213.4	201.6	206.4	205.8
<b>DuPont analysis</b>					
Net profit margin (%)	21.1	25.1	27.1	26.6	26.4
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	3.2	3.8	3.9	4.1
ROAA (%)	1.8	2.2	2.6	2.6	2.7
<b>Liquidity &amp; Efficiency</b>					
Cash conversion cycle	nm	nm	nm	nm	nm
Days receivable outstanding	72.6	70.3	67.5	68.4	68.1
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	2.4	2.3	2.2	2.1
<b>Leverage &amp; Expense Analysis</b>					
Asset/Liability (x)	3.2	3.1	3.1	3.0	2.9
Net gearing (%) (incl perps)	17.1	17.6	18.4	19.5	20.9
Net gearing (%) (excl. perps)	17.1	17.6	18.4	19.5	20.9
Net interest cover (x)	4.1	8.0	9.8	9.7	8.4
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	494.2	502.3	509.3	523.6

Source: Company; Maybank

## Research Offices

### ECONOMICS

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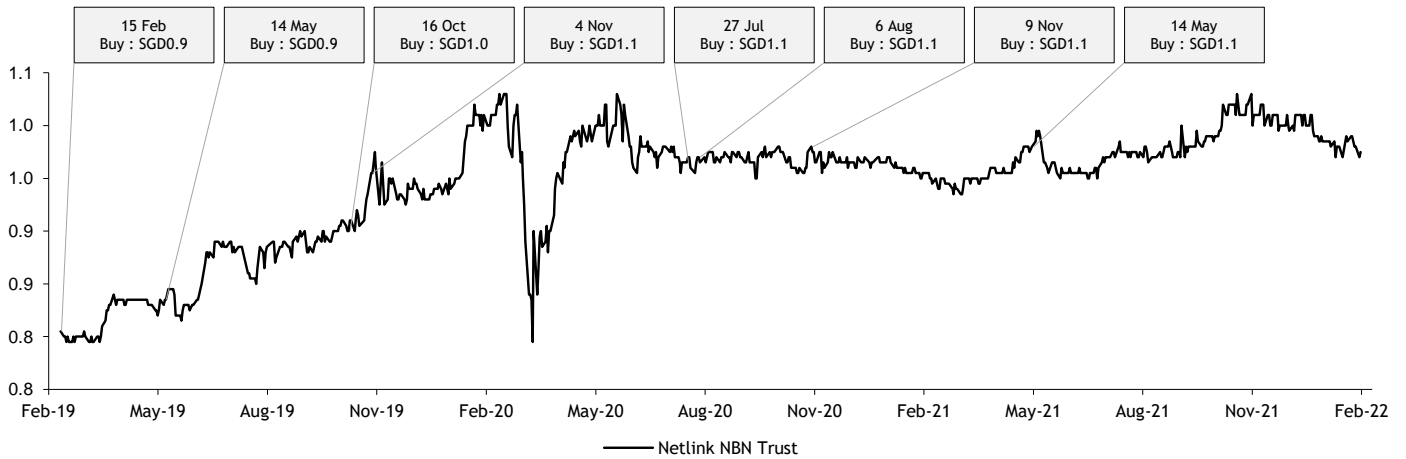
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