

3Q FYE DEC 2018 RESULTS REPORT

22 November 2018

Name of PLC: N2N Connect Berhad (N2N)		PLC Website: www.n2nconnect.com	
Business Summary: Provision of enterprise-wide integrated e-commerce securities trading solutions to stock broking firms and banks.			
Top Three Shareholders: N2N Connect Holdings Sdn Bhd		29.2%	
Nikkei Inc		11.4%	
Quick Corp		11.4%	
Market / Sector:	ACE/ Trading & Services	Stock Code:	0108
		Bloomberg Ticker:	N2N:MK
Market Capitalisation:	RM 687.6m	Recommendation:	BUY
Target Price:	RM 1.30	Expected Capital Gain:	12.1%
		Expected Div Yield:	2.7%
Current Price:	RM 1.16	Expected Total Return:	14.8%
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Key Stock Statistics	2016	2017	2018F	2019F
EPS (sen)	2.0	4.1	4.6	4.9
P/E (x)	57.3	28.0	25.2	23.6
EPS ex-EI (sen)	1.9	2.6	3.6	4.9
P/E ex-EI (x)	59.6	44.1	31.9	23.7
Net Dividend/Share (sen)	0.8	0.8	4.0	4.0
NTA/Share (RM)	0.38	0.24	0.37	0.38
Book Value/Share (RM)	0.37	0.40	0.50	0.51
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			27.2%	
Average volume (shares)			139k	

Per Share Data	2016	2017	2018F	2019F
Year-end 31 Dec				
Book Value/Share (RM)	0.37	0.40	0.50	0.51
Operating CF/Share (sen)	2.3	6.8	6.7	6.9
EPS (sen)	2.0	4.1	4.6	4.9
Net Dividend/Share (sen)	0.8	0.8	4.0	4.0
P/E (x)	57.3	28.0	25.2	23.7
P/Cash Flow (x)	50.2	17.1	17.4	16.7
P/Book Value (x)	3.1	2.9	2.3	2.3
Dividend Yield (%)	0.7	0.7	3.4	3.5
Payout Ratio (%)	40.4	19.6	86.0	82.0
ROE (%)	6.6	13.0	11.2	9.7
Net Gearing (%)	(18.4)	(14.8)	(31.0)	(27.6)

P&L Analysis (RM mil)	2016	2017	2018F	2019F
Revenue	41.8	97.3	108.0	124.1
EBITDA	18.7	35.2	41.9	43.7
Depreciation & amort	(7.4)	(10.3)	(12.2)	(12.7)
Net interest income	0.5	0.3	(0.8)	(0.4)
EI *	0.5	8.7	5.6	-
Pre-tax Profit	11.8	25.2	28.9	30.7
Net Profit	11.7	24.0	26.7	28.4
Core Net Profit	11.3	15.3	21.1	28.4
EBITDA Margin (%)	44.7	36.2	38.8	35.2
Pre-tax Margin (%)	28.2	25.9	26.8	24.7
Net-Margin (%)	28.1	24.6	24.7	22.9

1. 3QFY18 Results Highlight

	3Q FY18	3Q FY17	Chg
	RMm	RMm	%
Revenue	25.2	28.2	(10.4)
Operating Profit	3.9	5.7	(31.6)
Finance cost	(0.4)	(0.7)	(46.1)
Pre-tax Profit	3.5	5.0	(30.9)
Net Profit after Minority	2.2	5.1	(56.5)
Core Profit	3.9	3.9	(1.0)
Operating Margin (%)	15.6	20.4	
Pre-tax Margin (%)	13.7	17.8	
Net-Margin (%)	8.8	18.1	
Core-Margin (%)	15.5	14.0	

- N2N 3QFY18 revenue declined 10.4% y-o-y to RM25.2m due to weaker performance in both key segments of Malaysia (-16.5% y-o-y) and Hong Kong (-9.4% y-o-y). Lower contribution from Hong Kong was largely due to currency translation as a result of the weaker Hong Kong dollar against the Malaysian Ringgit in the period on y-o-y basis.
- 3QFY18 net profit was 56.5% lower y-o-y, attributed to unrealised forex loss (vs a gain in 3QFY17), higher tax bracket and lower other operating income. GP margin dropped 1.7ppt in the period as well.
- During the quarter, the Company declared a second interim dividend of 1 sen (ex-date 6 Dec 2018), bringing total YTD dividend per share to 4sen. This payout represents a four-fold increase as compared to FY17, translating into a decent yield of 3.4%.

