

Netlink NBN Trust (NETLINK SP)

Run its course for now

HOLD

[Prior:BUY]

Share Price	SGD 0.94
12m Price Target	SGD 1.00 (+6%)
Previous Price Target	SGD 1.05

Company Description

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

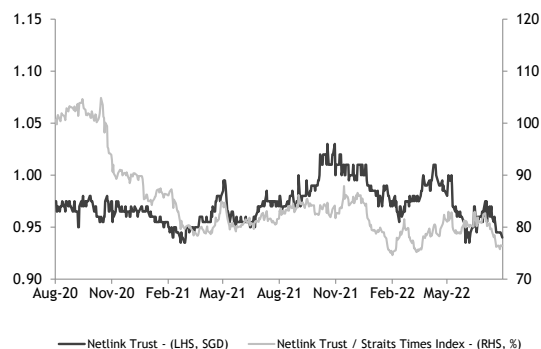
Statistics

52w high/low (SGD)	1.03/0.94
3m avg turnover (USDm)	5.4
Free float (%)	75.2
Issued shares (m)	3,897
Market capitalisation	SGD3.7B
	USD2.7B

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 (%)	(3)	(5)	(4)
Relative to index (%)	(8)	(7)	(7)

Source: FactSet

1Q23 broadly in line but limited growth; D/G to HOLD

PATMI for 1QFY23 rose to SGD27.6m (+11.3% YoY), ahead of MIBG/consensus expectations, accounting for 29%/28% of the respective FY23 forecasts. The increase was mainly due to a surge in ancillary project revenue (+137% YoY). We conservatively trim our FY23-25F PATMI estimates by 2-4% on concern over rising interest cost. As such, we downgrade our call from Buy to HOLD with a 5% lower DDM-based TP of SGD1.00 as we raise our cost of equity (COE) to 6.6% on a higher risk-free rate assumption.

Topline improved with continued operational growth

1QFY23 revenue increased (+2.3% QoQ) on a stronger contribution from ancillary project revenue (+33% QoQ) as more diversion projects completed compared to 1QFY22. This was partially offset by lower Central Office revenue (-12.6% YoY to SGD4m) on a drop in rental space that reduced rental income. Residential connection revenue remains the largest contributor to the group at 62% of revenue. As at 30 June 2022, there were 1.47m (+0.4% QoQ) residential connections, 50.8k (+1% QoQ) non-residential connections, 2.48m (+3.1% QoQ) NBAP connections and 2.17m (+14.2% QoQ) segment connections completed.

ICO pricing remains an overhang

The elephant in the room remains the IMDA review (ECD early 2023), which will determine the pricing of Netlink's ICO services. We believe that ICO pricing will come under pressure given lower interest rates (as compared to 2017), a higher RFR environment and an increasing number of fibre connections. High inflation reduces the attractiveness of dividend distributions as earnings growth will be limited. We are prudently below consensus as we reduce our FY23/24/25 PATMI forecasts by 4%/4%/2% and raise our COE from 6.3% to 6.6% on a higher RFR assumption.

Upside muted; downgrade to HOLD

We believe that share price will remain in suspended mode as the group waits for regulatory to complete the public consultation process. On possible inorganic growth, management remains patient in looking for undervalued opportunities, while taking a cautious stance amid market volatility. We remain cognisant of the company's profile as a high-yield, safe haven stock. Netlink's robust operating cashflow, attractive yield, and resilient business model keep us supportive of the name.

FYE Mar (SGD m)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	368	378	386	392	398
EBITDA	261	264	269	274	278
Core net profit	92	91	95	96	101
Core EPS (cts)	2.4	2.3	2.4	2.5	2.6
Core EPS growth (%)	18.2	(1.0)	4.1	1.1	5.0
Net DPS (cts)	5.1	5.1	5.3	5.3	5.5
Core P/E (x)	39.8	41.5	38.5	38.1	36.2
P/BV (x)	1.3	1.4	1.4	1.5	1.5
Net dividend yield (%)	5.4	5.2	5.6	5.7	5.9
ROAE (%)	3.2	3.3	3.6	3.7	4.0
ROAA (%)	2.2	2.2	2.4	2.5	2.7
EV/EBITDA (x)	16.0	16.3	15.6	15.3	15.2
Net gearing (%) (incl perps)	17.6	18.9	20.0	21.6	23.2
Consensus net profit	-	-	101	103	109
MKE vs. Consensus (%)	-	-	(5.8)	(6.3)	(6.9)

