

UPDATE REPORT

9 July 2018

<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 Sdn Bhd		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 800.6m	<b>Recommendation:</b>	BUY
<b>Target Price:</b>	RM1.50	<b>Expected Capital Gain:</b>	12.8%
		<b>Expected Div Yield:</b>	2.4%
<b>Current Price:</b>	RM 1.33	<b>Expected Total Return:</b>	15.2%
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Key Stock Statistics	2016	2017	2018F	2019F
EPS (sen)	2.0	4.1	5.3	5.8
P/E (x)	65.6	32.2	24.9	22.9
EPS ex-EI (sen)	1.9	2.6	4.4	5.8
P/E ex-EI (x)	68.4	50.6	30.5	22.9
Net Dividend/Share (sen)	0.8	0.8	2.9	3.3
NTA/Share (RM)	0.34	0.24	0.39	0.42
Book Value/Share (RM)	0.37	0.40	0.52	0.54
Issued Capital (mil shares)	476.4	477.1	579.8	579.8
52-weeks Share Price Range (RM)			0.67-1.37	
Estimated free float				23.6%
Average volume (shares)				1.93m

Per Share Data	2016	2017	2018F	2019F
Year-end 31 Dec				
Book Value/Share (RM)	0.37	0.40	0.52	0.54
Operating CF/Share (sen)	2.3	6.8	7.4	7.8
EPS (sen)	2.0	4.1	5.3	5.8
Net Dividend/Share (sen)	0.8	0.8	2.9	3.3
P/E (x)	65.2	32.2	24.9	22.9
P/Cash Flow (x)	57.6	19.7	18.1	17.1
P/Book Value (x)	3.6	3.3	2.6	2.5
Dividend Yield (%)	0.6	0.6	2.2	2.4
Payout Ratio (%)	40.4	19.6	55.0	56.0
ROE (%)	6.6	13.0	12.6	11.0
Net Gearing (%)	(18.4)	(14.8)	(30.6)	(29.5)

P&L Analysis (RM mil)	2016	2017	2018F	2019F
Revenue	41.8	97.3	111.6	129.1
EBITDA	18.7	35.2	46.2	48.9
Depreciation & amort	(7.4)	(10.3)	(12.2)	(12.7)
Net interest income	0.5	0.3	(0.7)	(0.1)
EI *	0.5	8.7	5.6	-
Pre-tax Profit	11.8	25.2	33.3	36.1
Net Profit	11.7	24.0	30.9	33.7
Core Net Profit	11.3	15.3	25.3	33.7
EBITDA Margin (%)	44.7	36.2	41.4	37.9
Pre-tax Margin (%)	28.2	25.9	29.9	27.9
Net-Margin (%)	28.1	24.6	27.7	26.1

1. **Investment Highlights/Summary**

- Positive takeaways from recent briefing. Management's key messages 1) business to remain on a growth trajectory with organic growth from its existing product offerings, including TCBO; 2) ability to cross-sell products and improve on cost efficiencies leveraging on both its strong domestic backbone and regional platforms, 3) continuously investing in related businesses to strengthen and expand market presence.
- N2N is progressing well in developing itself as a regional service provider with its integrated financial trading solutions and advance technology that we believe are ahead of many peers. N2N ultimately aspires to position itself as a dominant financial trading hub in Asia.
- We maintain FY18E earnings estimate at RM25m but revises FY19E earnings upwards from RM30m to RM34m. The upward revision is mainly due to the new assumptions of TC BOS.
- Upgraded to BUY. Our TP is raised from RM1.10 to RM1.50. We have also raised our target P/E from 20x to 26x which imply a PEG ratio of 1x, underscored by the company's 4-year core earnings CAGR of 25.9% (FY13-FY17), positive forward earnings outlook and corporate developments.

