

NetLink NBN Trust (NETLINK SP) : BUY

Mkt. Cap: US\$2,230m | **3m Avg. Daily Val:** US\$2.5m

Last Traded Price (1 Oct 2018): S\$0.785

Price Target 12-mth: S\$0.87 (11% upside)

Analyst

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Europe NDR takeaways: Safe yield with some growth

- Management optimistic about growth prospects over the next 3-5 years from rising adoption of fibre broadband
- Low gearing to support any potential rise in fibre-related capex as Singapore aims to be a Smart Nation
- We like Netlink for ~6% yield and mid-single-digit EBITDA growth prospects
- Maintain BUY with TP of S\$0.87

Forecasts and Valuation FY Mar (\$m)	2017A	2018A	2019F	2020F
Revenue	299	229	337	360
EBITDA	224	168	248	268
Pre-tax Profit	70.8	43.6	63.7	77.5
Net Profit	79.4	49.7	73.9	84.0
Net Pft (Pre Ex.)	79.4	49.7	73.9	84.0
Net Pft Gth (Pre-ex) (%)	97.2	(37.4)	48.7	13.6
EPS (S cts)	2.05	1.28	1.90	2.15
EPS Pre Ex. (S cts)	2.05	1.28	1.90	2.15
EPS Gth Pre Ex (%)	97	(38)	49	14
Diluted EPS (S cts)	2.05	1.28	1.90	2.15
Net DPS (S cts)	0.0	3.24	4.71	4.78
BV Per Share (S cts)	79.1	81.5	77.8	75.2
PE (X)	38.4	61.6	41.4	36.4
PE Pre Ex. (X)	38.4	61.6	41.4	36.4
P/Cash Flow (X)	15.6	19.3	10.7	12.3
EV/EBITDA (X)	15.8	20.8	14.2	13.2
Net Div Yield (%)	0.0	4.1	6.0	6.1
P/Book Value (X)	1.0	1.0	1.0	1.0
Net Debt/Equity (X)	0.2	0.1	0.2	0.2
ROAE (%)	2.6	1.6	2.4	2.8

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Company Guide

Summary of our point of view, and highlights the relevant data points, which are actively tracked

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What's New

We arranged an NDR for Netlink NBN management to meet with investors in Europe. The key takeaways are as follows:

What are the key growth drivers over the next 3-5 years?

Currently, Netlink secures revenue from ~1.2m households in Singapore and hopes to secure another ~300,000 subscribers over the next 3-5 years. There are ~200,000 households on older technologies such as coaxial cable and ~100,000 lower-income/retiree households without broadband access. Older technologies will be phased out in favour of fibre technology while lower-income/retiree households are likely to subscribe to fibre broadband supported by government subsidy schemes. Overall, the company offers mid-single-digit EBITDA growth prospects coupled with ~6% yield at the current stock price.

How will Netlink grow once fibre is activated in 100% of homes?

There are two possible scenarios post 100% penetration.

- 1) A conservative scenario of ~25,000 households added to Singapore annually as has been the case historically. This will translate into about 1.7% annual growth in subscriber base. In addition, NetLink is building greater resiliency into its core network and expanding its network to serve outdoor locations. These will require additional capex and lead to additional revenue growth due to its pricing framework.
- 2) A more optimistic scenario will be more households paying for two fibre connections in the long term as has been the case with mobile

phones. Possible examples are new services provided by different players using Internet of Things. In fact, new buildings in Singapore would have provision for four fibre connections in each home (versus two currently) should the new building code of COPIF 2018 be approved towards the end of 2018.

NetLink's distributions are much higher than its earnings. Does that imply that the asset base is declining with capex lagging the depreciation?

The earnings are lower due to much higher accounting depreciation than the regulatory depreciation. What matters most is the regulatory life of assets (~30 years) as that is used to calculate the regulatory return on the assets.

While capex may exceed or lag the regulatory depreciation in a given year, management intends to keep the regulatory asset base stable in the long run. For example, FY18 capex was much higher than the regulatory depreciation but should trend lower over the next 2-3 years.

Is there room to gear up in the long term?

There is no official gearing target but according to the company's internal assessment, it could gear up to 4x gross debt-to-EBITDA (versus 3.2x projected in FY19F) and still maintain a BBB+ credit profile. NetLink does not plan to obtain any credit rating though. This implies that NetLink has enough room to raise its capex and debt fund the capex if there is a need for it.

While entities using a regulated asset base (RAB) model can easily go to 7x gross debt-to-EBITDA due to the safe nature of their cash flows, NetLink does not plan to gear up that much and intends to keep its debt headroom to fund future growth opportunities.

Is 5G an opportunity or a threat for NetLink?

5G is not a threat, as like any other mobile network, it is a shared network, not designed for constant flow of traffic from a single user. 5G cannot compete with fibre in offering unlimited data capacity as rising data will also lead to a rise in 5G capex too.

There could be opportunities for NetLink from 5G if there is a need to build one common 5G network for multiple telcos in Singapore. Singapore's regulator has to make the final decision for the 5G model in Singapore.

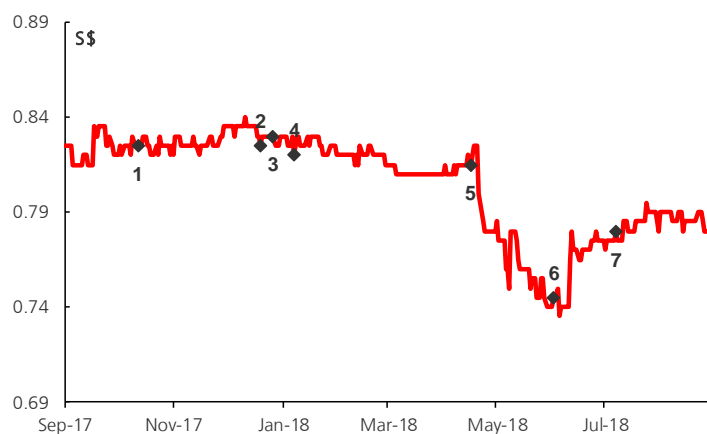
Will the expiry of licence in 2034 impact the business?

Management expects the licence to be renewed in 2034 without any hassle as the company pays an annual licence fee and meets all its licence obligations. Every telcos must renew their licences from time to time, which are duly done without issues.

Is there a risk that regulatory WACC of 7% may be lowered in the future?

The risk of WACC being revised downward is expected to be low due to the following reasons: (a) Singapore offers one of the cheapest fibre broadband services in the world despite having a high per capita income. For example, 1 Gbps speed is available to the end-customer for only S\$39.90 per month currently. As fibre broadband is highly affordable, the pressure to lower rates is quite low in Singapore. Even with the same WACC, regulatory pricing for fibre is likely to trend downward due to a bigger consumer base in the future, and (b) there is significant regulatory focus on the resilience of network as Singapore wants to be a leading Smart Nation and hence, fibre players need to be incentivised to invest more in the fibre infrastructure.

Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

Source: DBS Bank

Analyst: Sachin MITTAL

DBS Bank recommendations are based on Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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Sources for all charts and tables are DBS Bank unless otherwise specified.

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