

Singapore Company Guide

NetLink NBN Trust

Version 10 | Bloomberg: NETLINK SP | Reuters: NETL.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

11 Feb 2020

BUY

Last Traded Price (10 Feb 2020): S\$1.00 (STI : 3,163.15)

Price Target 12-mth: S\$1.05 (5% upside) (Prev S\$1.04)

Analyst

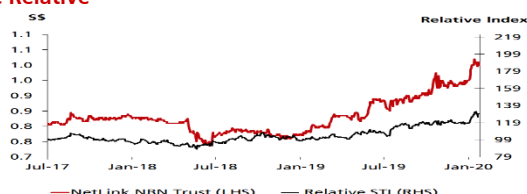
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What's New

- 3QFY20 results largely in line with consensus
- Residential connections grew 0.8% q-o-q; Starhub's fibre migration was completed in Sep 2019
- No DPU declared (unchanged y-o-y) as expected
- Maintain BUY, TP revised to S\$1.05 (Prev S\$1.04); stock currently yields c.5%

Price Relative



Forecasts and Valuation

FY Mar (S\$m)	2019A	2020F	2021F	2022F
Revenue	354	369	381	393
EBITDA	250	267	278	288
Pre-tax Profit	69.8	82.2	93.6	103
Net Profit	77.4	86.1	97.3	105
Net Pft (Pre Ex.)	77.4	86.1	97.3	105
Net Pft Gth (Pre-ex) (%)	54.9	11.3	13.0	7.8
EPS (S cts)	1.99	2.21	2.50	2.69
EPS Pre Ex. (S cts)	1.99	2.21	2.50	2.69
EPS Gth Pre Ex (%)	55	11	13	8
Diluted EPS (S cts)	1.99	2.21	2.50	2.69
Net DPS (S cts)	4.88	5.07	5.20	5.32
BV Per Share (S cts)	77.7	75.0	72.3	69.8
PE (X)	50.4	45.2	40.0	37.2
PE Pre Ex. (X)	50.4	45.2	40.0	37.2
P/Cash Flow (X)	17.0	12.4	15.1	14.6
EV/EBITDA (X)	17.6	16.3	15.7	15.1
Net Div Yield (%)	4.9	5.1	5.2	5.3
P/Book Value (X)	1.3	1.3	1.4	1.4
Net Debt/Equity (X)	0.2	0.2	0.2	0.2
ROAE (%)	2.5	2.9	3.4	3.8
Earnings Rev (%):		(6)	(8)	NEW
Consensus EPS (S cts):		2.20	2.40	2.50
Other Broker Recs:		B: 10	S: 0	H: 1

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

5% yield still attractive

5% yield still attractive amid weaker market sentiment. NetLink NBN Trust (NLT) is trading at c.5.0% FY20F yield, versus an average yield of 4.8 % offered by large-cap industrial S-REITs. We argue that NLT should trade at a lower yield than S-REITs as (1) NLT's asset life is much longer than S-REITs as it incurs annual capex of >S\$55m-60m to replenish its regulated asset base (RAB); (2) NLT's gearing is less than half of S-REITs' with an ample debt headroom to fund future growth; and (3) NLT's distributions are largely independent of the economic cycle due to the regulated nature of its business.

Where we differ: We believe that NLT's share price will continue to perform well amid a low interest rate environment. NLT's one unique advantage over REITs is that any rise in the cost of capital in the medium term might lead to higher regulated returns (versus 7% now) from 2022 onwards, translating into higher distributions.

Potential catalysts: (i) NLT could use its debt headroom to invest in Smart Nation initiatives, not factored into our TP, and (ii) clarity on NLT's potential role in 5G rollout.

Valuation:

Maintain BUY, higher TP of S\$1.05. Our DCF valuation assumes 5.4% WACC and 1.2% terminal growth based on long-term household formation rate. The slight change in TP is largely on the back of lower weighted average cost of capital (WACC) to 5.4% from 5.5% previously to factor the lower cost of debt. We revised our FY20F/21F EBITDA by -3% each mainly due to lower ducts and manhole revenue assumptions.

