Telecommunications

Singapore

July 27, 2020

Netlink NBN Trust (NETLINK SP)

Underground shelter to dividend downside

BUY

Share Price	SGD 0.97
12m Price Target	SGD 1.08 (+12%)

Yields are more stable vs telcos and REITS. BUY

Reinitiate coverage of NetLink NBN Trust with BUY and DDM-based (6.3% COE, 1.5% LTG) TP of SGD1.08. NetLink is the sole nationwide provider of passive fibre network infrastructure in Singapore. NetLink's business is less volatile than other yield plays such as certain REITs and telcos amid risks of DPU cut and competition. In addition, NetLink is a domestic-yield play amid COVID-19 re-opening uncertainties. Changes to its regulated returns (based on 7% pre-tax WACC) is the key upside or risk to our outlook.

Strong recurring cashflow: residential and non-fibre

92% of FY20 revenue was recurring cashflow. Residential connections represented 62.5% of FY20 revenue. We expect this segment to provide earnings stability for NetLink, driven by high residential broadband penetration rate of 94% and annual new household formation of 25,000 units or a 10-year CAGR of 1.7% through 2029. Meanwhile, we expect non-fibre segments (18.5% of FY20 revenue) to remain stable due to long-term contracts.

Opportunities: 5G and non-residential

We believe NetLink will continue to have a role in 5G deployment. Singapore will have two nationwide 5G network coverage by 2025 and incumbents currently only have their own coverage concentrated in the CBD and business park areas. Successful 5G rollout requires base stations to be linked with existing fibre infrastructure and we believe incumbents will use NetLink's fibre infrastructure instead of building their own to reduce capex. This presents an opportunity to grow NetLink's non-building address points (NBAP) segment. Meanwhile, the non-residential segment will be driven by office decentralisation and data centre growth.

Defensive yield play

NetLink's FY21E DPU yield of 5.2% is comparable to Singapore REITs' FY20E (end-Dec) average yield of 5.6% and telco players' 5.5%. We favour NetLink over telcos and certain REITs that exhibit higher risk of DPU downside from capital preservation amid COVID-19 outbreak, weak fundamentals and telcos' declining average revenue per user and equipment sales due to supply disruption.

FYE Mar (SGD m)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	354	370	383	391	395
EBITDA	246	253	274	278	282
Core net profit	77	78	101	97	98
Core EPS (cts)	2.0	2.0	2.6	2.5	2.5
Core EPS growth (%)	54.9	1.0	29.6	(4.2)	0.7
Net DPS (cts)	4.9	5.0	5.0	5.1	5.2
Core P/E (x)	41.8	45.1	37.1	38.7	38.5
P/BV (x)	1.1	1.2	1.3	1.4	1.4
Net dividend yield (%)	5.9	5.5	5.2	5.3	5.4
ROAE (%)	2.5	2.6	3.5	3.5	3.7
ROAA (%)	1.8	1.8	2.4	2.4	2.5
EV/EBITDA (x)	15.1	15.9	15.5	15.3	15.1
Net gearing (%) (incl perps)	16.0	17.1	17.7	18.5	19.2
Consensus net profit	-	-	93	99	104
MKE vs. Consensus (%)	-	-	9.4	(2.1)	(6.1)

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Company Description

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

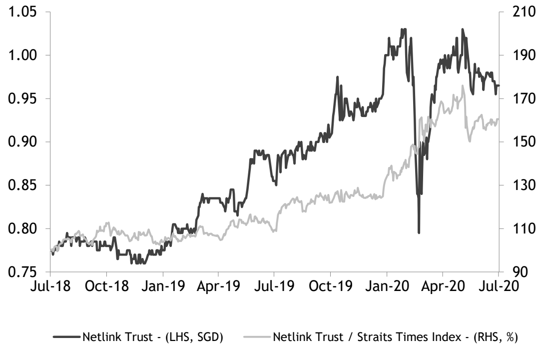
Statistics

52w high/low (SGD)	1.03/0.80
3m avg turnover (USDm)	8.1
Free float (%)	74.2
Issued shares (m)	3,897
Market capitalisation	SGD3.8B
	USD2.7B

Major shareholders:

Singapore Telecommunications Ltd.	24.8%
Matthews International Capital Managemen	5.4%
The Vanguard Group, Inc.	2.2%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(2)	(3)	13
Relative to index (%)	(1)	(4)	47

Source: FactSet

IMDA - Infocomm Media Development Authority

Co. Reg No: 198700034E MICA (P) : 099/03/2012

ESG

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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.

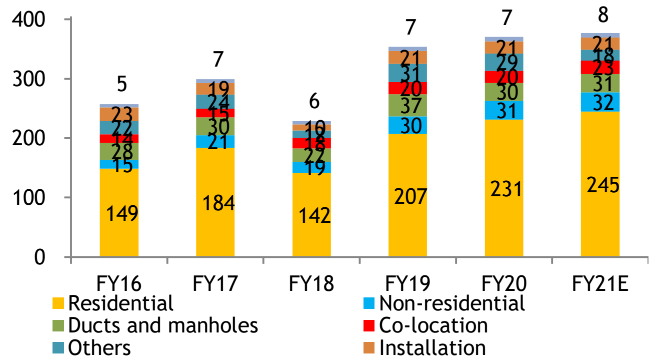
Key G metrics and issues

- 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.

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.

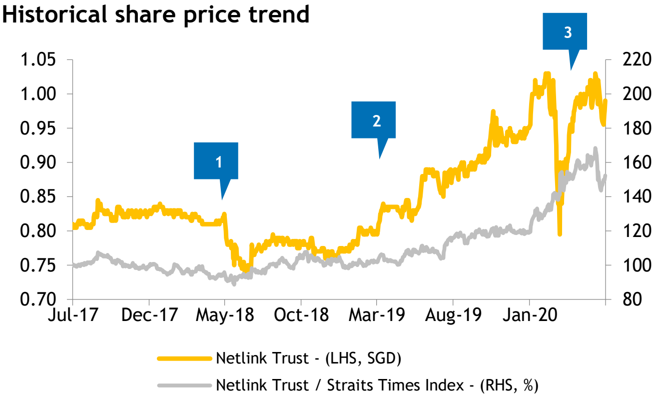
Revenue breakdown (SGD m) - residential matters most



Source: Company

Price Drivers

Historical share price trend



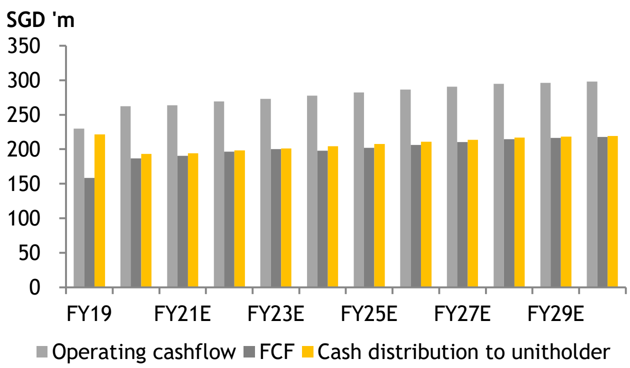
Source: Company, Maybank Kim Eng

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



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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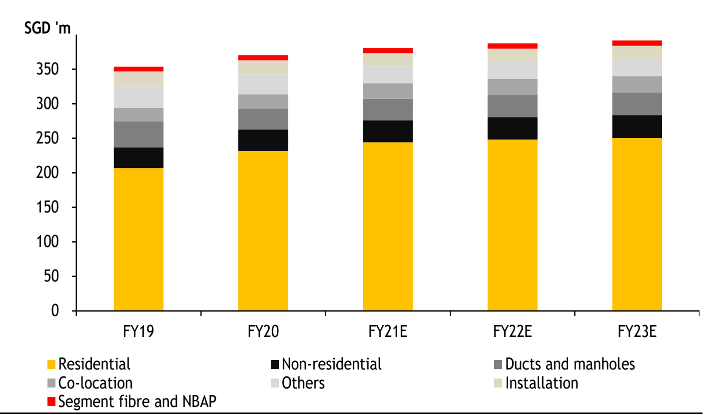
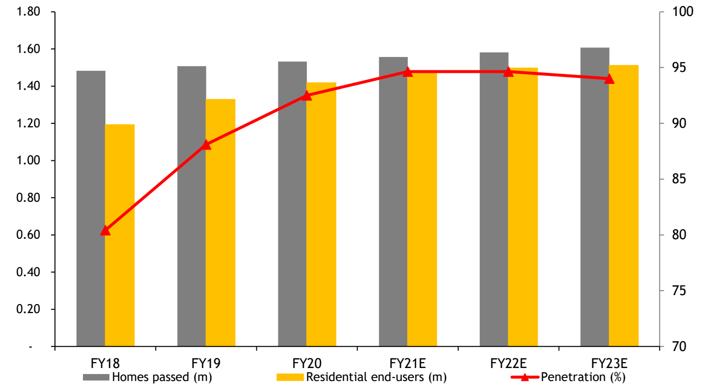
Focus Charts

