Maybank Kim Eng

Telecommunications

Netlink NBN Trust (NETLINK SP)

DPU immune to COVID-19

BUY

Share Price	SGD 0.98
12m Price Target	SGD 1.11 (+13%)
Previous Price Target	*SGD 1.07*

Sustained DPU despite headwinds; Maintain BUY

1HFY21 earnings were slightly below, at 47% of MKE/consensus FY21E profit. Interim DPU was 0.4% above MKE's estimate, despite the tough environment. We trimmed our FY21E PAT by 3.5% to reflect change in operational forecast and one-off under provision tax expense. But we raised FY21E DPU by 3.3% to reflect better operating cashflow. This lifts our DDM-based TP (COE: 6.3%, LTG: 1.5%) to SGD1.11. Maintain BUY as 5.2% FY21E yield is sustainable.

Results hit by work stoppage

1HFY21 revenue fell 2.5% YoY to SGD181.5m, in line with MKE/consensus. This was mainly due to weakness in diversion (-47.4% YoY), ducts and manholes (-6% YoY), and installation-related revenue (-44.3% YoY) due to construction work stoppage and foreign worker shortage amid Covid-19. Higher EBITDA margin of 77% (+4.4ppt) was a result of favourable sale-mix shift towards higher-margin residential connection business and government relief grants received. Core profit of SGD44.8m (+1.5% YoY) was partially dragged by one-off tax expense of SGD2.1m (1HFY20: SGD1.9m tax credit) due to insufficient provisions in the previous year.

Diversion and installation divisions to normalise

NetLink's manpower capacity has normalised to pre-Covid levels. Management is seeing a pick-up in general construction activities to pre-COVID levels since 2QFY21, which bodes well for its diversion and installation divisions. That said both divisions are unlikely to catch up on projects that have been delayed. Non-residential segment revenue were slightly below, at 47% of MKE's forecast. It appears that the well-served and competitive non-residential market has tempered our revenue-growth assumptions. Meanwhile, growth of the residential division is capped by muted new connections due to Covid-19.

Defensive nature proven by stable DPU

Although management did not comment on whether 2HFY21E DPU would match 1HFY21 levels, distributions have been stable and/or growing based on its track record. We forecast a higher cash distribution due to better-than-expected operating cash flow amid expanded EBITDA margins. FY21E DPU of SDG0.05 translates to a dividend yield of 5.2%, offering better dividend visibility than many yield plays as 94% of its revenue is secured by recurring cash flows. Risks to the outlook for NetLink include any negative revisions to its regulatory regime.

FYE Mar (SGD m)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	354	370	372	388	392
EBITDA	246	253	272	282	285
Core net profit	77	78	93	98	98
Core EPS (cts)	2.0	2.0	2.4	2.5	2.5
Core EPS growth (%)	54.9	1.0	18.9	5.2	0.5
Net DPS (cts)	4.9	5.0	5.1	5.4	5.4
Core P/E (x)	41.8	45.1	41.1	39.0	38.8
P/BV (x)	1.1	1.2	1.4	1.4	1.5
Net dividend yield (%)	5.9	5.5	5.2	5.5	5.5
ROAE (%)	2.5	2.6	3.3	3.6	3.7
ROAA (%)	1.8	1.8	2.2	2.4	2.5
EV/EBITDA (x)	15.1	15.9	15.9	15.4	15.3
Net gearing (%) (incl perps)	16.0	17.1	18.3	19.5	20.8
Consensus net profit	-	-	94	99	103
MKE vs. Consensus (%)	-	-	(1.4)	(0.9)	(4.7)

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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.

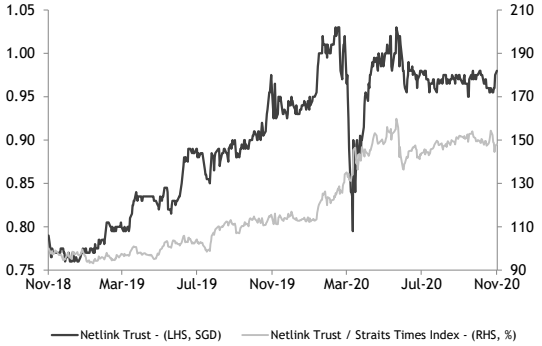
Statistics

52w high/low (SGD)	1.03/0.80
3m avg turnover (USDm)	8.2
Free float (%)	75.2
Issued shares (m)	3,897
Market capitalisation	SGD3.8B
	USD2.8B

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 (%)	1	2	2
Relative to index (%)	(1)	0	29

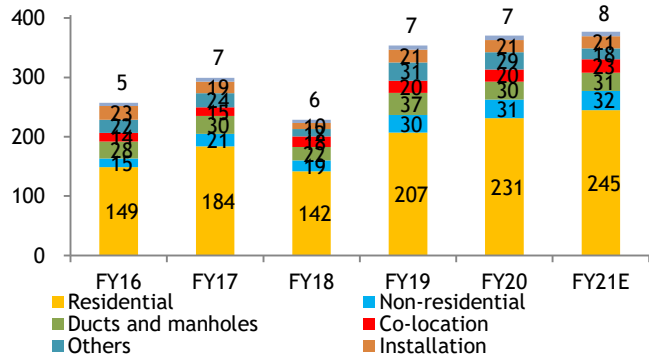
Source: FactSet

ESG
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.