Key Risks to Our View:

Key risks to our view will be regulatory changes in 2022. As ~80% of the revenue is regulated under the RAB model, any changes in nominal pre-tax WACC from 2022 onwards may lead to changes in Interconnection Offer (ICO) pricing.

At A Glance

Issued Capital (m shrs)	3,897
Mkt. Cap (S\$m/US\$m)	3,897 / 2,805
Major Shareholders (%)	
Temasek Holdings Pte Ltd	25.4
UBS AG / Singapore	5.6
Lazard Ltd	4.9
Free Float (%)	64.1
3m Avg. Daily Val (US\$m)	5.0
GIC Industry : Communication Services / Telecommunication Services	



Live more, Bank less

WHAT'S NEW

3QFY20 results broadly in line with consensus

3QFY20 results broadly in line with consensus. 3QFY20's revenue and NPAT of S\$91.6m and S\$21.5m were +3.0% y-o-y/-2.6% q-o-q and +9.6% y-o-y/-7.2% q-o-q respectively, broadly in line with consensus. Revenue growth y-o-y was largely from higher residential connections, offset by lower installation-related revenue, diversion revenue, and ducts and manhole revenue. Lower installation-related revenue (-30.1% y-o-y/-19.0% q-o-q) of S\$4.4m was largely due to lower residential installation charges and service activation charges. EBITDA margin improved to 73.6% (2Q19: 73.0%) as expenses were largely flat y-o-y/+7.0% q-o-q. No DPU was declared this quarter (unchanged y-o-y).

Lower ducts and manhole revenues. Ducts and manhole revenues, which is regulated under RAB, have been declining y-o-y over the last three quarters. For 9MFY20, ducts and manhole revenues declined 18.3% to S\$23.0m. According to management, the decline is attributable to (i) a slow down of jointly-built projects with Singtel ii) a portion of contractual ducts and manholes revenue pertains to rental of ducts and manholes by Singtel for their copper wires; chargeable length of wires has decreased during the period and is expected to decrease over the next few years as Singtel continues to reduce copper wires network. While there may be topline impact for NLT, we remain satisfied that the lower revenues will be included in RAB assessment at the next regulatory reset, which will go into determining the ICO price offered to retail players

Residential fibre connections continued to grow strongly. As of 31 Dec 2019, NLT's residential connections grew 0.8% q-o-q to reach 1.42m connections. Starhub cable migrations were largely over last quarter and according to management, 0.8%

q-o-q is closer to the steady state growth expected in subsequent quarters. Together with telcos, NLT is looking into extending fibre connections to unreached groups e.g. elderly homes and those in the lower income brackets.

Non-residential fibre and Non-Building Access Points (NBAP) connections largely flat for the quarter; potential from 5G developments. On the other hand, non-residential fibre connections grew 1.4% q-o-q, while NBAP connections and segment connections increased 3.5% and 9.4% q-o-q. Competition in the non-residential fibre connections space remains similar to previous quarters. NLT is working with telcos to target ~200k smaller SMEs who are currently not on fibre broadband.

Currently, NLT has no further details on timing of 5G rollout by telcos. NLT has been supporting M1 and TPG on various 5G trials and is able to support telcos should they require more base stations during 5G rollout.

Value and Recommendation

Maintain BUY, higher TP of S\$1.05. Our DCF valuation assumes 5.4% WACC and 1.2% terminal growth based on long-term household formation rate. Our change in TP is largely on the back of lower WACC (5.5% previously) to factor the reduced cost of debt. We revised our EBITDA by -3% each for FY20/21F mainly due to lower ducts and manhole revenue assumptions.

