

|   |                         |  |        |
|---|-------------------------|--|--------|
| <b>Name of PLC:</b> N2N Connect Berhad (N2N)  |                         | <b>PLC Website:</b> <a href="http://www.n2nconnect.com">www.n2nconnect.com</a> |        |
| <b>Business Summary:</b> Provision of enterprise-wide integrated e-commerce securities trading solutions to stock broking firms and banks.  |                         |  |        |
| <b>Top Three Shareholders:</b> N2N Connect Holdings SdnBhd  |                         | 29.2%  |        |
| Nikkei Inc  |                         | 11.4%  |        |
| Quick Corp  |                         | 11.4%  |        |
| <b>Market / Sector:</b>   | ACE/ Trading & Services | <b>Stock Code:</b>   | 0108   |
|   |                         | <b>Bloomberg Ticker:</b>   | N2N:MK |
| <b>Market Capitalisation:</b>   | RM 578m                 | <b>Recommendation:</b>   | HOLD   |
| <b>Target Price:</b>  | RM1.10                  | <b>Expected Capital Gain:</b>  | 2.8%   |
| <b>Current Price:</b>   | RM 1.07                 | <b>Expected Div Yield:</b>   | 2.8%   |
|   |                         | <b>Expected Total Return:</b>  | 5.6%   |
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| Key Stock Statistics            | 2016  | 2017  | 2018F | 2019F     |
|---------------------------------|-------|-------|-------|-----------|
| EPS (sen)                       | 2.2   | 4.4   | 5.6   | 5.5       |
| P/E (x)                         | 49.7  | 24.4  | 19.3  | 19.5      |
| EPS ex-EI (sen)                 | 2.1   | 2.8   | 4.5   | 5.5       |
| P/E ex-EI (x)                   | 51.8  | 38.3  | 23.6  | 19.5      |
| Net Dividend/Share (sen)        | 1.0   | 1.0   | 3.0   | 3.0       |
| NTA/Share (RM)                  | 0.34  | 0.24  | 0.30  | 0.32      |
| Book Value/Share (RM)           | 0.37  | 0.40  | 0.43  | 0.45      |
| Issued Capital (mil shares)     | 476.4 | 477.1 | 545.8 | 545.8     |
| 52-weeks Share Price Range (RM) |       |       |       | 0.67-1.14 |
| Estimated free float            |       |       |       | 25.8%     |
| Average volume (shares)         |       |       |       | 2.71m     |

| Per Share Data           | 2016   | 2017   | 2018F  | 2019F  |
|--------------------------|--------|--------|--------|--------|
| Year-end 31 Dec          |        |        |        |        |
| Book Value/Share (RM)    | 0.37   | 0.40   | 0.43   | 0.45   |
| Operating CF/Share (sen) | 2.5    | 7.2    | 7.8    | 7.8    |
| EPS (sen)                | 2.2    | 4.4    | 5.6    | 5.5    |
| Net Dividend/Share (sen) | 1.0    | 1.0    | 3.0    | 3.0    |
| P/E (x)                  | 49.7   | 24.4   | 19.3   | 19.5   |
| P/Cash Flow (x)          | 43.6   | 14.9   | 13.8   | 13.7   |
| P/Book Value (x)         | 2.9    | 2.7    | 2.5    | 2.4    |
| Dividend Yield (%)       | 0.8    | 0.8    | 2.8    | 2.8    |
| Payout Ratio (%)         | 40.4   | 19.6   | 54.0   | 55.0   |
| ROE (%)                  | 6.6    | 13.0   | 14.3   | 12.4   |
| Net Gearing (%)          | (18.4) | (14.8) | (25.1) | (23.9) |

| P&L Analysis (RM mil) | 2016  | 2017   | 2018F  | 2019F  |
|-----------------------|-------|--------|--------|--------|
| Revenue               | 41.8  | 97.3   | 111.6  | 119.1  |
| EBITDA                | 18.7  | 35.2   | 46.2   | 46.1   |
| Depreciation & amort  | (7.4) | (10.3) | (12.2) | (12.7) |
| Net interest income   | 0.5   | 0.3    | (1.1)  | (0.8)  |
| EI *                  | 0.5   | 8.7    | 5.6    | -      |
| Pre-tax Profit        | 11.8  | 25.2   | 33.0   | 32.6   |
| Net Profit            | 11.7  | 24.0   | 30.3   | 30.0   |
| EBITDA Margin (%)     | 44.7  | 36.2   | 41.4   | 38.7   |
| Pre-tax Margin (%)    | 28.2  | 25.9   | 29.6   | 27.4   |
| Net-Margin (%)        | 28.1  | 24.6   | 27.2   | 25.2   |