Figure 1: Revenue breakdown by segments



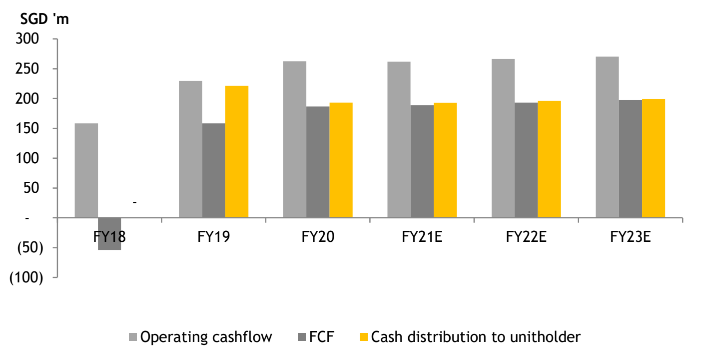
Source: Company data, Maybank Kim Eng

Figure 2: Residential connections growth



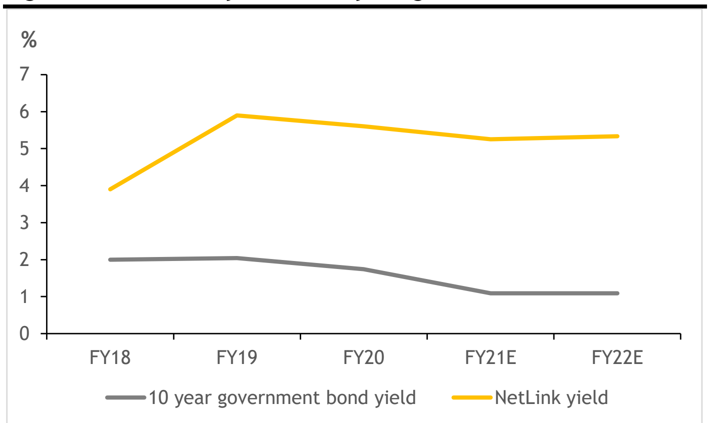
Source: Company data, Maybank Kim Eng

Figure 3: Healthy OCF, FCF vs cash distribution



Source: Company data, Maybank Kim Eng

Figure 4: NetLink's yield vs 10-year government bond



Source: Company data, Maybank Kim Eng

Figure 5: MKE vs consensus

(end-Mar, SGD m)	FY21E	FY22E	FY23E
Revenue (MKE)	383	391	395
Core profit (MKE)	101	97	98
DPS (SGD, MKE)	0.050	0.051	0.052
TP (SGD / unit)	1.08		
Revenue (cons)	381	390	397
Core profit (cons)	92	97	102
DPS (SGD, cons)	0.050	0.052	0.053
TP (SGD / unit)	1.05		
MKE vs cons (Revenue)	0.0%	-0.7%	-1.2%
MKE vs cons (core profit)	6.8%	-2.6%	-7.7%
MKE vs cons (DPS)	-0.4%	-0.8%	-4.4%
MKE vs cons (TP)	%		

Figure 6: Sensitivity analysis

Variable	FY21E	FY22E	FY23E
5% Change in residential revenues			
Revenue	-3.2%	-3.2%	-3.2%
Core profit	-11.1%	-12.3%	-11.9%
TP (SGD / unit)	-4%		
10% Change in non-residential revenues			
Revenue	-0.9%	-0.9%	-0.8%
Core profit	-3.2%	-3.1%	-3.8%
TP (SGD / unit)	-1.5%		
10% Change in manholes and ducts revenues			
Revenue	-0.9%	-0.9%	-0.8%
Core profit	-3.2%	-3.1%	-2.7%
TP (SGD / unit)	-1.5%		

Source: Company data, Maybank Kim Eng

1. Investment thesis

1.1 Residential and non-fibre businesses to provide stable earnings visibility

NetLink is the sole nationwide provider of passive fibre network infrastructure in Singapore. 92% of NetLink's FY20 revenue was recurring income and predictable cash flow. 81% of NetLink's FY20 revenue was under the regulated asset base (RAB) regime. The Infocomm Media Development Authority (IMDA) sets NetLink's pricings and returns for a five-year period based on its asset base and pre-tax WACC. The current five-year period will last until Dec 2022 (FY23), with a 7% pre-tax WACC designated as NetLink's fixed return on its assets.

Figure 7: Breakdown of business segment

	RAB revenue				Non-RAB revenue			
	Residential	Non-residential	NBAP and segment	Ducts and manholes	Installation	Diversion	Co-location and other	Central Office
% of FY20 revenue	62.5%	8.4%	2.0%	8.2%	5.6%	3.0%	5.5%	4.8%
Recurring predictable cash flows	✓	✓	✓	✓	-	-	✓	✓
Long-term contracts/sustainability	✓	✓	✓	✓	-	-	✓	✓
Regulated revenues	✓	✓	✓	✓	✓	-	✓	-
Credit worthy customers	✓	✓	✓	✓	✓	✓	✓	✓

Source: Company data

Residential connection revenue represents the bulk (FY20: 62.5%) of the business and we expect this segment to continue to provide stable earnings for NetLink.

With current residential internet access penetration rate already high at 98%, NetLink's residential connection growth will be driven by Singapore's new household formation going forward.

Based on HDB and URA projections, Singapore's new household formation is estimated to be 25,000 per year for the next 50 years, in new estate areas such as Tenggah and Punggol.

Due to its large exposure in this segment, any downward revision in IMDA's regulated pricing in residential connection in 2023 will impact earnings and TP the most. Every 2% change will lead to a potential 1.5% impact to TP.

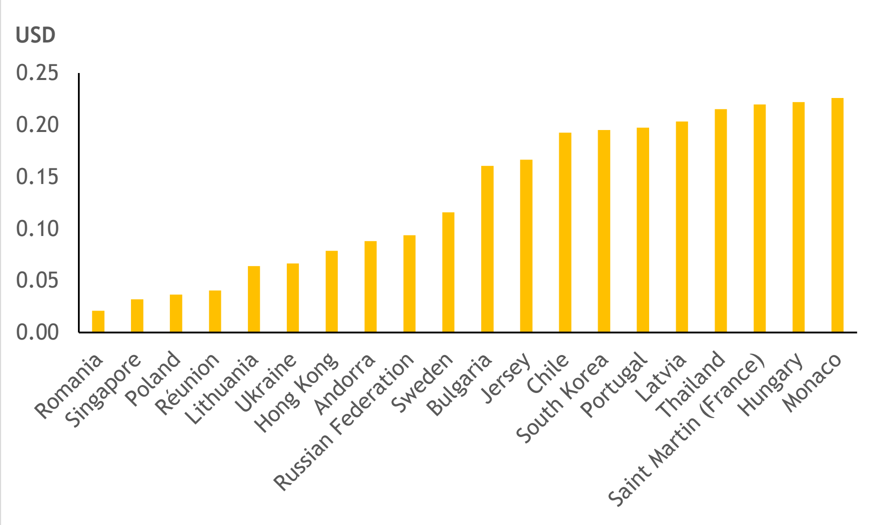
Figure 8: Change in residential pricing in 2023

Change in residential connection pricing	TP (SGD)	TP Change
-2%	1.06	-1.5%
-4%	1.04	-3.4%
-6%	1.03	-4.3%
-8%	1.01	-6.2%

Source: Maybank Kim Eng

That said, we think a drastic downward revision by IMDA is unlikely, as Singapore's broadband connection pricing is one of the lowest globally already.

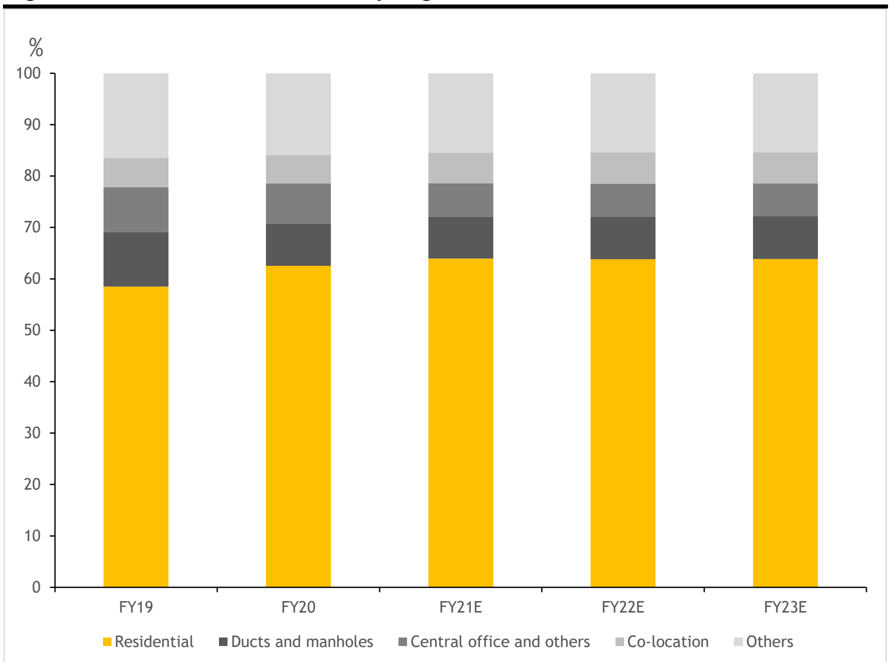
Figure 9: Countries with lowest average cost of broadband (per megabit/mth)



Source: Cable.co.uk

Meanwhile, we expect other non-fibre businesses (FY20: 18.5%) such as ducts & manholes, co-location and central office segments to remain stable due to long-term contracts with its customers.