NetLink NBN Trust
Quarterly / Interim Income Statement (S\$m)

FY Mar	3Q2019	2Q2020	3Q2020	% chg yoy	% chg qoq
Revenue	89.0	94.1	91.6	3.0	(2.6)
Cost of Goods Sold	0.0	0.0	0.0	-	-
Gross Profit	89.0	94.1	91.6	3.0	(2.6)
Other Oper. (Exp)/Inc	(66.4)	(67.2)	(66.0)	(0.6)	(1.7)
Operating Profit	22.6	26.9	25.6	13.3	(4.7)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Associates & JV Inc	0.0	0.0	0.0	-	-
Net Interest (Exp)/Inc	(4.5)	(4.7)	(5.1)	(13.7)	(9.5)
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Pre-tax Profit	18.1	22.2	20.5	13.3	(7.7)
Tax	1.52	0.97	1.02	(33.3)	5.3
Minority Interest	0.0	0.0	0.0	-	-
Net Profit	19.6	23.2	21.5	9.6	(7.2)
Net profit bef Except.	19.6	23.2	21.5	9.6	(7.2)
EBITDA	62.8	67.6	67.9	8.0	0.4
Margins (%)					
Gross Margins	100.0	100.0	100.0		
Opg Profit Margins	25.4	28.6	27.9		
Net Profit Margins	22.1	24.6	23.5		

Source of all data: Company, DBS Bank

NetLink NBN Trust

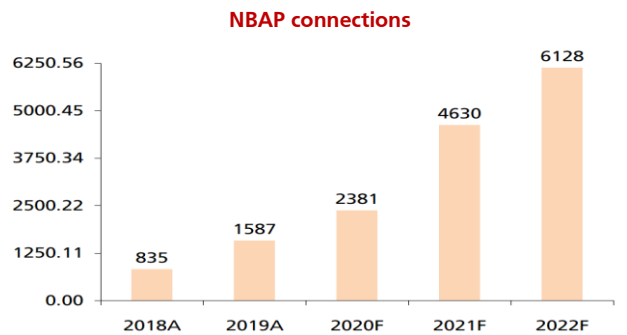
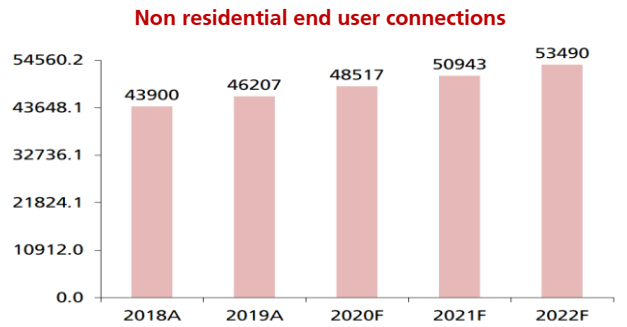
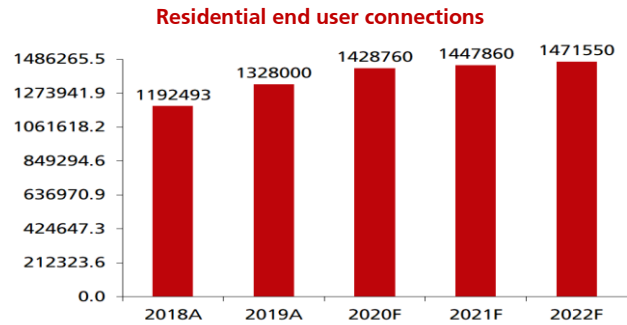
CRITICAL DATA POINTS TO WATCH

Critical Factors

Fibre broadband penetration set to rise from c.94% currently. As of Dec 2019, NLT’s network had passed over 1.5m residential homes, while there were 1.42m residential end-user connections, representing 94.5% of homes passed. NLT should benefit from StarHub’s accelerated fibre migration over 1HFY20 which will have a full-year impact over FY21F. In the subsequent years, we expect NLT to benefit from (a) higher end-user fibre penetration currently, and (b) growth in the number of new households.