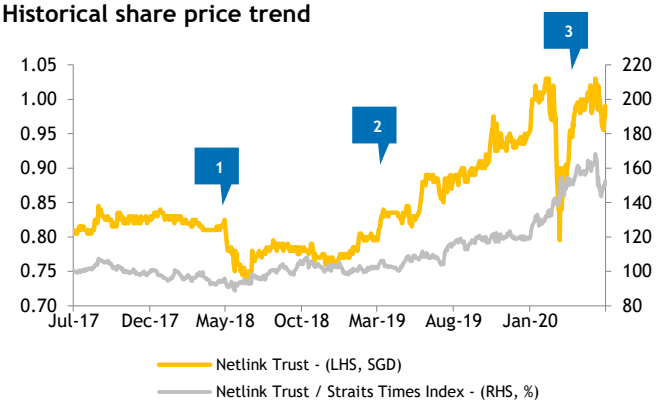
Revenue breakdown (SGD m) - residential matters most



Source: Company

Price Drivers

Historical share price trend



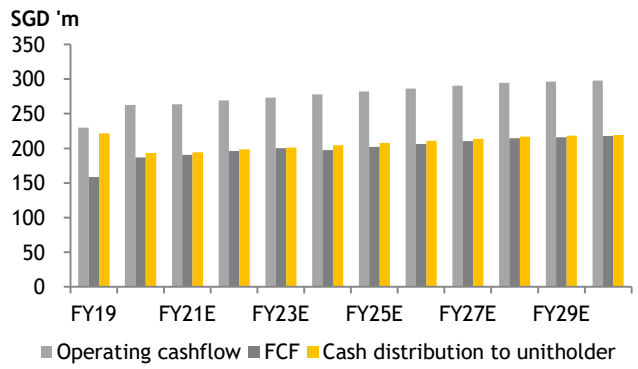
Source: Company, Maybank Kim Eng

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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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.

Figure 1: Forecast revisions

end-Mar	FY21E	FY22E	FY23E
Revised revenue (SGD m)	372	388	392
Revised EBITDA (SGD m)	272	282	285
Revised core profit (SGD m)	93	98	98
Revised DPU (SGD)	0.051	0.054	0.054
Revised TP (SGD)	1.11		
Previous revenue (SGD m)	372	388	393
Previous EBITDA (SGD m)	269	275	279
Previous core profit (SGD m)	96	94	95
Previous DPU (SGD)	0.049	0.051	0.051
Previous TP (SGD)	1.07		
Change in revenue	0.2%	-0.1%	-0.1%
Change in EBITDA	1.0%	2.5%	2.2%
Change in core profit	-3.5%	3.6%	3.4%
Change in TP	3.7%		

Source: Maybank Kim Eng

Figure 2: MKE vs consensus

(end-Mar, SGD m)	FY21E	FY22E	FY23E
Revenue (MKE)	372	388	392
EBITDA (MKE)	272	282	285
Core profit (MKE)	93	98	98
TP (SGD / unit)	1.11		
Revenue (cons)	377	389	397
EBITDA (cons)	273	280	287
Core profit (cons)	95	98	101
TP (SGD / unit)	1.06		
MKE vs cons (Revenue)	-1.3%	-0.3%	-1.1%
MKE vs cons (EBITDA)	-0.4%	0.7%	-0.5%
MKE vs cons (core profit)	-1.7%	-0.3%	-3.1%
MKE vs cons (TP)	5.1%		