## 2. Corporate Development

- N2N hosted an analysts' briefing last Thursday, and we came away with positive takeaways. Management's key messages include: 1) business will remain on a growth trajectory with organic growth from its existing product offerings, including TC BOS; 2) ability to cross-sell products and improve on cost efficiencies leveraging on both its strong domestic backbone and regional platforms, and 3) continuously investing in related businesses to strengthen and expand market presence.
- N2N-AFE (Hong Kong) Limited (formerly known as AFE Solutions Limited; AFE) has an approximate market share of 35% for market information and 15% for trading solutions. The Company is in the midst of changing its business model from a typical subscription-based licensing model to being a hassle-free one-stop solution service provider to increase the stickiness of clients and enhance profit margins through the provision of hardware, software, infrastructure and more. Meanwhile, the management also recognised that there is room for further profit margin improvements at AFE through cost rationalisation. Through the following efforts, management foresees an estimated RM10m of savings to be captured, having reaped savings of RM3-4m already in the recently reported results.
  - Lowering office rentals 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% cost savings in hosting services;
  - Setting up in-house IT-support services instead of outsourcing to higher-cost third-parties, where applicable.
- N2N has recently rolled out a new Back-Office System called TC BOS. This system is suitable for both local and regional clients as N2N has developed a comprehensive regional framework that could comply with each of the countries' regulation without customization. We also understand that management will not sell the system outright but intends to include it as part of its managed services, offering reliability and sustainability to clients with an indicative 30% savings compared to the typical BOS in the market. Ideally, a conservative assumption of securing five clients per annum would offer a positive impact of 5% revenue growth to the overall group. Currently there are clients who have subscribed to this TC BOS system, including two brokers from the Philippines. Assuming a lead time of 6 months to commence activation, the product is expected to contribute positively from FY19E onwards.
- The Company has continued to actively pursue means to expand its market base and create borderless trading with its technology evolution. This is expected to be a major catalyst when regional brokerage partners are drawn to the ease and 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. Its borderless trading for Singapore, Malaysia, Hong Kong and US markets are expected to be ready by CY18 while product harmonisation for its remaining markets (Thailand, Philippines, Japan, Vietnam and Australia) are expected to take off by CY19. 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.
- On 13 June 2018, N2N completed the private placement of 52m new shares at RM1.25 per share to SBI Holdings Inc (SBI), representing 9% of the Company's enlarged shareholdings. SBI is a listed company on the First Section of Tokyo Stock Exchange with market capitalisation of RM23.9b. It operates in the financial services business, asset management business and biotechnology related business segments. This strategic partnership is expected to pave the way for potential collaboration between the SBI Group and N2N. One of which is the exposure to the blockchain technology within SBI, which is a secure and efficient means of recording and confirming transactions that can be applied to securities trading. This technology can help to simplify trade settlements to result in same day settlement, rather than T+3 under the current system in Malaysia, for example. There can also be flexibility to offer fractional shares trading which allows for improved affordability and liquidity in securities trading. N2N can leverage on the blockchain technology knowhow of SBI to further strengthen its Asian Trading Hub platform.

- Incorporating blockchain technology into its current structure ensures N2N as a comprehensive front and back-end solutions provider in its plans to develop a Asia Trading Hub not just for securities trading, but to be applied to Alternate Trading Systems ('ATS'), as well as Cryptocurrency trading, if that can become a certainty. This would set it apart further from current peers in the market. As it is, N2N is participating in the Securities Commission's ('SC') dialogue sessions under the SC's FinTech Innovation Lab as it explores establishing a legal framework for alternative trading systems for our local bourse. We opine that if SC does introduce ATS into the market, there is a strong possibility of N2N participating meaningfully given its current expertise as well as that of its strategic partner, SBI.

### N2N's Corporate Mission



Source: The Company

### 3. Earnings Outlook

- In 1QFY18, N2N's revenue and core profits improved 126% and 41.6% y-o-y due to the full consolidation of AFE after its acquisition in March 2017. Setting aside the results of AFE, the core profit of N2N alone increased 7% y-o-y in the quarter. We maintain FY18E earnings estimate at RM25m but revises FY19E earnings upwards from RM30m to RM34m. The upward revision is mainly due to the new assumptions of TC BOS which we have not factored in earlier, and a relatively lower tax bracket adjustment for lower AFE contribution (from 60% previously to 50% due mainly to growth from other segments). Note that the Company is still enjoying the MSC status with a five plus five year 100% tax exemption, expiring in 2025 while AFE is subjected to a 15% tax bracket. Near term, we believe growth would continue to be driven by growth in existing and new products and solutions, as well as margin improvement from cost rationalisation of AFE.
- The Company's balance sheet remains healthy at net cash of 30% for FY18-19E, despite an assumed RM20m per annum allocation for acquisitions and business expansion.

### 4. Valuation and Recommendation

- N2N is progressing well in developing itself as a regional service provider with its integrated financial trading solutions and advance technology that we believe are ahead of many peers. 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.
- Post briefing, we came away positive on N2N's near and longer term prospect. We upgraded our HOLD recommendation to BUY. Our TP is raised from RM1.10 to RM1.50. We have also raised our target P/E from 20x to 26x which imply a PEG ratio of 1x, underscored by the company's 4-year core earnings CAGR of 25.9% (FY13-FY17), positive forward earnings outlook and corporate developments.

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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