Figure 10: Revenue breakdown by segments



Source: Company data, Maybank Kim Eng

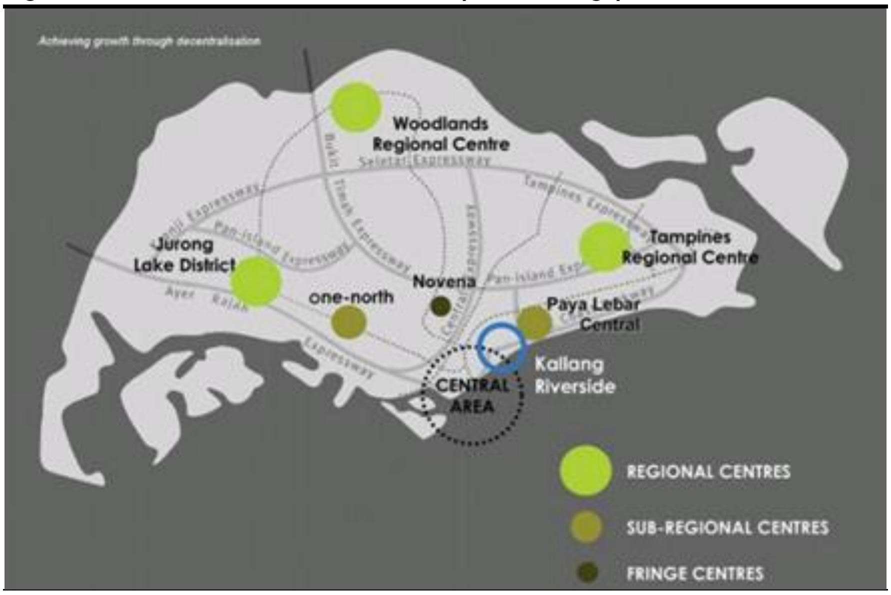
1.2 Non-residential: office decentralisation, data centres

Non-residential connections (RAB revenue) made up 8.4% of FY20 revenue. As of Dec 2019, NetLink had 37% market share of corporate fixed broadband subscribers recorded by IMDA, up from 34% last year.

This is driven by connections by SMEs and commercial developments located outside of the CBD, where NetLink's network is a monopoly. Currently, competitors' (incumbent telcos) network deployment is largely concentrated within the CBD and business parks.

As such, NetLink should continue to benefit from the government's drive to decentralise business activities and commercial centres to outside of the CBD, such as to Jurong East, the Woodlands, Tampines, one-north and Paya Lebar Central.

Figure 11: Government decentralisation plan for Singapore



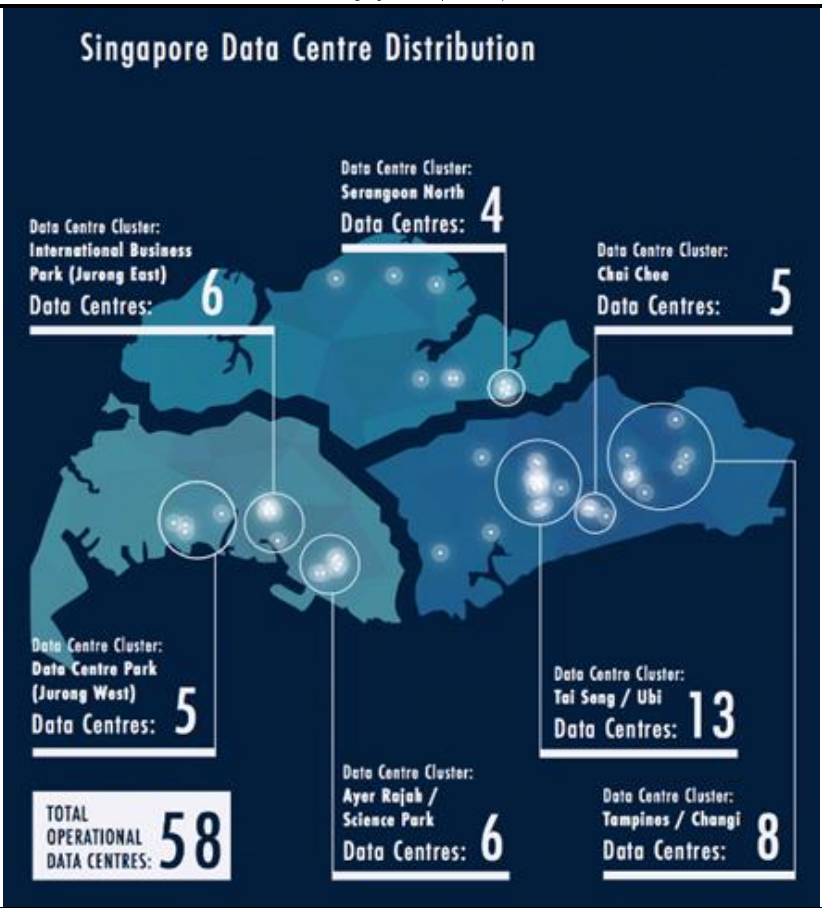
Source: URA

Decentralisation of commercial activities to outside of the CBD could potentially push the incumbents to expand their coverage beyond the CBD and business park areas, thus competing with NetLink and each other.

However, the probability of this happening is low as the incumbent telco service providers, unlike NetLink, do not have any guaranteed returns on such capex and are subject to market forces.

Going forward, NetLink will also aim to improve its presence in major data centre sites.

Figure 12: Data centre sites in Singapore (2017)



Source: Structure Research

Based on a market research report by ReportLinker, while Singapore is one of the mature data centre markets in APAC, it is likely to remain a major connectivity hub in the region as global cloud service providers continue to expand their presence. As such, Singapore's data centre market size is projected to grow at a CAGR of 4% to SGD2.5b from 2020-2025. Further, growth in Internet of Things and 5G network generate demand for edge computing data centres in Singapore.

1.3 5G not a threat but an opportunity

5G wireless network uses higher frequency millimetre (mm) wave spectrum to provide higher bandwidth with virtually no latency. As such, 5G wireless network will provide nearly 100% network availability with less than 1 millisecond latency.

This implies that 5G technology could provide 1,000 times the current bandwidth and 10 gigabit-per second (Gbps) speed, up from the current maximum speed of 1Gbps. To put things in perspective, this enables one to download a two-hour movie in 3.6 seconds. The same task would take about six minutes on 4G.

The key benefit of 5G technology spans far beyond speed. It allows a massive increase in connected devices at lower latency and it's the key enabler for industrial automation and autonomous driving.

High frequency mm waves can travel only about 250 feet so this means telco players have to set up denser 5G base stations on streetlamps and buildings to power 5G network.

According to RCR Wireless News, successful 5G rollout would require existing fibre infrastructure, and both networks will never be mutually exclusive. 5G base stations have to be linked to Singapore's fibre backhaul. It is helpful to imagine that 5G will function as capillaries (mobile fronthaul), but most of the internet traffic is carried by arteries (fibre backhaul).

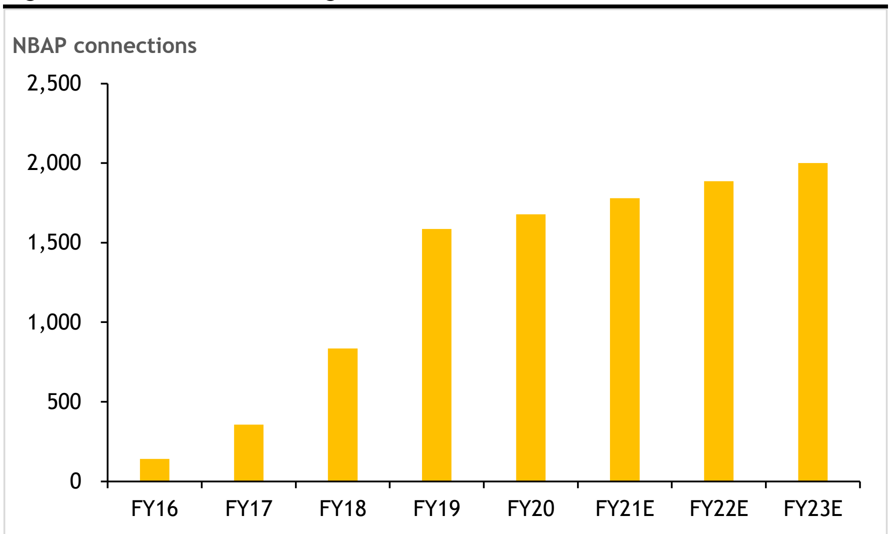
Based on an US case study by Deloitte, only 10% of internet traffic is carried by wireless networks (5G), while the remaining 90% is supported by wireline network (fibre backhaul). Without fibre, telcos will not be able to support the projected four-fold increase in mobile data traffic between 2016 and 2021.