Source: Maybank Kim Eng, Factset

Figure 3: Quarterly segmental revenue breakdown

(end-Mar, SGD m)	4QFY20	1QFY21	2QFY21	QoQ	YoY	2QFY21 % of MKE FY21E	1HFY21 % of MKE FY21E	1HFY21 % of cons FY21E
Ducts and manholes	7.3	7.4	7.2	-2.6%	-8.1%		**47%**	
Central office	4.1	4.8	4.7	-2.4%	5.0%		**52%**	
Finance lease income								
Service income and charges								
Connection revenue - Residential	59.0	59.2	59.3	0.2%	2.6%	**24.5%**	**49%**	
Connection revenue - Non-residential	7.9	7.4	7.9	6.5%	1.3%	**24.3%**	**47%**	
Connection revenue - NBAP and segment	1.8	1.9	2.1	11.4%	16.0%	**27.5%**	**52%**	
Co-location	5.0	4.8	4.7	-1.3%	-7.0%	**23.0%**	**46%**	
Installation	3.7	2.1	4.8	122.7%	-12.9%	**31.6%**	**46%**	
Diversion	3.6	1.4	1.8	28.9%	-52.3%	**36.3%**	**65%**	
Total revenue	**92.4**	**89.0**	**92.5**	3.9%	-1.7%	**24.8%**	**49%**	**48%**
EBITDA	**51.6**	**68.8**	**70.9**	3.1%	4.1%	**26.1%**	**51%**	**51%**
Core profit	**12.5**	**23.5**	**21.3**	-9.4%	-8.2%	**22.9%**	**48%**	**47%**
EBITDA margin	*55.9%*	*77.3%*	*76.7%*					

Source: Company data, Maybank Kim Eng. Factset

Figure 4: Revenue breakdown - residential continues to be key driver

	4QFY20	1QFY21	2QFY21
Return on asset base (RAB) regulated revenue			
Residential	63.8%	66.5%	64.1%
Ducts and manholes	7.9%	8.3%	7.8%
Non-residential	8.6%	8.3%	8.5%
NBAP / Segment fibre	2.0%	2.1%	2.3%
Sub-total	**82.3%**	**85.2%**	**82.7%**
Non-RAB regulated revenue			
Co-location	5.4%	5.4%	5.1%
Installation	4.0%	2.4%	5.1%
Sub-total	**9.4%**	**7.8%**	**10.3%**
Non-regulated revenue			
Central office	4.4%	5.4%	5.1%
Diversion	3.9%	1.6%	2.0%
Sub-total	**8.4%**	**7.0%**	**7.1%**
Total	**100.0%**	**100.0%**	**100.0%**

Source: Company data

Figure 5: Operating statistics

Fibre connections	4QFY20	1QFY21	2QFY21	QoQ	YoY
Residential end-users (m)	1.427	1.428	1.437	0.7%	1.9%
Non-residential end-users (m)	0.048	0.047	0.048	1.3%	1.8%
NBAP	1,679	1,772	1,847	4.2%	17.7%
Segment	415	430	457	6.3%	23.2%

Source: Company data

FYE 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Key Metrics					
P/E (reported) (x)	39.4	45.1	41.1	39.0	38.8
Core P/E (x)	41.8	45.1	41.1	39.0	38.8
P/BV (x)	1.1	1.2	1.4	1.4	1.5
P/NTA (x)	1.1	1.2	1.4	1.4	1.5
Net dividend yield (%)	5.9	5.5	5.2	5.5	5.5
FCF yield (%)	4.9	5.3	4.8	5.2	5.3
EV/EBITDA (x)	15.1	15.9	15.9	15.4	15.3
EV/EBIT (x)	43.5	47.4	42.7	39.6	39.6
INCOME STATEMENT (SGD m)					
Revenue	353.6	370.2	372.5	387.5	392.3
Gross profit	353.6	370.2	372.5	387.5	392.3
EBITDA	246.2	252.6	271.7	282.2	285.2
Depreciation	(160.8)	(167.8)	(170.3)	(172.7)	(175.2)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	85.4	84.8	101.4	109.5	110.0
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	12.0	3.1	3.1
Pretax profit	69.8	71.9	93.1	91.8	92.3
Income tax	7.6	6.2	(0.2)	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	92.9	97.8	98.3
Core net profit	77.4	78.1	92.9	97.8	98.3
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	148.6	168.6	152.8	140.4	128.8
Accounts receivable	75.8	73.4	73.9	76.8	77.8
Inventory	4.7	4.3	4.3	4.5	4.6
Property, Plant & Equip (net)	3,124.5	3,026.7	2,929.4	2,829.6	2,727.5
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**	**4,096.1**	**3,987.1**	**3,874.4**
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	56.0	58.5	50.1	52.4	53.3
LT interest bearing debt	634.6	664.8	666.0	666.0	666.0
Other liabilities	561.0	579.0	579.0	579.0	579.0
Total Liabilities	**1,251.9**	**1,301.8**	**1,294.7**	**1,296.9**	**1,297.9**
Shareholders Equity	3,029.9	2,906.9	2,802.7	2,691.4	2,577.8
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	**3,029.9**	**2,906.9**	**2,802.7**	**2,691.4**	**2,577.8**
Total liabilities and equity	**4,281.8**	**4,208.8**	**4,097.3**	**3,988.3**	**3,875.6**
CASH FLOW (SGD m)					
Pretax profit	69.8	71.9	93.1	91.8	92.3
Depreciation & amortisation	160.8	167.8	170.3	172.7	175.2
Adj net interest (income)/exp	18.3	19.6	20.3	20.8	20.8
Change in working capital	2.3	4.8	(8.9)	(0.9)	(0.1)
Cash taxes paid	(0.6)	(0.2)	6.0	6.0	6.0
Other operating cash flow	(23.8)	(19.2)	(26.5)	(20.8)	(20.8)
Cash flow from operations	226.8	na	254.3	269.6	273.3
Capex	(71.1)	(75.5)	(73.0)	(73.0)	(73.0)
Free cash flow	158.5	187.0	181.3	196.6	200.3
Dividends paid	(221.3)	(193.3)	(197.2)	(209.0)	(211.9)
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)	na	(15.8)	(12.4)	(11.6)