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Definitions:

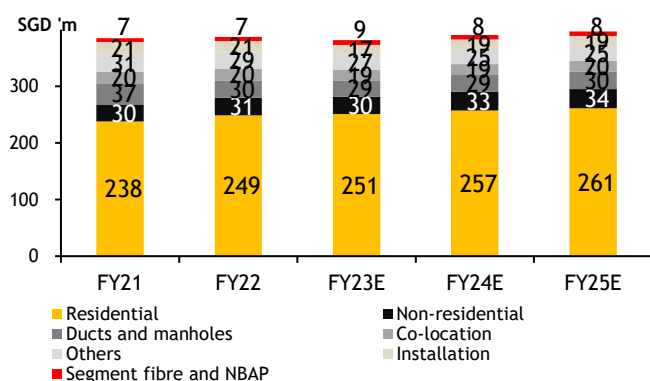
- IMDA - Infocomm Media Development Authority
- ECD - Estimated Completion Date
- ICO - Interconnection Offer
- RFR - Risk Free Rate
- COE - Cost of Equity
- NBAP - Non-Building Access Point

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Tear Sheet Insert

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.

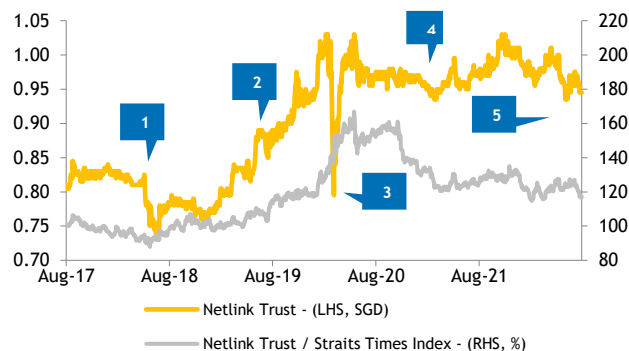
Revenue breakdown (SGD m) - residential matters most



Source: Company

Price Drivers

Historical share price trend



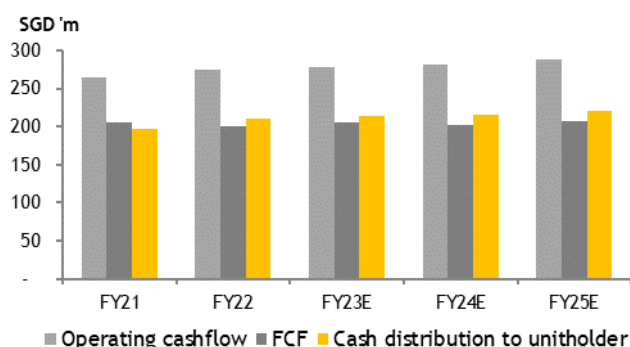
Source: Company, Maybank IBG Research

- FY18 profit was 6% below the 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

Financial Metrics

- Healthy balance sheet and free cashflow can support 100% payout of its cash available for distribution.
- Following capex of SGD73m in FY22, management guided FY23E capex is at the lower range of SGD70-80m. We assume SGD80m per year until FY25E.

Free cashflow to support DPU



Source: Company

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 ¹	27.0
Score Momentum ²	-1.1
Last Updated	01 Apr 2022
Controversy Score ³	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. 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.
- 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.

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**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. ²**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. ³**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).

1. 1Q23 results highlights

Fig 1: Quarterly income statement breakdown

(end-Mar, SGD m)	1Q22	2Q22	3Q22	4Q22	1Q23	QoQ	YoY	% of MKE FY22	YTD % of cons FY22
Revenue									
Ducts and manholes	7	7	7	7	7	1.6%	-0.3%	25%	
Central office	4	4	4	3	4	13.4%	-12.6%	23%	
Finance lease income									
Service income and charges									
Connection revenue - Residential	60	61	60	61	61	0.2%	1.7%	24%	
Connection revenue - Non-residential	8	8	8	8	8	-1.5%	4.0%	23%	
Connection revenue - NBAP and segment	3	3	3	4	4	-5.1%	33.3%	44%	
Co-location	5	5	5	5	5	7.3%	9.3%	27%	
Installation	5	5	5	5	5	8.4%	5.3%	27%	
Diversion	2	2	2	3	4	32.6%	136.9%	44%	
Total revenue	93	95	94	96	98	2.3%	4.8%	25%	25%
EBITDA	69	58	70	70	73	4.3%	5.0%	27%	26%
Core profit	24	13	25	25	28	10.4%	11.3%	29%	28%