In other words, the quality and reliability of 5G technology is dependent on fibre network transmitting data traffic to and fro 5G base stations.

As such, 5G deployment will not pose a threat to NetLink's business but rather an opportunity to grow its Non-Building Address Points (NBAP) segment.

We have captured this to a small degree. Our base case assumes NBAP connections to grow at 10% per year through FY23, up from FY20's growth rate of 6%.

Figure 13: Forecasted NBAP growth



Source: Company data, Maybank Kim Eng

Areas of growth clusters include the following trial sites:

- **Smart Estates:** Singapore Science Park by CapitaLand, TPG Telecom and Navinfo Datatech
- **Industry 4.0:** Changi Business Park by ARTC, Singapore and JTC
- **Urban Mobility:** NTU Smart Campus by M1 and NTU
- **Maritime Operations:** Singapore Maritime Drone Estate (near Marina South Pier) by Singtel, M1 and PSA
- **Cloud Gaming:** Shaw Centre and Ngee Ann City (Orchard) and one-north by Razer and Singtel

By 2025, Singapore will have two nationwide full-fledged 5G coverage. The telcos will have to achieve at least 50% coverage by end-2022. Currently, incumbent telco players such as Singtel (ST SP, Non-rated), StarHub (STH SP, Non-rated) and M1 do have their own fibre infrastructure, but those are only concentrated within CBD and business park areas.

In order to achieve nationwide coverage, incumbents are likely to rent from NetLink's fibre infrastructure, rather than expanding their current fibre coverage to reduce capex spent on 5G development.

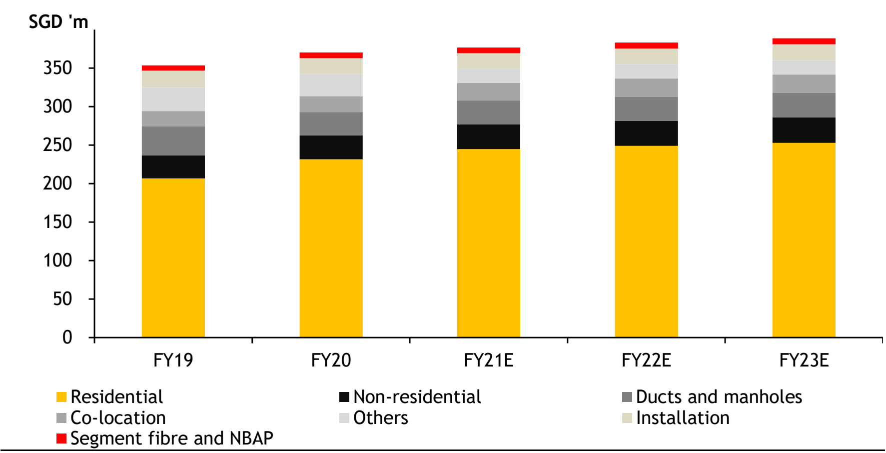
In fact, NetLink's NBAP growth in recent years was mainly led by new telco entrant TPG's (TPM AU, Non-rated) 5G trial network deployment across Singapore Science Park 1 and 2. As such, we believe it's likely that incumbents would rent from NetLink's infrastructure instead of building up their own fibre network for 5G deployment.

The approach is similar in China, as its two large mobile telcos are trying to build out their 5G capability at low cost through co-sharing 5G mobile network with rivals to reduce capex and maintain stable dividend.

For instance, China Telecom (728 HK, Non-rated) and rival China Unicom (762 HK, Non-rated) have agreed to jointly build a 5G network and they will share part of the infrastructure.

5G base-station linkage by fibre will be a boon for NBAP connection and installation revenue. That said, NetLink's NBAP and segment business made up only 2% of FY20 revenue and will remain a small revenue contributor to the trust.

Figure 14: Revenue breakdown by business segments



Source: Company data, Maybank Kim Eng

1.4 Defensive yield play

We believe our DDM methodology is best suited for NetLink as its business trust structure returns 100% of its free cashflow to unit holders. This mimics the payout and valuation methodology for REITs.

At current levels, NetLink's FY21E (end-Mar) yield of 5.2% for FY21E is comparable to Singapore's REITs' FY20E average yield of 5.6%. We favour NetLink over certain REITs with lower yields and higher risk of DPU downside as some are looking at dividend reduction to preserve capital amid the COVID-19 outbreak.

Our REITs analyst Chua Su Tye remains selective on retail REITs due to downward rent pressure and lower occupancies, as well as hospitality REITs with declining RevPARs.

Against Singapore telco players' average yield of 5.5%, NetLink also provides comparable yield, while offering shelter to dividend downside and persistently weak ARPUs.

For 1QCY20 results, both Singtel and StarHub's earnings were hit by the COVID-19 pandemic as travel and movement restrictions led to lower prepaid and roaming revenue. Meanwhile, equipment sales also saw a decline due to supply chain disruptions.

As a result, Singtel cut MarFY20 dividend by 30% to SGD0.1225 (dividend yield: 4.8%), while StarHub did not declare any quarterly dividend for 1Q20. Both groups withdrew their forward-dividend guidance.

Figure 15: Valuation and dividend yield comparison

	Rec	Price	TP	P/E (x)		P/B (x)		Div Yield (%)	
		SGD	SGD	CY20E	CY21E	CY20E	CY21E	CY20E	CY21E
NetLink NBN Trust	Buy	0.97	1.08	41.51	40.56	1.30	1.40	5.2	5.3
Singtel	NR	2.48	-	15.66	14.03	1.50	1.40	5.0	5.3
StarHub	NR	1.28	-	16.52	15.34	4.80	4.70	6.1	6.1
Singapore telcos			**Average**	16.09	14.68	3.15	3.05	5.54	5.72
Ascott Residence	Buy	0.94	1.06	31.53	17.52	0.80	0.90	4.7	7.2
CDL Hosp.	Sell	1.01	0.70	92.74	17.72	0.70	0.70	4.5	6.8
Far East Hosp.	Buy	0.50	0.59	-	19.30	0.60	0.60	4.9	6.2
Frasers Hosp.	Buy	0.46	0.58	44.39	20.18	0.70	0.70	4.2	7.0
Hospitality REITs			**Average**	44.39	19.74	0.65	0.65	4.57	6.63
AIMS APAC	Buy	1.22	1.55	13.60	13.30	0.90	0.90	7.6	7.8
Ascendas	Hold	3.48	3.45	22.96	21.87	1.50	1.50	4.5	4.7
ARA LOGOS Log.	Buy	0.61	0.71	17.21	13.51	1.00	-	8.0	8.2
Mapletree Ind.	Overweight	3.16	3.25	26.48	24.67	1.80	1.80	3.8	4.2
Mapletree Log.	Overweight	2.14	2.20	28.42	27.81	1.60	1.60	3.9	3.9
Industrial REITs			**Average**	27.45	26.24	1.70	1.70	3.85	4.05
CapitaLand Malls	Buy	1.98	2.45	22.30	16.78	1.00	0.90	4.5	5.9
Frasers Ctpt.	Hold	2.39	2.25	25.81	21.50	1.10	1.10	3.9	5.1
Mapletree Comm.	Hold	1.88	2.05	24.13	20.93	1.20	1.20	4.4	5.0
SPH REIT	Hold	0.85	0.81	20.24	16.11	0.79	0.79	4.5	6.6
Sasseur	Buy	0.76	0.89	12.28	11.53	0.80	0.80	7.9	8.5
Starhill Global	Buy	0.49	0.63	17.21	12.08	0.60	0.60	7.8	8.0
Retail REITs			**Average**	14.74	11.81	0.70	0.70	7.84	8.26
Manulife US*	Buy	0.73	0.85	13.95	12.94	1.00	1.10	8.3	8.5
Prime US	Buy	0.78	0.88	13.50	13.24	1.00	1.10	8.6	8.9
Office REITs			**Average**	13.72	13.09	1.00	1.10	8.44	8.74
*USD									

Source: Company data, Maybank Kim Eng

NetLink's FY20E net gearing of 18% is low compared to infrastructure fund's average of 123%. The trust has significant room to fund its future capex with debt to maintain its DPU.