Growing market share in non-residential fibre business. NLT expanded its market share from c.30% in FY17 to c.34% in FY18, having grown from zero in 2012. Growth in market share will be driven by an expanding SME market, which is mainly located outside of the Central Business District (CBD) and business parks where NLT faces lower competition from other fibre network providers due to its relatively extensive nationwide network coverage. Key strategies include (1) deploying fibre within selected non-residential buildings, and (2) extending network footprint into new major developments such as the Greater Southern Waterfront project.

Opportunities in Non-Building Access Points (NBAP) segment. Growth opportunities could arise from the Smart Nation Programme, which requires the deployment of a network of sensors and monitoring equipment across Singapore to support applications such as autonomous vehicles, high-definition surveillance cameras, parking space management and weather data collection. NLT continues to support the Requesting Licensees and government agencies on the rollout of Smart Nation initiatives.



Source: Company, DBS Bank

NetLink NBN Trust

Appendix 1: A look at Company's listed history – what drives its share price?



Source: Bloomberg Finance L.P., DBS Bank

NLT's share price correlates positively to the inverse of Singapore's 10 year benchmark government bond yield.

We believe NLT is being priced like a bond proxy due to its strong yield characteristics. In a lower yield environment, NLT's share price should perform well as it continues to deliver DPU growth.

NetLink NBN Trust

Balance Sheet:

Prudent capital structure. NLT has in place a prudent capital structure, with a S\$510m term loan plus two revolving credit facilities totalling S\$300m (S\$90m + S\$210m). Total gross debt as of 31Dec 2019 stood at S\$636m. Net debt-to-equity ratio for the Trust is low, at around 0.2x. More importantly, the Trust's gross debt/EBITDA ratio as of 31 Dec 2019 at 2.2x is quite conservative compared to other listed utility/infrastructure companies and business trusts.

Low gearing allows for opportunistic acquisitions, developments. Current gearing is low, with net debt-to-equity ratio at c.0.2x. The Manager has ample headroom for opportunistic acquisitions and developments.

Share Price Drivers:

We identify several catalysts for NLT's share price: (i) wider scope of Smart Nation initiatives as NLT could use its debt headroom to invest in those initiatives, leading to a healthy growth in distributions in the long term, and (iii) more clarity on NLT's potential participation, if at all, in the 5G rollout programme that is expected over next two years.

Key Risks:

Regulatory changes. As ~80% of the revenue is regulated under the RAB model, any changes in nominal pre-tax WACC from 2022 onwards may lead to changes in Interconnection Offer (ICO) pricing. The pre-tax WACC for the current review period is currently set at 7%.