## 1. Investment Highlights/Summary

- We expect moderate revenue growth in coming years underpinned by full year consolidation of AFE and cross-sell potential opportunities among the product varieties. Nevertheless, earnings growth is encouraging, mainly from the cost rationalisation at AFE which could save approximately USD2-3m per annum.
- In longer-term, N2N is progressing as a regional player with its integrated financial trading solutions. The Company's comprehensive range of products and services will provide a strong platform for domestic growth and greater regional reach. N2N ultimately aspires to position itself as a dominant financial trading hub in Asia.
- We have fine-tuned our FY18 core profits forecast and introduced FY19 numbers at RM24.7m and RM30.0m respectively. It represents 62% and 21% y-o-y growth. However, we downgraded our BUY recommendation to HOLD, mainly due to the dilution impact from the recent warrants conversion prior to their expiry in April 2018. Despite having rolled forward our valuation to FY19, our TP reduces from RM1.20 to RM1.10 from the dilution in EPS from 6.3sen to 5.5sen. Our TP is based on unchanged target P/E of 20x, implying a PEG ratio of 1x, underscored by the company's 4-year core earnings CAGR of 25.9% (FY13-FY17) and positive forward earnings outlook.

## 2. Corporate Development

- FY17 is a remarkable year for N2N as the company registered a stellar revenue and core profits growth of 133% and 93%, respectively. Topline grew substantially attributable mainly to the consolidation of N2N-AFE (Hong Kong) Limited (formerly known as AFE Solutions Limited; AFE). There were 9 months contributions from AFE to the financial year since the completion of the acquisition on 31 March 2017 for a cash consideration of RM93.3m. Its existing business revenue also grew healthily at 17% y-o-y.
- Going-forward, we expect to see moderate growth in revenue due to the large base effect. However, we are optimistic of AFE's strategy ahead, with their intention to expand its business from their predominantly retail broker coverage to the larger institutional brokers, as well as the boutique 'moms and pops' brokers which may require time to set up cloud base trading systems from the existing terminal based systems. In addition, there will also be cross-sell potential opportunities among the product varieties across market segments.
- The Company is mindful of the comparably lower profit margins at AFE, which was partly due to its higher operating costs. The Company has since made cost management at AFE a priority. In the coming two years, we estimate cost savings at AFE to progressively range from USD2-3m per annum, substantially from the items below :
  - Reducing rental rate through the relocation of its 11,000 sq ft office to a smaller, 5,000 sq ft office in a less prime area to house its staff of 70 people;
  - Reducing third party fees through renegotiating or restructuring existing terms with its external service providers, this is expected to be done in stages, completing by 1Q19;
  - Seeking out alternative data centre provider in Hong Kong that could potentially result in 50-60% cost savings in hosting services;
  - Setting up in-house IT-support services instead of outsourcing to higher-cost third-parties, where applicable.
- The Company also looks forward to further expanding its market base and creating borderless trading with its constant technology evolution. This is expected to be a major catalyst as all regional brokerage partners will be able to enjoy cost efficient cross border trading through the N2N network. Meanwhile, the Company is assessing a few more potential targets for acquisition to further establish its Pan Asia presence.

Recently, the Company subscribed 28% shareholdings of OurMoneyMarket Holdings Pty Ltd (OMM) for a total cash consideration of AUD2.8m or RM8.3m. OMM is Australia's first hybrid market place lender, utilising the latest peer-to-peer lending technology in combination with traditional structured finance methods to fund high yielding unsecured personal loans. OMM intends to redefine the role that marketplace lending plays in Australia financial services with a focus on collaborating with, rather than competing against, traditional lenders. OMM's platform provides borrowers with a quick and simple online application process, whilst awarding good borrowers with lower rates than traditional lenders. Its advanced investor platform applies securitisation "best practice" methods to provide investors with detailed portfolio analytics, whilst ensuring a robust foundation to scale its operations. The investor platform is open to both retail and institutional investors, who can now access an alternative asset class to traditional equities and bonds. Investors using the platform are able to invest as little as AUD50 in any single loan.