	9MFY18	9MFY17	Chg
	RMm	RMm	%
Revenue	80.3	69.6	15.3
Operating Profit	16.9	20.1	(16.0)
Finance cost	(1.4)	(1.5)	(7.4)
Pre-tax Profit	15.3	18.5	(17.5)
Net Profit after Minority	10.3	18.7	(44.9)
Core Profit	16.4	12.5	31.5
Operating Margin (%)	21.0	28.9	
Pre-tax Margin (%)	19.1	26.6	
Net-Margin (%)	12.8	26.8	
Core-Margin (%)	20.4	17.9	

- 9MFY18 core profit came in below expectation at 65% of our full year estimates of RM25.3m. However, revenue was broadly in-line at 72%. 9MFY18 revenue improved 15.3% y-o-y, aided by the full consolidation of the nine-month financial results of N2N-AFE (Hong Kong) Limited (AFE) as opposed to the six-month consolidation in the preceding year as the acquisition was only completed on 31 March 2017. Consequently, 9MFY18 core profit improved 31.5% y-o-y to RM16.4m. However, PATAMI declined 44.9% y-o-y to RM10.3m hampered by lower unrealised forex gains of RM0.34m (versus RM5.1m in 9MFY17) and an additional tax and penalty of RM5.3m for the years of assessment 2012 to 2016.
- In 9MFY18, it was encouraging to see EBITDA margin from Hong Kong segment improved to 23.0% from 16.5% in 9MFY17. This reflects 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.

2. Corporate Development

- On 2 November 2018, the Company announced a proposed bonus issue of warrants, comprising the issuance of up to 149.5m free warrants on the basis of 1 warrant for every 4 existing N2N shares held by the entitled shareholders. The warrants will be issued at no cost to shareholders, providing an opportunity to the Company to raise proceeds as and when the warrants are exercised during the tenure of warrants over five years. The exercise price and entitlement date have not been fixed. Based on an indicative exercise price of RM 0.98 per warrant, representing a discount of 15.5% from last price, the Company will potentially be able to raise RM146.5m mainly for future working capital requirements. This is largely a long-term plan to position for future expansion where N2N develops itself as a regional service provider with ultimate aspiration to be a dominant financial trading hub in Asia. The proposal is currently pending for Bursa and shareholders' approval which the EGM is fall on 12 December 2018. The exercise is expected to be completed by early 2019.
- Another agenda that will arise at the same EGM will be the proposal to introduce a long-term incentive plan (5+5 years) of up to 15% of the total number of issued shares of the Company for eligible executive directors and employees as well as for its subsidiary companies. We view this incentive positively as it aims to encourage a high-performance culture in the group, and would align senior staff's interest with the corporate goals and objectives of N2N in creating sustainable value enhancement for its shareholders.

	Number of shares ('m)	Total Value (RM'm)	Value per unit (RM)	Total Equity (RM'm)	NA/Share	FY19 EPS	Dilution Impact
Issued Capital	597.9	261.0	0.44				
Less: Treasury Shares	(30.6)	-	-				
	567.3		-	246.7	0.43	5.02	
Full conversion of warrants	141.8	139.0	0.98	139.0			
Post warrants	709.1	400.0	0.56	385.7	0.54	4.02	-20.0%
Proposed LTIP	106.4	108.5	1.02	108.5			
Post LTIP	815.4	508.5	0.62	494.2	0.61	3.49	-30.4%

Table above is based on indicative price and our own estimates.

- During the quarter, the Company repurchased 2.98m units of its shares at an average price of RM1.22 per share or RM3.7m, bringing the total share buyback to 28.4m unit at average price of RM0.98 or total cost of RM26.1m.

3. 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.
- Financial performance has been steady, reflecting N2N’s progress in developing itself as a regional service provider with its integrated financial trading solutions and advance technology.
- Business growth will continue to be underpinned by 1) 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. However, near term growth momentum could well be undermined by concerns over current uncertain global economic environment in affecting investors’ participation in equity trading, as well as in escalating costs. We have tweaked i) our gross profit margin from 58%-59% to 55%-56%, ii) USDMYR assumptions from RM3.90 to RM4.00 and RM4.20 for FY18-19E, iii) Malaysia segment growth being cut according to the downward adjustment of consensus’s revenue growth of Bursa Malaysia. As a result, our FY18E-19E earnings estimates are adjusted lower from RM25m and RM34m to RM21m and RM28m, respectively.

4. Valuation and Recommendation

- Maintain BUY. Our TP is adjusted lower from RM1.50 to RM1.30 on lower earnings estimates based on an unchanged PER of 26x over FY19E EPS, which implies 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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