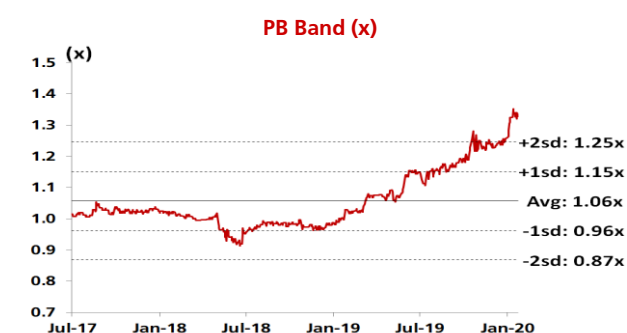
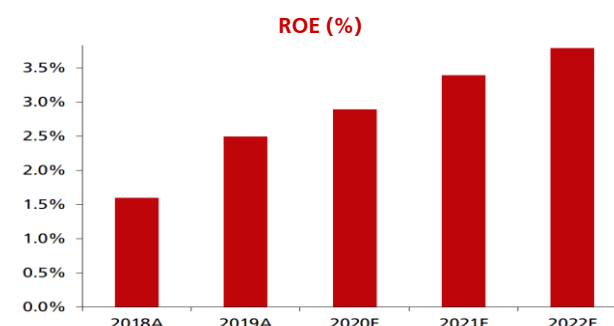
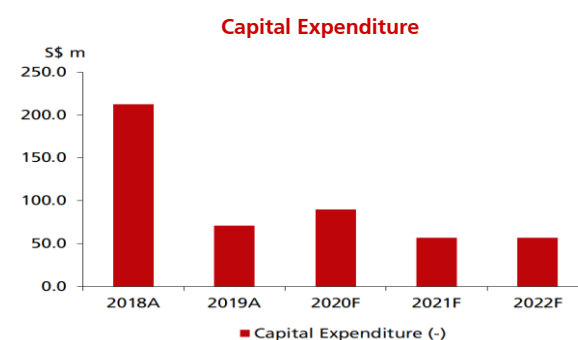
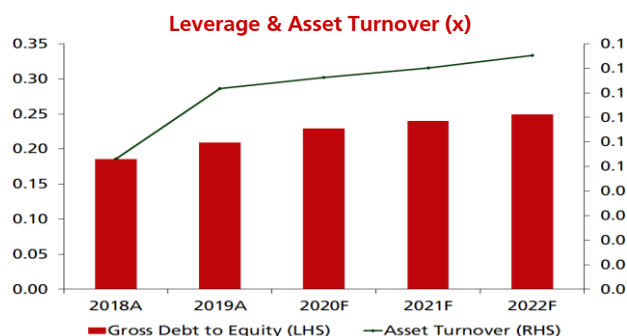
Technology risk. We note that NLT's unique "ring" and "star" topology schemes are considered as highly future-proof passive infrastructure. While wired fibre broadband remains the most efficient and effective technology today for the transmission of large amounts of data at high bandwidth with low latency from point-to-point directly and is often thought to be future-proof with limited substitution risk, there is risk of technology obsolescence with new technologies.

Environment, Social, Governance:

In FY19, NLT determined its material environmental, social and governance aspects, as it continues to expand its business and network infrastructure while upholding various sustainability efforts. NLT has formed a Sustainability Steering Committee to monitor and manage sustainability approaches as well as various ESG risks and opportunities.

Company Background

NLT designs, builds, owns and operates the fibre network infrastructure which is the foundation of Singapore's Next Generation Nationwide Broadband Network.



Source: Company, DBS Bank

NetLink NBN Trust

Key Assumptions

FY Mar	2018A	2019A	2020F	2021F	2022F
Residential end user	1,192,493	1,328,000	1,428,760	1,447,860	1,471,550
Non residential end user	43,900	46,207	48,517	50,943	53,490
NBAP connections	835	1,587	2,381	4,630	6,128

Segmental Breakdown

FY Mar	2018A	2019A	2020F	2021F	2022F
Revenues (\$m)					
Residential connections	196	207	233	238	242
Non-residential & NBAP	26.4	30.0	33.0	35.9	39.2
Ducts, manholes and CO	47.3	54.9	46.1	46.1	46.5
Others	(40.9)	62.0	57.1	60.6	65.3
Total	229	354	369	381	393

We project 99% fibre penetration in FY22F; non-residential to benefit from rise in market share

Income Statement (\$m)