We also understand from management that N2N is also keen to explore expansion into the Japanese and Thai markets, and hope to be able to include these two new markets into their table over the next two years.

- Its Singapore, Malaysia and Hong Kong markets are well equipped with a platform for borderless trading. Phase 1 of product harmonisation for its remaining markets are expected to complete by the end of this year. We view this positively as this would be a breakthrough in introducing a market-friendly platform to boost trading activities. If successful, growth should be imminent.

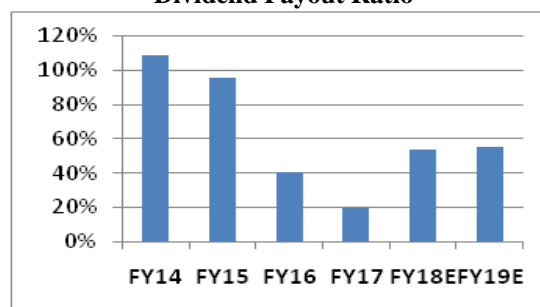
**3. Earnings Outlook**

- FY17 reported earnings doubled to RM24m, which was mainly driven by RM8m forex gains and RM1.0m gains from fair value change on financial assets. The forex gains were mainly due to the timely drawdown of USD borrowings at weakest level of Ringgit (close to RM4.50). Stripping off the one off items, core earnings grew 35.2% to RM15.3m. We have since reviewed and fine-tuned our FY18 revenue and earnings forecast marginally. We expect core earnings to improve further to RM24.6m and RM30.0m in FY18-19E underpinned by a full year consolidation of AFE and margin improvement due to cost rationalisation of AFE. Assuming MYR holds at current levels against the USD, there could potentially be further forex gain of RM5-6m in FY18, bringing reported earnings to RM30m.
- The Company’s balance sheet remains healthy at net cash of 25-24% for FY18-19E, despite an assumed RM20m per annum allocation for acquisitions and business expansion. Cash position should also improve further if we include RM43.9m in marketable securities. Hence, we believe the Company has ample capacity to repay the USD loan and lock in the current forex gains should it choose to do so.
- The Company paid a 3sen dividend for FY18 in March, which represents a 54% payout ratio to our forecast. Historically, the Company has once declared more than 100% in FY14 and paid out twice in a year before. We have inputted a 3 sen dividend for FY18-19, translating to a reasonable dividend yield of 2.8%. However, given its strong cash position, near term dividend payment may surprise on the upside.

**Historical Dividend Pattern**

| Ex-date   | FYE  | Sen |
|-----------|------|-----|
| 26/3/2014 | FY14 | 1.5 |
| 11/9/2014 | FY14 | 0.7 |
| 11/9/2015 | FY15 | 1.0 |
| 10/3/2016 | FY15 | 1.0 |
| 14/9/2016 | FY16 | 1.0 |
| 11/8/2017 | FY17 | 1.0 |
| 14/3/2018 | FY18 | 3.0 |

**Dividend Payout Ratio**



**4. Valuation and Recommendation**

- N2N is progressing well as a regional player with its integrated financial trading solutions. The Company’s comprehensive range of products and services will provide a strong platform for domestic growth and greater regional reach. N2N ultimately aspires to position itself as a dominant financial trading hub in Asia.
- We downgraded our BUY recommendation to HOLD, mainly due to the dilution impact from the recent warrants conversion prior to their expiry in April 2018. Despite having rolled forward our valuation to FY19, our TP reduces from RM1.20 to RM1.10. As the number of shareholdings increased from 477m to 545m, our EPS reduces from 6.3 sen to 5.5 sen. Our TP is based on unchanged target P/E of 20x, implying a PEG ratio of 1x, underscored by the company’s 4-year core earnings CAGR of 25.9% (FY13-FY17) and positive forward earnings outlook. Catalysts for upgrades would be success in expanding into new markets as well as success in holistically growing its regional trade connection platform.

Share price chart of N2N



### Disclosures/Disclaimer

Investment ratings:

Buy (generally >10% upside over the next 12 months)

Hold (generally negative 10% downside to positive 10% upside over the next 12 months)

Sell (generally >10% downside over the next 12 months)

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