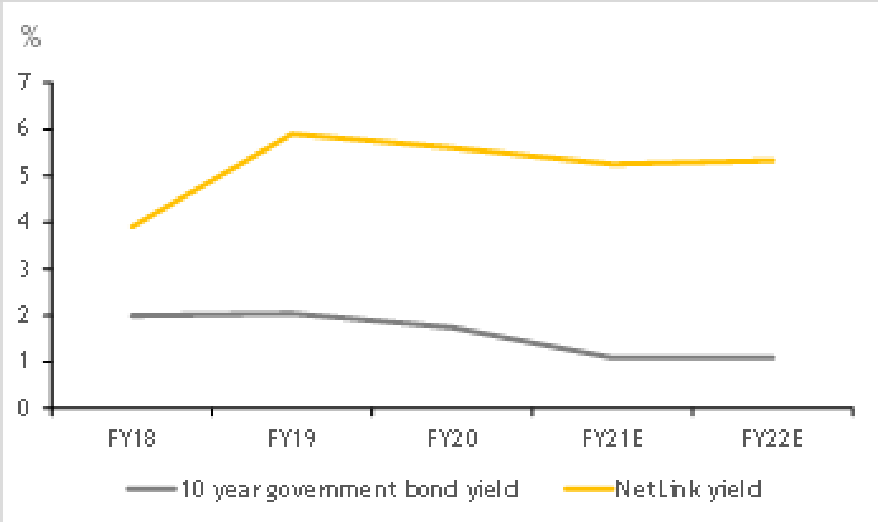
Figure 16: Valuation against infrastructure funds

	Rec	Price	TP (Cons)	P/E (x)		P/B (x)		Div Yield (%)		Net Gearing	
		LC	LC	CY20E	CY21E	CY20E	CY21E	CY20E	CY21E	CY20E	CY21E
NetLink NBN Trust	Buy	0.96	1.08	41.51	40.56	1.30	1.40	5.2	5.3	18%	18%
Keppel DC	NR	2.91	2.78	30.3	28	2.5	2.5	3.1	3.4	49%	49%
Keppel Infrastructure Trust	NR	0.55	0.57	36.8	34.9	2.2	2.5	6.8	6.8	134%	147%
Bharti infratel	NR	194.55	204.15	11.4	11.1	2.6	2.5	7.8	7.7	5%	-1%
Tower Bersama	NR	1210	1415	25	21.2	4.9	4.4	2.5	2.9	412%	383%
Jasmine Broadband Internet infra.	NR	9.90	9.50	9.3	9.2	0.9	0.9	9.7	9.6	13%	10%
Infrastructure fund			Average	**22.56**	**20.88**	**2.62**	**2.56**	**5.98**	**6.08**	**123%**	**118%**

Source: Factset, Maybank Kim Eng

Given the low interest rate environment, NetLink's FY21E/FY22E dividend yield of 5.2%/5.3% may benefit from yield compression in the near term.

Figure 17: NetLink's forward yield vs 10-year Singapore government bond



Source: Company data, Maybank Kim Eng

2. Valuation

2.1 DDM methodology

We use dividend discount model methodology to determine our TP. We believe this is appropriate as NetLink's business trust structure declares its free cash flow as cash available for distribution. We discount its cash distribution by its cost of equity of 6%. We derive a TP of SGD1.08.

We have assumed that rates and regulated returns to remain unchanged following the review period in FY23E and capex stays at between SGD70-80m per year.

Based on the current share price, the stock is yielding 5.2% and 5.3% for FY21E and FY22E.

Figure 18: DDM valuation

(end-Mar, SGD m)	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E
Cash distribution paid	195	199	202	207	211	215	218	222	225	217	218
PV of cash distribution	195	187	178	172	165	158	151	145	138	131	125
Total PV of cash distribution	1,693										
Terminal value	4,152										
PV of Terminal Value	2,388										
Equity value	4,081										
Equity value / share (SGD)	**1.08**										

Source: Company data, Maybank Kim Eng

Figure 19: Cost of equity and terminal growth

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: Company data, Maybank Kim Eng

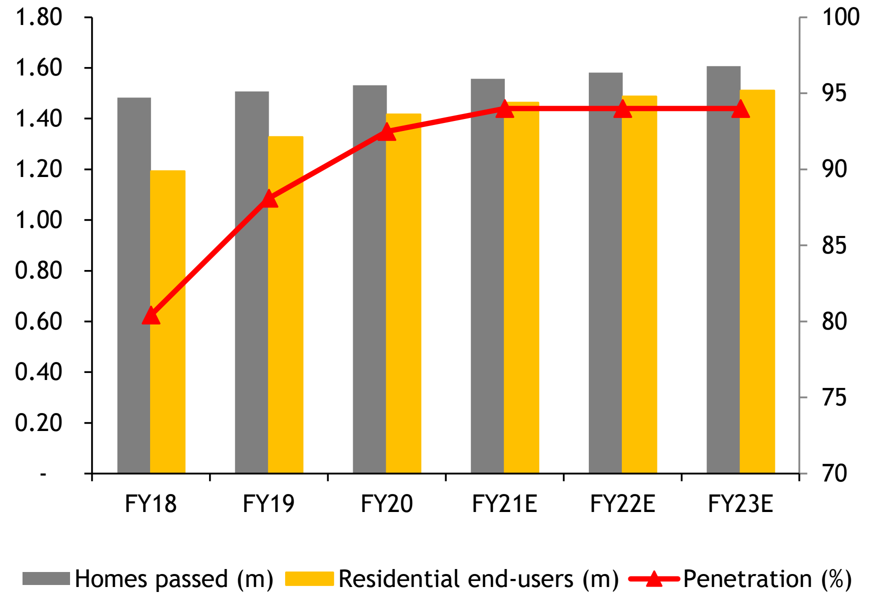
3. Financial analysis

3.1 P&L

We project revenue CAGR of 1% in FY21-23E on the back of continued growth in the residential connection segments. This is underpinned by annual new household formation of 25,000 and the assumption of household broadband penetration rate of 94% through FY21-FY23E, up from the current 93% as households continue to connect on fibre via government-subsidised initiatives such as IMDA's Home Access programme for low-income households. There are currently 100,000 of such households which are not connected to fibre broadband. Tele-commuting trend should help accelerate broadband penetration rate.

We assume EBITDA margin to expand to 71.7% and 71.4% in FY21E/FY22E. This is higher than FY20's 68.2% due to cost savings from COVID-19 Job Support Scheme (est SGD4.9m in CY20), property tax rebates (est SGD 4.9m), as well as the absence of one-time write-off of capitalised project cost of SGD15.4m relating to discontinuation of contract.

Figure 20: Residential connections assumptions



Source: Company data, Maybank Kim Eng

Figure 21: P&L and key growth assumptions

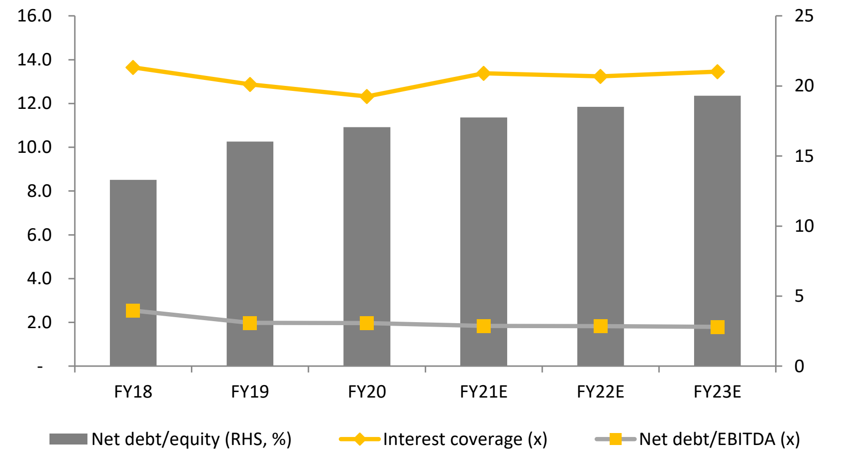
FYE 31 Mar (SGD 'm)	FY19	FY20	FY21E	FY22E	FY23E	Comments
Revenue	353.6	370.2	383.4	390.6	395.3	Mainly driven by 1% CAGR due to annual new household formation and higher broadband penetration rate
Key growth assumptions						
Connection revenue - Residential	207	231	246	250	252	
Connection revenue - Non-residential	30	31	33	34	35	
Connection revenue - NBAP and segment	7	7	8	8	8	
Operating expenses	268.2	285.4	280.2	286.4	290.4	Lower in FY21E due to cost savings from COVID-19 Job Support Scheme
Operating profit	85.4	84.8	103.2	104.2	104.9	
Finance cost	-19.1	-20.5	-20.3	-20.8	-20.8	
Other income	3.5	7.5	12.4	7.5	7.5	Higher in FY21E due to property tax rebates
Pretax profit	69.7	71.9	95.3	91.0	91.7	
Income taxes	7.6	6.2	6.0	6.0	6.0	
PATMI	77.4	78.1	101.3	97.0	97.7	
EBITDA (SGD 'm)	246.2	252.6	274.0	277.9	281.6	
EBITDA margin (%)	69.6	68.2	71.5	71.2	71.2	
Growth (YoY)						
Revenue	54.7%	4.7%	3.6%	1.9%	1.2%	
Connection revenue - Residential	45.9%	12.0%	6.3%	1.4%	0.9%	Driven by household formation of 25,000 and IMDA's Home Access programme for low-income household. There are currently 100k household not connected to fibre broadband.
Connection revenue - Non-residential	61.1%	4.1%	4.9%	4.0%	3.0%	
Connection revenue - NBAP and segment	23.3%	4.9%	4.4%	3.7%	3.1%	

Source: Company data, Maybank Kim Eng

3.2 Balance sheet and cash flow

With interest coverage estimated at 13x for FY21E-23E and net gearing at 18%over the period, we believe NetLink's balance sheet is capable of sustaining its 100% cash distribution policy. In order to maintain an optimal capital structure, we assume it will be refinancing its existing debts in FY21E.

