

**2Q FYE DEC 2018 RESULTS REPORT**

29 August 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 681.58m	<b>Recommendation:</b>	BUY
<b>Target Price:</b>	RM1.50	<b>Expected Capital Gain:</b>	33.9%
<b>Current Price:</b>	RM 1.12	<b>Expected Div Yield:</b>	2.6%
		<b>Expected Total Return:</b>	36.5%
<b>Analyst:</b> Bryan Chan   Tel: +603 2163 3200; Email: <a href="mailto:chanb@bcta.com.my">chanb@bcta.com.my</a>			

<b>Key Stock Statistics</b>	<b>2016</b>	<b>2017</b>	<b>2018F</b>	<b>2019F</b>
EPS (sen)	2.0	4.1	5.3	5.8
P/E (x)	55.3	27.1	21.0	19.3
EPS ex-EI (sen)	1.9	2.6	4.4	5.8
P/E ex-EI (x)	57.6	42.6	25.7	19.3
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)	1.72m			

<b>Per Share Data</b>	<b>2016</b>	<b>2017</b>	<b>2018F</b>	<b>2019F</b>
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)	55.3	27.1	21.0	19.3
P/Cash Flow (x)	48.5	16.6	15.2	14.4
P/Book Value (x)	3.0	2.8	2.2	2.1
Dividend Yield (%)	0.7	0.7	2.6	2.9
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)

<b>P&amp;L Analysis (RM mil)</b>	<b>2016</b>	<b>2017</b>	<b>2018F</b>	<b>2019F</b>
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. 2QFY18 Results Highlight**

	<b>2Q FY18</b>	<b>2Q FY17</b>	<b>Chg</b>
	<b>RMm</b>	<b>RMm</b>	<b>%</b>
Revenue	29.3	30.1	(2.5)
Operating Profit	5.6	10.7	(47.9)
Finance cost	(0.4)	(0.8)	
Pre-tax Profit	5.1	9.9	(48.6)
Net Profit after Minority	1.4	9.9	(86.1)
Core Profit	8.1	5.2	54.6
Operating Margin (%)	18.9	35.4	
Pre-tax Margin (%)	17.4	32.9	
Net-Margin (%)	4.7	33.0	
Core-Margin (%)	27.6	17.4	

- In 2QFY18, N2N's revenue declined marginally by 2.5% y-o-y to RM29.3m due to the weaker Hong Kong dollar against the Malaysian Ringgit. USD also weakened by 9.0% y-o-y in 2QCY18 against Ringgit Malaysia. Gross profits were flat at RM17.6m with margin improvement of approximately 1.4ppt. Overall operations and sales were showing improvement y-o-y.
- 2QFY18 net profits were 86.1% lower y-o-y due to forex movements as well as one-off additional tax charges. Stripping off the items, core profits increased by 54.6% y-o-y to RM8.1m. The adjustment includes a net forex gain of RM1.3m in 2QFY18 vs a net forex loss of RM3.9m in 2QFY17, the additional tax paid and fair value change on financial assets.
- On 9 July 2018, N2N announced that it has paid the Inland Revenue an additional tax and penalty of RM5.3m for the years of assessment 2012 to 2016. We have clarified there will be no more additional tax needed to be paid.

	1HFY18	1HFY17	Chg
	RMm	RMm	%
Revenue	55.0	41.5	32.7
Operating Profit	12.9	14.4	(9.8)
Finance cost	(1.0)	(0.8)	26.8
Pre-tax Profit	11.8	13.5	(12.5)
Net Profit after Minority	8.1	13.6	(40.5)
Core Profit	12.5	8.6	45.3
Operating Margin (%)	23.5	34.6	
Pre-tax Margin (%)	21.5	32.6	
Net-Margin (%)	14.7	32.7	
Core-Margin (%)	22.7	20.7	

- 1HFY18’s core profits came in within expectations at 50% of our full year estimates of RM25.3m. 1HFY18 revenue improved 32.7% y-o-y due to the consolidation of the six month financial results of N2N-AFE (Hong Kong) Limited (AFE) as compared to the three month consolidation in the preceding year as the acquisition was completed on 31 March 2017. Consequently, 1HFY18 core profits improved 45.3% y-o-y to RM12.5m.
- In 1HFY18, we have seen the EBITDA margin from Hong Kong improved from 18.0% in 1HFY17 to 25.0%. This illustrates management’s success in curtailing spending on the newly acquired subsidiary – AFE which initially has much thinner margins than N2N’s core operations. The positive impact from cost rationalisation will continue to be recognized progressively in the coming years.
- Recall that the subscription of 28% shareholdings of OurMoneyMarket Holdings Pty Ltd (OMM) for a total cash consideration of AUD2.8m or RM8.3m by N2N was completed on 12 April 2018. The Company also started incurring minor losses for the associates during the quarter. However, we do not expect material impact to the group for the time-being. 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.

## 2. Earnings Outlook

- N2N is a leading provider of trading solutions in Malaysia with a market share of 70% in equities trading solutions segment and 80% in derivatives and commodities trading. Its new product offerings, including TcProGlobal, TcPlus and TcMobile, will serve to further enhance the Company’s comprehensive range of products and services, providing a strong platform for domestic growth and greater regional reach. N2N ultimately aspires to position itself as a dominant financial trading hub in Asia.
- The decent results reassure that 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.
- We remain positive that its 1) business to remain on a growth trajectory with organic growth from its existing product offerings, including TCBOS; 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. Hence, we maintain FY18E-19E earnings estimate of RM25m and RM34m respectively.

**3. Valuation and Recommendation**

- Maintain BUY and TP of RM1.50. Our TP is based on PER of 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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