FYE 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Key Ratios					
Growth ratios (%)					
Revenue growth	54.7	4.7	0.6	4.0	1.2
EBITDA growth	48.1	2.6	7.6	3.9	1.0
EBIT growth	56.8	(0.7)	19.6	7.9	0.5
Pretax growth	59.2	3.0	29.6	(1.4)	0.5
Reported net profit growth	54.9	1.0	18.9	5.2	0.5
Core net profit growth	54.9	1.0	18.9	5.2	0.5
Profitability ratios (%)					
EBITDA margin	69.6	68.2	73.0	72.8	72.7
EBIT margin	24.2	22.9	27.2	28.3	28.0
Pretax profit margin	19.7	19.4	25.0	23.7	23.5
Payout ratio	245.5	247.2	212.0	213.5	215.4
DuPont analysis					
Net profit margin (%)	21.9	21.1	24.9	25.2	25.0
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	3.3	3.6	3.7
ROAA (%)	1.8	1.8	2.2	2.4	2.5
Liquidity & Efficiency					
Cash conversion cycle	nm	nm	nm	nm	nm
Days receivable outstanding	70.9	72.6	71.2	70.0	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	2.6	2.5
Leverage & Expense Analysis					
Asset/Liability (x)	3.4	3.2	3.2	3.1	3.0
Net gearing (%) (incl perps)	16.0	17.1	18.3	19.5	20.8
Net gearing (%) (excl. perps)	16.0	17.1	18.3	19.5	20.8
Net interest cover (x)	4.5	4.1	5.0	5.3	5.3
Debt/EBITDA (x)	2.6	2.6	2.5	2.4	2.3
Capex/revenue (%)	20.1	20.4	19.6	18.8	18.6
Net debt/ (net cash)	485.9	496.2	513.2	525.6	537.2

Source: Company; Maybank

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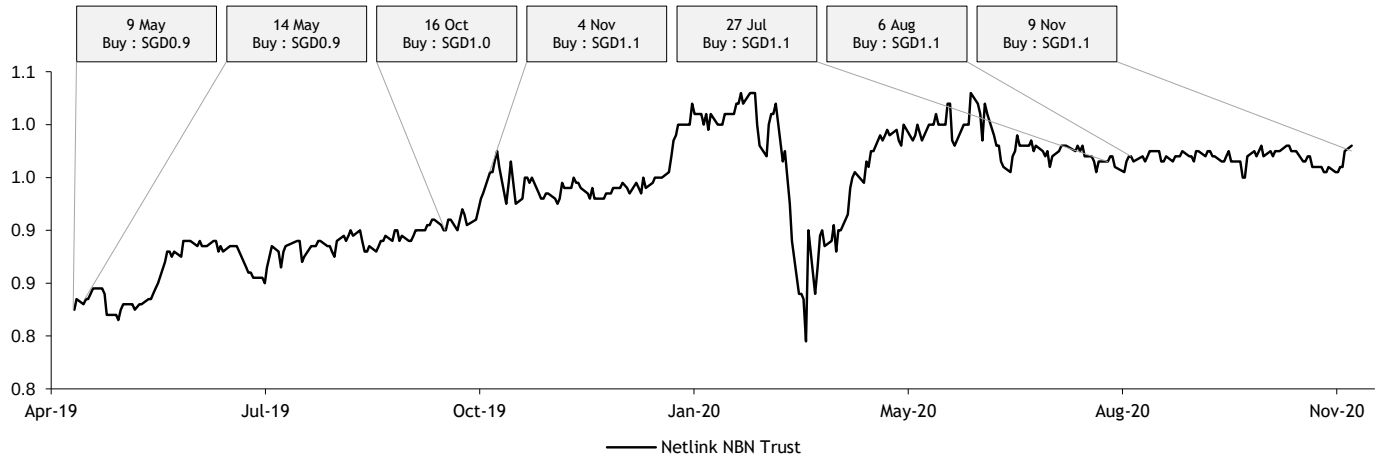

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