Source: Maybank IBG Research

Fig 2: Quarterly Revenue breakdown

Revenue breakdown	1QFY21	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23
RAB regulated revenue									
Residential	66.5%	64.1%	63.0%	64.9%	64.2%	63.8%	64.0%	63.3%	62.0%
Ducts and manholes	8.3%	7.8%	7.6%	7.5%	7.5%	7.5%	7.5%	7.1%	7.1%
Non-residential	8.3%	8.5%	7.9%	8.4%	8.1%	8.1%	8.2%	8.3%	8.0%
NBAP / Segment fibre	2.1%	2.3%	2.6%	2.7%	3.0%	3.2%	3.3%	4.1%	3.8%
NBAP									
Sub-total	85.2%	82.7%	81.0%	83.5%	82.8%	82.6%	83.0%	82.9%	80.9%
Non-RAB regulated revenue									
Co-location	5.4%	5.1%	5.1%	5.3%	5.2%	5.2%	5.2%	5.1%	5.4%
Installation	2.4%	5.1%	5.3%	5.1%	5.3%	5.1%	5.2%	5.0%	5.3%
Sub-total	7.8%	10.3%	10.4%	10.4%	10.5%	10.3%	10.4%	10.2%	10.7%
Non-regulated revenue									
Central office	5.4%	5.1%	4.5%	4.7%	4.7%	4.7%	4.3%	3.5%	3.9%
Diversion	1.6%	2.0%	4.2%	1.5%	2.0%	2.4%	2.3%	3.5%	4.5%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%

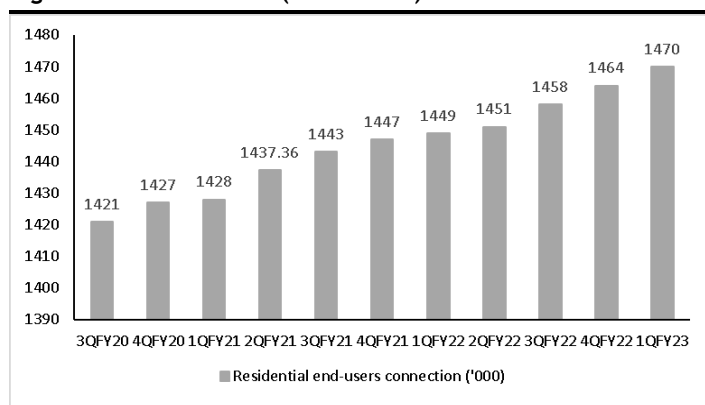
Source: Maybank IBG Research

Fig 3: Operating Statistics

Fibre connections	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	QoQ	YoY
Residential end-users (m)	1,449	1,451	1,458	1,464	1,470	0.4%	1.4%
Non-residential end-users (m)	0,049	0,049	0,050	0,050	0,051	1.0%	4.5%
NBAP	2,101	2,197	2,294	2,404	2,17	14.2%	66.9%

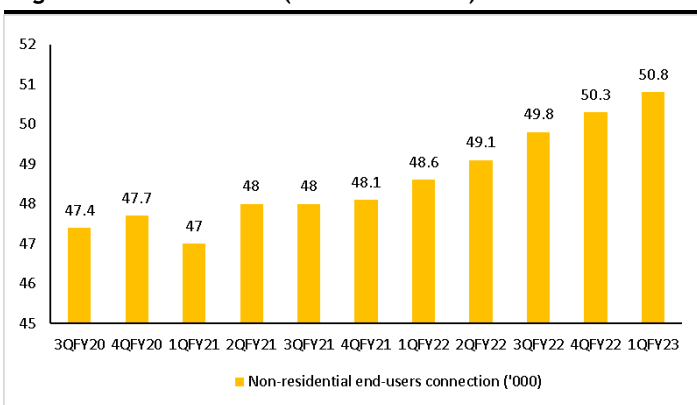
Source: Company

Fig 4: Fibre Connection (Residential)