FY Mar	2018A	2019A	2020F	2021F	2022F
Revenue	229	354	369	381	393
Cost of Goods Sold	0.0	0.0	0.0	0.0	0.0
Gross Profit	229	354	369	381	393
Other Opng (Exp)/Inc	(173)	(265)	(266)	(266)	(269)
Operating Profit	56.0	88.9	103	115	124
Other Non Opng (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(12.2)	(19.1)	(20.4)	(21.1)	(21.2)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	43.8	69.8	82.2	93.6	103
Tax	6.14	7.61	3.90	3.72	2.17
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	50.0	77.4	86.1	97.3	105
Net Profit before Except.	50.0	77.4	86.1	97.3	105
EBITDA	168	250	267	278	288
Growth					
Revenue Gth (%)	(23.6)	54.7	4.4	3.2	3.1
EBITDA Gth (%)	(24.9)	48.3	6.8	4.1	3.6
Opg Profit Gth (%)	(30.8)	58.7	15.5	11.7	8.1
Net Profit Gth (Pre-ex) (%)	(37.1)	54.9	11.3	13.0	7.8
Margins & Ratio					
Gross Margins (%)	100.0	100.0	100.0	100.0	100.0
Opg Profit Margin (%)	24.5	25.1	27.8	30.1	31.6
Net Profit Margin (%)	21.9	21.9	23.3	25.6	26.7
ROAE (%)	1.6	2.5	2.9	3.4	3.8
ROA (%)	1.2	1.8	2.0	2.3	2.5
ROCE (%)	1.3	2.1	2.5	2.8	3.1
Div Payout Ratio (%)	252.8	245.8	229.5	208.0	197.7
Net Interest Cover (x)	4.6	4.6	5.0	5.4	5.8

Source: Company, DBS Bank

NetLink NBN Trust

Quarterly / Interim Income Statement (\$m)

FY Mar	3Q2019	4Q2019	1Q2020	2Q2020	3Q2020
Revenue	89.0	87.9	92.0	94.1	91.6
Cost of Goods Sold	0.0	0.0	0.0	0.0	0.0
Gross Profit	89.0	87.9	92.0	94.1	91.6
Other Oper. (Exp)/Inc	(66.4)	(65.8)	(67.6)	(67.2)	(66.0)
Operating Profit	22.6	22.1	24.5	26.9	25.6
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(4.5)	(4.4)	(4.5)	(4.7)	(5.1)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	18.1	17.7	20.0	22.2	20.5
Tax	1.52	2.32	0.96	0.97	1.02
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	19.6	20.0	20.9	23.2	21.5
Net profit bef Except.	19.6	20.0	20.9	23.2	21.5
EBITDA	62.8	62.8	65.2	67.6	67.9
Growth					
Revenue Gth (%)	(1.7)	(1.3)	4.8	2.2	(2.6)
EBITDA Gth (%)	1.4	0.0	3.8	3.7	0.4
Opg Profit Gth (%)	6.5	(2.3)	11.0	9.8	(4.7)
Net Profit Gth (Pre-ex) (%)	5.0	2.0	4.6	10.8	(7.2)
Margins					
Gross Margins (%)	100.0	100.0	100.0	100.0	100.0
Opg Profit Margins (%)	25.4	25.1	26.6	28.6	27.9
Net Profit Margins (%)	22.1	22.8	22.7	24.6	23.5

Net profit number is not a meaningful figure as accounting depreciation is much higher than regulatory depreciation. Regulatory depreciation is used to calculate the regulated returns

Balance Sheet (\$m)

FY Mar	2018A	2019A	2020F	2021F	2022F
Net Fixed Assets	3,211	3,125	3,051	2,945	2,838
Invts in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other LT Assets	928	924	924	924	924
Cash & ST Invts	167	149	214	223	229
Inventory	3.89	4.74	6.47	6.68	6.89
Debtors	63.5	75.8	69.8	72.0	74.3
Other Current Assets	4.28	4.34	4.34	4.34	4.34
Total Assets	4,377	4,282	4,269	4,175	4,076
ST Debt	0.0	0.0	0.0	0.0	0.0
Creditor	48.4	56.0	120	124	128
Other Current Liab	12.5	23.7	23.7	23.7	23.7
LT Debt	589	635	670	678	678
Other LT Liabilities	553	538	534	530	528
Shareholder's Equity	3,174	3,030	2,922	2,819	2,719
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Cap. & Liab.	4,377	4,282	4,269	4,175	4,076
Non-Cash Wkg. Capital	10.8	5.20	(63.1)	(64.5)	(65.9)
Net Cash/(Debt)	(421)	(486)	(455)	(455)	(449)
Debtors Turn (avg days)	95.0	71.9	72.0	68.0	68.0
Creditors Turn (avg days)	(220.2)	(118.5)	(196.1)	(273.4)	(280.6)
Inventory Turn (avg days)	(15.2)	(9.8)	(12.5)	(14.7)	(15.1)
Asset Turnover (x)	0.1	0.1	0.1	0.1	0.1
Current Ratio (x)	3.9	2.9	2.1	2.1	2.1
Quick Ratio (x)	3.8	2.8	2.0	2.0	2.0
Net Debt/Equity (X)	0.1	0.2	0.2	0.2	0.2
Net Debt/Equity ex MI (X)	0.1	0.2	0.2	0.2	0.2
Capex to Debt (%)	36.0	11.2	13.4	8.4	8.4
Z-Score (X)	2.0	1.9	1.8	1.7	1.7