Figure 22: Un-stretched balance sheet



Source: Factset, Maybank Kim Eng

We assume capex of SGD73m per year for FY21-23E, at the lower range of FY19-20's capex, as NetLink aims to keep its capex stable.

Figure 23: Capex projection

	FY19	FY20	FY21E	FY22E	FY23E
Capex	71	76	73	73	73

Source: Company data, Maybank Kim Eng

4. Corporate information

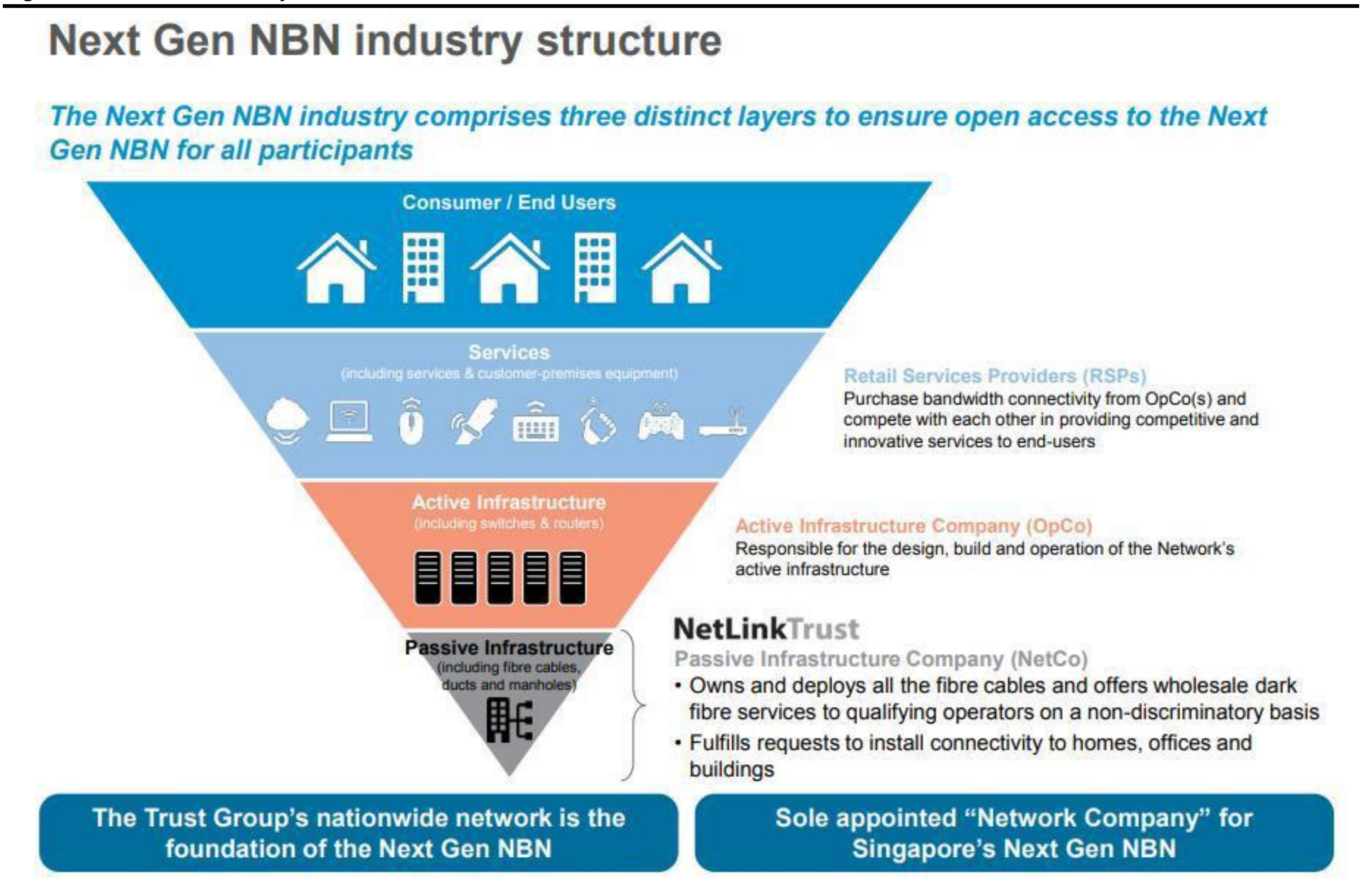
Netlink NBN Trust, which owns 100% of the units in Netlink Trust, has a nationwide network that is the foundation of Singapore's Next Generation Nationwide Broadband Network (NBN). This delivers ultra-high speed internet access throughout Singapore. As of 31 Dec 2018, the trust owns 10 central offices, 76,000km of fibre cables, 16,200km of ducts and 62,000 manholes.

4.1 Backbone of Singapore's digital-nation plan

Netlink NBN Trust (NetLink) commenced operations and deployment of Singapore's Next Generation NBN in 2009 in support of the government's Intelligent Nation (iN2015) Masterplan. As of Mar 2020, the network is connected to 1.4m residential end-users, 47,681 non-residential end-users and 1,679 NBAPs (locations without postal codes such as traffic lights, lamp posts and bus stops).

The trust provides nationwide coverage to Requesting Licensees (RL, also known as OpCos) at regulated rates. The RLs sell fibre services to Retail Service Providers (RSP) that market services to end-users. These end-user segments are: i) residential connections; ii) non-residential (enterprise or commercial) connections; and iii) NBAP connections.

Figure 24: NetLink industry structure



Source: Company data, Maybank Kim Eng

NetLink has a universal service obligation to provide fibre connectivity to all parties based on a set of IMDA-approved service rates. Since Apr 2013, IMDA instituted a requirement for all new homes in Singapore to be prewired with an optical fibre termination point within the household. In Nov 2018, IMDA revised its requirement, mandating all new homes to be fitted with an additional fibre termination point given the expected increase in smart devices within a household.

81% of NetLink's FY20 revenue is under the RAB regime. The RAB regime sets rates based on NetLink's forecasted revenues, opex and capex. The IMDA has agreed to an overall pre-tax WACC of 7% as Netlink's return on its asset base. The rates are reviewed every five years, with the current agreed prices ending in Dec 2022.

Figure 25: FY20 revenue breakdown

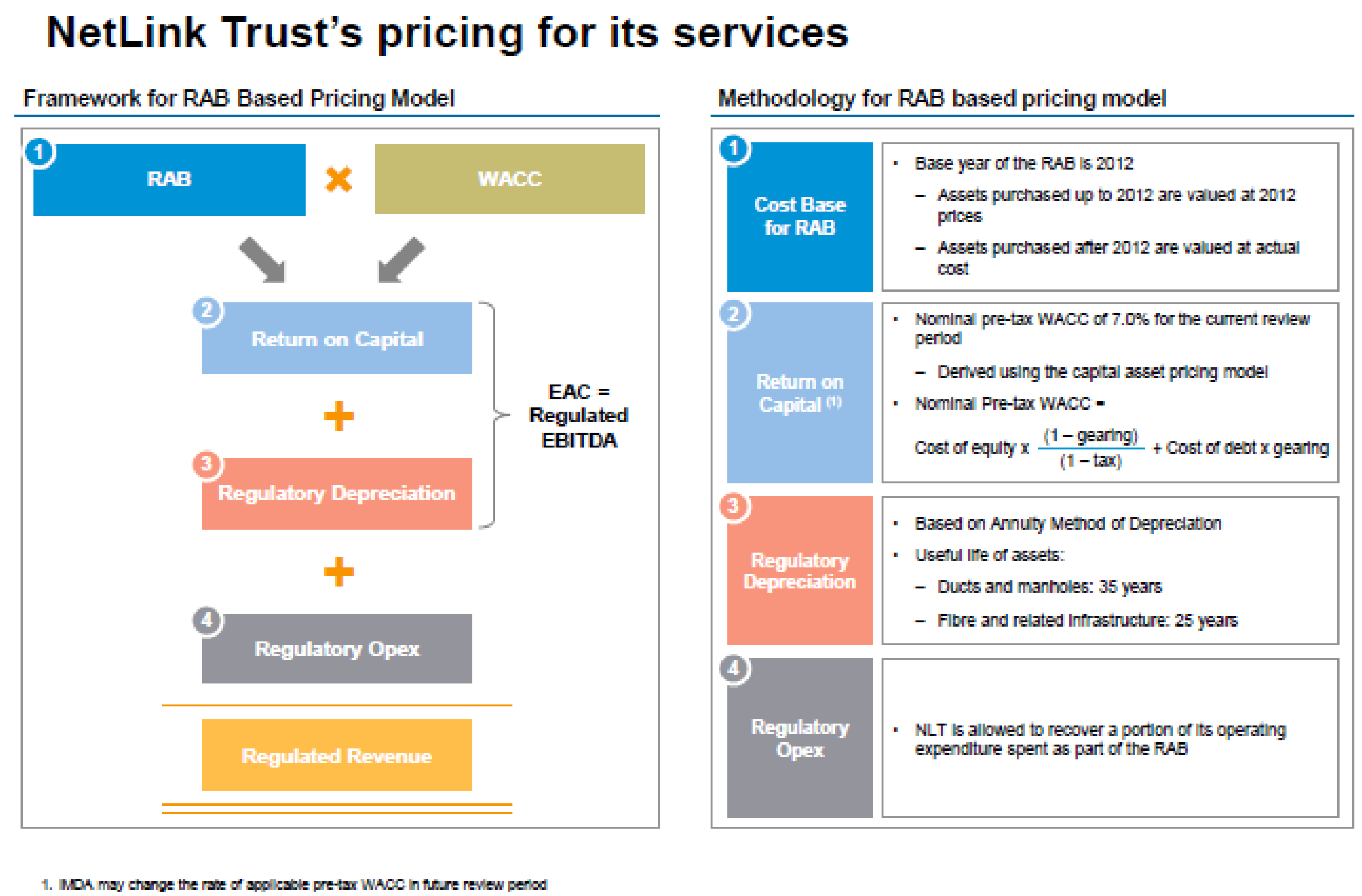
	RAB revenue				Non-RAB revenue			
	Residential	Non-residential	NBAP and segment	Ducts and manholes	Installation	Diversion	Co-location and other	Central Office
% of FY20 revenue	62.5%	8.4%	2.0%	8.2%	5.6%	3.0%	5.5%	4.8%
Recurring predictable cash flows	✓	✓	✓	✓	-	-	✓	✓
Long-term contracts/sustainability	✓	✓	✓	✓	-	-	✓	✓
Regulated revenues	✓	✓	✓	✓	✓	-	✓	-
Credit worthy customers	✓	✓	✓	✓	✓	✓	✓	✓