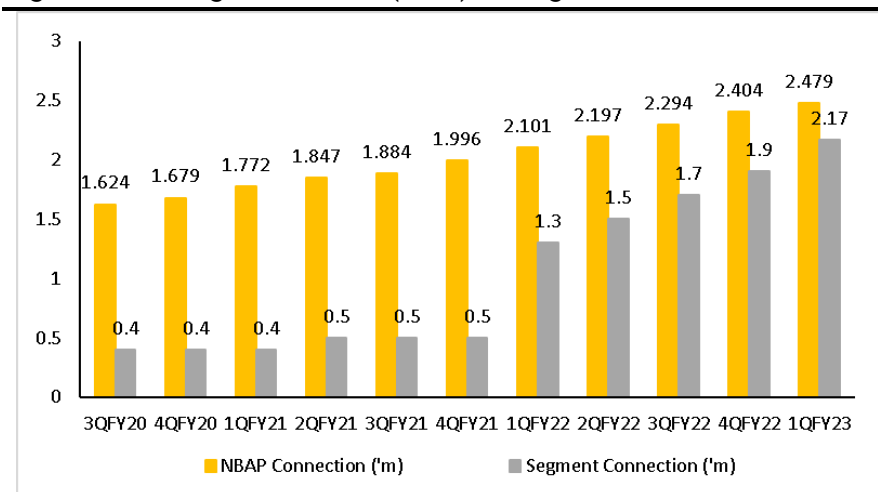
Source: Company

Fig 5: Fibre Connection (Non-Residential)



Source: Maybank IBG Research

Fig 6: Non-Building Address Point (NBAP) and Segment Connections



Source: Maybank IBG Research

2. Forecast and valuation changes

Amid a rising rates environment and short-term cost pressures, we believe concerns over a cut in regulatory WACC remains an imminent theme for this name. In view of the overall macroeconomic environment, we have conservatively reduced our FY23/24/25F PATMI forecasts by 4%/4%/2%. That said, we continue to believe that Netlink’s robust balance sheet, attractive yield, and resilient business model will be able to sustain its current dividend, especially given current market conditions.

Fig 7: MIBG vs consensus estimate

(end-Mar, SGD m)	FY23E	FY24E	FY25E
Revenue (MKE)	386	392	398
EBITDA (MKE)	269	274	278
Core profit (MKE)	95	96	101
TP (SGD / unit)	1.00		
Revenue (cons)	385	388	395
EBITDA (cons)	277	277	282
Core profit (cons)	100	100	104
TP (SGD / unit)	1.03		
MKE vs cons (Revenue)	0.2%	1.0%	0.7%
MKE vs cons (EBITDA)	-3.0%	-1.1%	-1.6%
MKE vs cons (core profit)	-4.9%	-3.9%	-2.9%
MKE vs cons (TP)	-3.3%		

Source: Maybank IBG Research, Bloomberg

Fig 8: Forecast revisions

	FY23E	FY24E	FY25E
Revised revenue (SGD m)	386	392	398
Revised EBITDA (SGD m)	269	274	278
Revised core profit (SGD m)	95	96	101
Revised DPU (SGD)	0.053	0.053	0.055
Revised TP (SGD)	1.00		
Previous revenue (SGD m)	389	397	403
Previous EBITDA (SGD m)	273	279	283
Previous core profit (SGD m)	99	100	103
Previous DPU (SGD)	0.053	0.054	0.056
Previous TP (SGD)	1.05		
Change in revenue	-0.8%	-1.2%	-1.2%
Change in EBITDA	-1.3%	-1.8%	-1.8%
Change in core profit	-3.6%	-4.0%	-2.0%
Change in DPU	-0.9%	-1.4%	-0.7%
Change in TP	-4.8%		

Source: Maybank IBG Research

Our DDM based TP of SGD1.05 has been reduced by 5% to SGD1.00 as we have raised the WACC on a higher risk free rate assumption. Hence, we downgrade our rating to HOLD from BUY.

Fig 9: DDM Valuation

(end-Mar, SGD m)	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E
Cash distribution paid	206	208	215	220	224	228	232	236
PV of cash distribution	193	184	179	172	165	158	151	144
Total PV of cash distribution	1,347							
Terminal value	4,141							
PV of Terminal Value	2,534							
Equity value	3,880							
Equity value / share (SGD)	1.00							

Source: Maybank IBG Research

Fig 10: DDM Parameters

Parameter	
Risk Free Rate (%)	2.8%
Market risk premium (%)	6.5%
Beta (x)	0.59
Cost of Equity (%)	6.3%
Terminal Growth (%)	1.0%

Source: Maybank IBG Research

3. Risks

The key downside risks to our forecasts remains to be less favourable pricing for service offered by regulated IMDA and subject to review/renewal every 5 years. Lower tariff may impact cash available for distribution, this might lead to higher borrowings or lower capital expenditure to main near term dividends.