Net debt to EBITDA of less than 2x implies big room for raising cheap debt if needed as RAB Trusts can lever up to 5x easily

Source: Company, DBS Bank

NetLink NBN Trust

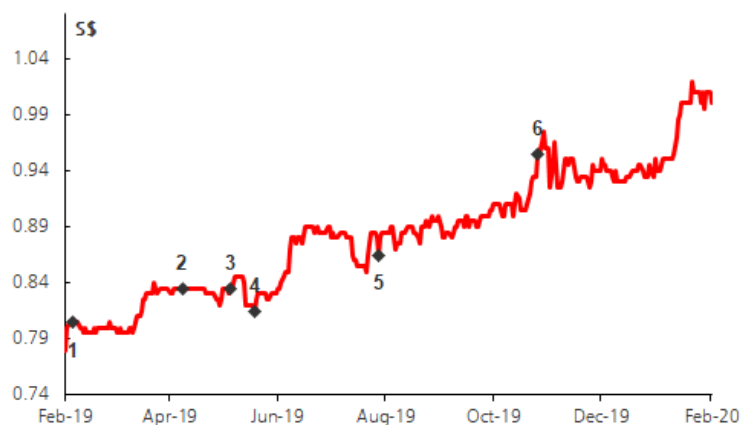
Cash Flow Statement (\$m)

FY Mar	2018A	2019A	2020F	2021F	2022F
Pre-Tax Profit	4.81	69.8	82.2	93.6	103
Dep. & Amort.	112	162	164	163	164
Tax Paid	(11.5)	(6.1)	0.0	0.0	0.0
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	21.1	2.30	68.3	1.39	1.42
Other Operating CF	31.7	2.05	0.0	0.0	0.0
Net Operating CF	158	230	315	258	268
Capital Exp.(net)	(212)	(71.1)	(90.0)	(57.0)	(57.0)
Other Invt.(net)	(1,095)	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.0	0.01	0.0	0.0	0.0
Net Investing CF	(1,307)	(71.1)	(90.0)	(57.0)	(57.0)
Div Paid	0.0	(221)	(194)	(200)	(205)
Chg in Gross Debt	(1,020)	45.0	35.0	8.00	0.0
Capital Issues	2,335	0.0	0.0	0.0	0.0
Other Financing CF	0.0	0.0	0.0	0.0	0.0
Net Financing CF	1,315	(176)	(159)	(192)	(205)
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	166	(17.8)	65.6	8.79	5.88
Opg CFPS (S cts)	3.53	5.83	6.32	6.58	6.84
Free CFPS (S cts)	(1.4)	4.07	5.76	5.15	5.41

Regular annual capex is S\$50-60m but there is an additional S\$30m capex incurred in FY20F

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	14 Feb 19	0.81	0.87	BUY
2:	17 Apr 19	0.84	0.87	BUY
3:	14 May 19	0.84	0.90	BUY
4:	28 May 19	0.82	0.90	BUY
5:	06 Aug 19	0.87	0.95	BUY
6:	04 Nov 19	0.96	1.04	BUY

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

Source: DBS Bank

Analyst: Sachin MITTAL

Rui Wen LIM

DBS Bank recommendations are based on an 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 share price 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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