Source: Company data, Maybank Kim Eng

Interconnection offers are prices regulated by IMDA using the RAB framework. The pricing is based on:

- Return on capital: based on the value of the asset base and pre-tax WACC of 7% for the current review period.
- Operating expenditure
- Depreciation

Figure 26: RAB-based pricing framework



Source: Company data

Pricing for respective segments are as follows:

Figure 27: Pricing of RAB segments

Segments	Pricing per connection per month (SGD)
Residential	13.80
Non-residential	55.00
NBAP	73.80

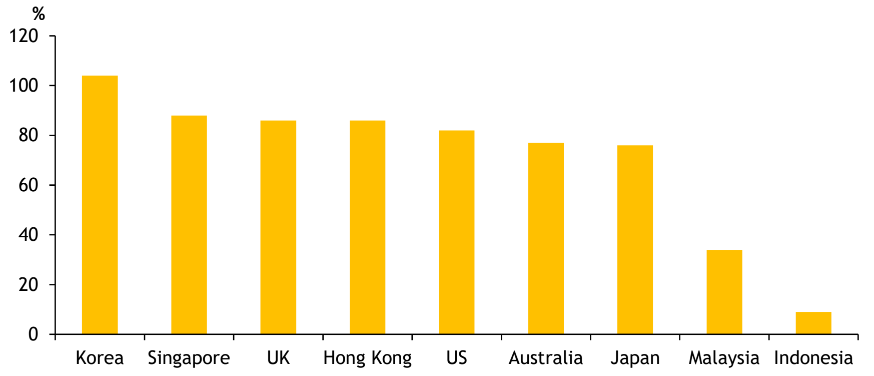
Source: Company data

4.2 Residential connections: natural monopoly

NetLink operates the only fibre network with nationwide coverage in Singapore. Entry barrier is high for any potential competitor, as it would require significant costs and permits to build coverage of the same scale as NetLink's.

Further, residential fibre penetration is already high at 93.5% as at Jan 2020 so redundancy risk is high for any greenfield network project. On the other hand, high penetration rate also means growth potential for NetLink's residential fibre business is limited to Singapore's new home growth. Going forward, Singapore's housing supply is projected to grow at 25,000 homes per year or a 10-year CAGR of 1.7% through 2029.

Figure 28: Fixed broadband penetration rate 2016



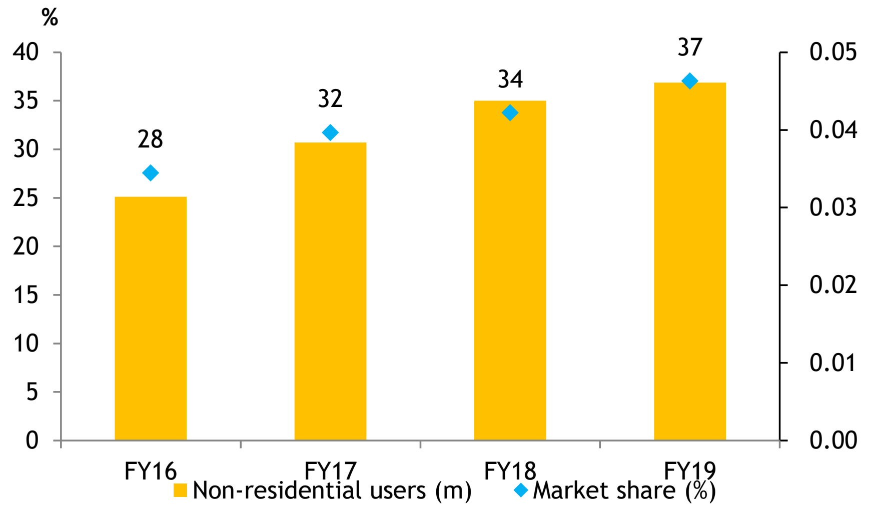
Source: Media Partner Asia

4.3 Non-residential: aims to grow market share

In this segment, NetLink competes for market share in enterprise and commercial segments with telco incumbents that utilise their own network infrastructure to serve enterprise and commercial end-users.

As of Dec 2019, NetLink had 37% market share of the corporate fixed broadband subscribers recorded by IMDA, up from 34% in 2018.

Figure 29: Non-residential users market share



Source: IMDA, Company data

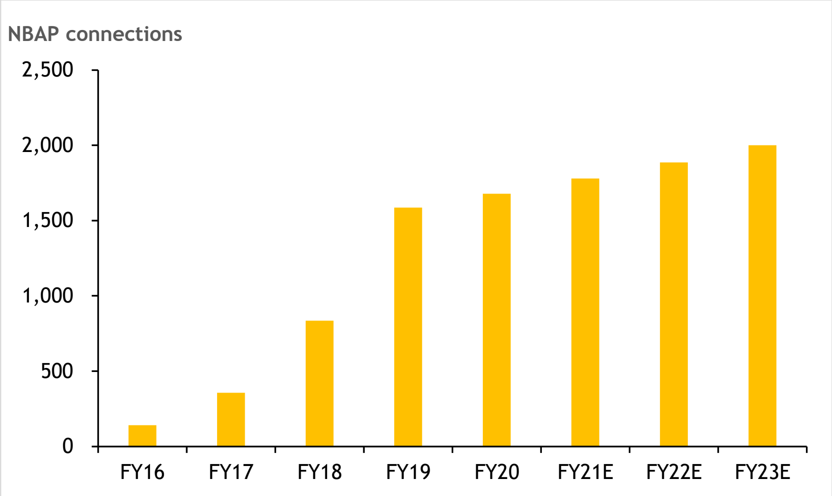
The growth is driven by SMEs and commercial developments located outside the CBD, where NetLink's network is a monopoly. NetLink remains a beneficiary of the government's continuous push to decentralise business activities and commercial centres to outside of the CBD, such as to Jurong East, Woodlands, Tampines, one-north and Paya Lebar.

4.4 NBAP and segment: small contribution but growing

NBAP and segment connection revenue grew at a 3-year CAGR of 19% to SGD7m between FY18-FY20. This was mainly driven by fourth mobile network operator TPG (TPM AU, Non-Rated) building connections for its base station deployment.

Based on Media Partner Asia (MPA, source: NetLink prospectus) estimates for FY18 market size, NetLink had 32% share in NBAP, up from 25% a year earlier. MPA estimated industry NBAP connections to grow by a CAGR of 76% from FY16-FY21E to 8,171. This is driven by the expansion of Wireless@SG hotspots and the introduction of Heterogeneous Networks under Singapore's Smart Nation Plan.

Figure 30: NetLink NBAP connections



Although NBAP has the potential to scale up in volumes, Netlink's high revenue base should keep NBAP and segment's revenue share at single-digit levels.

4.5 Other regulated revenues – recurring vs project-based

Revenues generated by co-location and installation business segments are non-RAB, but IMDA regulated. This accounted for 11% of FY20 revenue. The former involves leasing rooms within central offices for RLs to host active network equipment and servers.