Meanwhile the key upside risks would be 1) more opportunities arising from mobile operators' fibre network densification demand, NBAP growth from Smart City initiatives, higher-than-expected dividend payout and earnings accretive M&A opportunities.

FYE 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
Key Metrics					
P/E (reported) (x)	40.8	41.8	38.5	38.1	36.2
Core P/E (x)	39.8	41.5	38.5	38.1	36.2
P/BV (x)	1.3	1.4	1.4	1.5	1.5
P/NTA (x)	1.3	1.4	1.4	1.5	1.5
Net dividend yield (%)	5.4	5.2	5.6	5.7	5.9
FCF yield (%)	5.6	4.9	5.3	5.2	5.4
EV/EBITDA (x)	16.0	16.3	15.6	15.3	15.2
EV/EBIT (x)	46.1	45.7	43.5	42.7	42.5

INCOME STATEMENT (SGD m)

Revenue	368.5	377.6	385.7	392.1	397.7
EBITDA	260.7	264.1	268.9	273.9	278.0
Depreciation	(170.3)	(169.7)	(172.7)	(175.6)	(178.8)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	90.4	94.4	96.3	98.3	99.2
Net interest income / (exp)	(11.3)	(10.4)	(10.4)	(11.4)	(7.4)
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	10.0	3.2	3.2	3.2	3.2
Pretax profit	89.1	87.2	89.1	90.1	95.0
Income tax	3.2	4.2	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	92.3	91.3	95.1	96.1	101.0
Core net profit	92.3	91.3	95.1	96.1	101.0
Preferred Dividends	0.0	0.0	0.0	1.0	2.0

BALANCE SHEET (SGD m)

Cash & Short Term Investments	170.5	149.8	138.4	120.7	105.1
Accounts receivable	70.4	95.7	97.7	99.3	100.8
Inventory	5.2	4.1	4.2	4.3	4.3
Property, Plant & Equip (net)	2,927.4	2,830.7	2,731.0	2,635.4	2,536.6
Intangible assets	864.0	879.2	879.2	879.2	879.2
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	85.9	72.4	72.4	72.4	72.4
Total assets	4,123.5	4,031.9	3,922.9	3,811.3	3,698.4
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	58.7	55.4	57.0	57.6	58.4
LT interest bearing debt	664.7	663.7	663.7	663.7	663.7
Other liabilities	596.0	596.0	572.0	572.0	572.0
Total Liabilities	1,319.8	1,315.4	1,292.7	1,293.3	1,294.2
Shareholders Equity	2,803.7	2,716.4	2,630.2	2,518.0	2,404.2
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	2,803.7	2,716.4	2,630.2	2,518.0	2,404.2
Total liabilities and equity	4,123.5	4,031.9	3,922.9	3,811.3	3,698.4

CASH FLOW (SGD m)

Pretax profit	89.1	87.2	89.1	90.1	95.0
Depreciation & amortisation	170.3	169.7	172.7	175.6	178.8
Adj net interest (income)/exp	11.3	10.4	10.4	11.4	7.4
Change in working capital	2.3	(27.5)	(0.6)	(1.0)	(0.7)
Cash taxes paid	4.2	6.0	6.0	6.0	6.0
Other operating cash flow	(12.3)	(12.2)	(10.4)	(10.4)	(5.4)
Cash flow from operations	264.9	233.6	267.2	271.7	281.1
Capex	(60.2)	(73.9)	(73.0)	(80.0)	(80.0)
Free cash flow	204.8	184.9	194.2	190.7	199.1
Dividends paid	(197.2)	(199.1)	(205.6)	(208.4)	(214.8)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	0.0	(2.6)	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	1.0	2.0
Net cash flow	7.5	(42.0)	(11.5)	(15.6)	(11.7)