Installation involves providing civil works for network-rollout projects and thus is dependent on project awards and timeline.

4.6 Non-regulated revenues - stable vs volatile

8% of NetLink's total revenue is not under the regulated regime. These involve central office and diversion segments.

Central office revenue is mainly derived from leases to Singtel for hosting certain equipment and operations. Contracts for such arrangements are long term in nature, thus providing stable top line for NetLink.

On the other hand, diversion involves providing re-routing civil works on a project basis. Similar to the installation segment, this segment is more volatile as project pipeline is less predictable.

5. Opportunities, risks and sensitivity analysis

Under the RAB framework, Netlink is subject to pricing revision by regulator IMDA every five years. The adoption of this framework has led to rate reductions (-8% in Residential/ +10% in non-residential/ -60% in NBAP/ -29% in inter-Central Office connections) in the last review in 2017. As such, a change in its regulatory set return of pre-tax WACC of 7% and approved capex would impact its tariff structure.

If the IMDA were ever to rule that NetLink had generated excess returns within the review period, there is no claw back/refund required but rather an adjustment to future capex that would translate to tariff cuts. The lack of claw back lessens the risk of significant one-time earnings and cashflow swings in the event of any negative decisions.

We illustrate in Fig 32 the sensitivity of profit and target price to potential swings in revenues and connection rates.

As residential revenue is the largest revenue component of NetLink, it is the most significant as every 5% change would lead to a 4% to TP.

At the other end of the spectrum is NBAP and segment revenue, which would need a substantial deviation to move the needle.

Figure 31: Sensitivity in connection revenues

Variable	FY21E	FY22E	FY23E
5% Change in residential revenues			
Revenue	-3.2%	-3.2%	-3.2%
Core profit	-11.1%	-12.3%	-11.9%
TP (SGD / unit)	-4%		
10% Change in non-residential revenues			
Revenue	-0.9%	-0.9%	-0.8%
Core profit	-3.2%	-3.1%	-3.8%
TP (SGD / unit)	-1.5%		
10% Change in manholes and ducts revenues			
Revenue	-0.9%	-0.9%	-0.8%
Core profit	-3.2%	-3.1%	-2.7%
TP (SGD / unit)	-1.5%		

Source: Company data, Maybank Kim Eng

From the standpoint of the stock being a dividend-yielding investment, the direction of interest rates is likely to influence share price performance. This is also the case with REITs and dividend-yielding telcos.

The stock's low 3-year beta of 0.59 against the STI has exhibited low volatility to market movements. As such, it could underperform during an up-cycle but it's relatively defensive during a downturn.

Every 0.5% change in COE impacts our TP by 8%. While every 0.5% change in long-term growth (LTG) impacts our TP by 9%.

Figure 32: TP sensitivity to cost of equity and long-term growth

		Cost of equity				
LTG		**5.0%**	**5.5%**	**6.3%**	**6.5%**	**7.0%**
	0.0%	1.10	1.01	0.93	0.86	0.80
	0.5%	1.17	1.06	0.97	0.90	0.83
	1.5%	1.37	1.21	**1.08**	0.99	0.91
	2.0%	1.53	1.33	1.18	1.06	0.96
	2.5%	1.73	1.47	1.28	1.14	1.03

Source: Maybank Kim Eng

FYE 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Key Metrics					
P/E (reported) (x)	39.4	45.1	37.1	38.7	38.5
Core P/E (x)	41.8	45.1	37.1	38.7	38.5
P/BV (x)	1.1	1.2	1.3	1.4	1.4
P/NTA (x)	1.1	1.2	1.3	1.4	1.4
Net dividend yield (%)	5.9	5.5	5.2	5.3	5.4
FCF yield (%)	4.9	5.3	5.1	5.3	5.3
EV/EBITDA (x)	15.1	15.9	15.5	15.3	15.1
EV/EBIT (x)	43.5	47.4	41.3	40.8	40.6
INCOME STATEMENT (SGD m)					
Revenue	353.6	370.2	383.4	390.6	395.3
Gross profit	353.6	370.2	383.4	390.6	395.3
EBITDA	246.2	252.6	274.0	277.9	281.6
Depreciation	(160.8)	(167.8)	(170.8)	(173.7)	(176.6)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	85.4	84.8	103.2	104.2	104.9
Net interest income /(exp)	(19.1)	(20.5)	(20.3)	(20.8)	(20.8)
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	3.5	7.5	12.4	7.5	7.5
Pretax profit	69.8	71.9	95.3	91.0	91.7
Income tax	7.6	6.2	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	77.4	78.1	101.3	97.0	97.7
Core net profit	77.4	78.1	101.3	97.0	97.7
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	148.6	168.6	165.6	164.0	163.2
Accounts receivable	75.8	73.4	76.0	77.5	78.4
Inventory	4.7	4.3	4.5	4.5	4.6
Property, Plant & Equip (net)	3,124.5	3,026.7	2,928.9	2,828.1	2,724.5
Intangible assets	836.1	843.5	843.5	843.5	843.5
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	92.0	92.3	92.3	92.3	92.3
Total assets	**4,281.8**	**4,208.8**	**4,110.7**	**4,009.9**	**3,906.4**
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	56.0	58.5	54.4	56.0	56.6
LT interest bearing debt	634.6	664.8	664.8	664.8	664.8
Other liabilities	561.0	579.0	579.0	579.0	579.0
Total Liabilities	**1,251.9**	**1,301.8**	**1,297.8**	**1,299.4**	**1,299.9**
Shareholders Equity	3,029.9	2,906.9	2,812.9	2,710.5	2,606.5
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	**3,029.9**	**2,906.9**	**2,812.9**	**2,710.5**	**2,606.5**
Total liabilities and equity	**4,281.8**	**4,208.8**	**4,110.7**	**4,009.9**	**3,906.4**
CASH FLOW (SGD m)					
Pretax profit	69.8	71.9	95.3	91.0	91.7
Depreciation & amortisation	160.8	167.8	170.8	173.7	176.6
Adj net interest (income)/exp	18.3	19.6	20.3	20.8	20.8
Change in working capital	2.3	4.8	(6.8)	0.1	(0.4)
Cash taxes paid	(0.6)	6.0	6.0	6.0	6.0
Other operating cash flow	(23.8)	(25.4)	(20.3)	(20.8)	(20.8)
Cash flow from operations	226.8	258.8	265.2	270.8	273.9
Capex	(71.1)	(75.5)	(73.0)	(73.0)	(73.0)
Free cash flow	158.5	187.0	192.2	197.8	200.9
Dividends paid	(221.3)	(193.3)	(195.3)	(199.4)	(201.6)
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	45.0	30.0	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
Net cash flow	(20.6)	20.0	(3.1)	(1.6)	(0.8)

FYE 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Key Ratios					
Growth ratios (%)					
Revenue growth	54.7	4.7	3.6	1.9	1.2
EBITDA growth	48.1	2.6	8.4	1.5	1.3
EBIT growth	56.8	(0.7)	21.6	1.0	0.7
Pretax growth	59.2	3.0	32.6	(4.5)	0.8
Reported net profit growth	54.9	1.0	29.6	(4.2)	0.7
Core net profit growth	54.9	1.0	29.6	(4.2)	0.7
Profitability ratios (%)					
EBITDA margin	69.6	68.2	71.5	71.2	71.2
EBIT margin	24.2	22.9	26.9	26.7	26.5
Pretax profit margin	19.7	19.4	24.8	23.3	23.2
Payout ratio	245.5	247.2	192.6	205.4	206.2
DuPont analysis					
Net profit margin (%)	21.9	21.1	26.4	24.8	24.7
Revenue/Assets (x)	0.1	0.1	0.1	0.1	0.1
Assets/Equity (x)	1.4	1.4	1.5	1.5	1.5
ROAE (%)	2.5	2.6	3.5	3.5	3.7
ROAA (%)	1.8	1.8	2.4	2.4	2.5
Liquidity & Efficiency					
Cash conversion cycle	nm	nm	nm	nm	nm
Days receivable outstanding	70.9	72.6	70.2	70.7	71.0
Days inventory outstanding	nm	nm	nm	nm	nm
Days payables outstanding	nm	nm	nm	nm	nm
Dividend cover (x)	0.4	0.4	0.5	0.5	0.5
Current ratio (x)	2.9	2.7	2.8	2.8	2.8
Leverage & Expense Analysis					
Asset/Liability (x)	3.4	3.2	3.2	3.1	3.0
Net gearing (%) (incl perps)	16.0	17.1	17.7	18.5	19.2
Net gearing (%) (excl. perps)	16.0	17.1	17.7	18.5	19.2
Net interest cover (x)	4.5	4.1	5.1	5.0	5.0
Debt/EBITDA (x)	2.6	2.6	2.4	2.4	2.4
Capex/revenue (%)	20.1	20.4	19.0	18.7	18.5
Net debt/ (net cash)	485.9	496.2	499.2	500.8	501.6

Source: Company; Maybank

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