FYE 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
Key Ratios					
Growth ratios (%)					
Revenue growth	(0.5)	2.5	2.2	1.6	1.4
EBITDA growth	3.2	1.3	1.8	1.9	1.5
EBIT growth	6.6	4.3	2.0	2.2	0.9
Pretax growth	24.0	(2.2)	2.2	1.2	5.4
Reported net profit growth	18.2	(1.0)	4.1	1.1	5.0
Core net profit growth	18.2	(1.0)	4.1	1.1	5.0
Profitability ratios (%)					
EBITDA margin	70.8	69.9	69.7	69.9	69.9
EBIT margin	24.5	25.0	25.0	25.1	24.9
Pretax profit margin	24.2	23.1	23.1	23.0	23.9
Payout ratio	213.4	217.8	216.1	216.5	212.5
DuPont analysis					
Net profit margin (%)	25.1	24.2	24.6	24.5	25.4
Revenue/Assets (x)	0.1	0.1	0.1	0.1	0.1
Assets/Equity (x)	1.5	1.5	1.5	1.5	1.5
ROAE (%)	3.2	3.3	3.6	3.7	4.0
ROAA (%)	2.2	2.2	2.4	2.5	2.7
Liquidity & Efficiency					
Cash conversion cycle	nm	nm	nm	nm	nm
Days receivable outstanding	70.3	79.2	90.2	90.5	90.6
Days inventory outstanding	nm	nm	nm	nm	nm
Days payables outstanding	nm	nm	nm	nm	nm
Dividend cover (x)	0.5	0.5	0.5	0.5	0.5
Current ratio (x)	2.4	2.1	2.0	1.9	1.7
Leverage & Expense Analysis					
Asset/Liability (x)	3.1	3.1	3.0	2.9	2.9
Net gearing (%) (incl perps)	17.6	18.9	20.0	21.6	23.2
Net gearing (%) (excl. perps)	17.6	18.9	20.0	21.6	23.2
Net interest cover (x)	8.0	9.1	9.3	8.6	13.4
Debt/EBITDA (x)	2.5	2.5	2.5	2.4	2.4
Capex/revenue (%)	16.4	19.6	18.9	20.4	20.1
Net debt/ (net cash)	494.2	513.9	525.3	543.0	558.6

Source: Company; Maybank IBG Research

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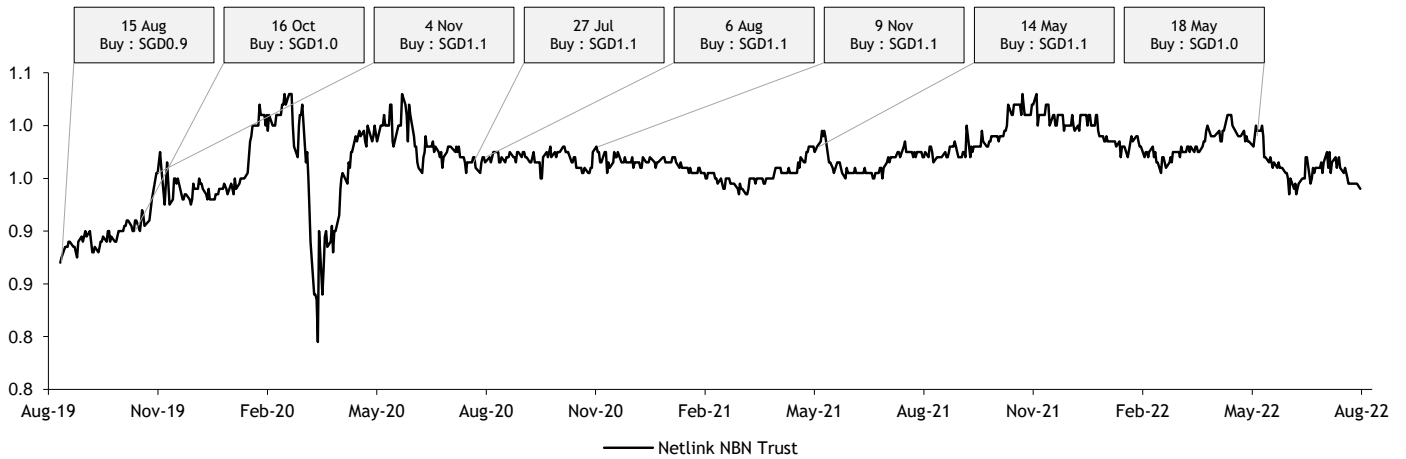
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