

China / Hong Kong Company Update

HKBN Ltd.

Bloomberg: 1310 HK Equity | Reuters: 1310.HK

Refer to important disclosures at the end of this report

WeDBS Group Research . Equity

22 Apr 2022

BUY

Last Traded Price (21 Apr 2022): HK\$9.00 (HSI : 20,682)

Price Target 12-mth: HK\$13.60 (51% upside)

Analyst

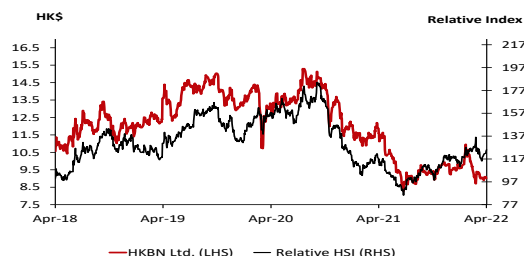
Tsz Wang Tam +852 36684195 tszwangtam@dbs.com

Harry Zhuang harryzhuangy@dbs.com

What's New

- 1HFY8/22 results beat; AFF grew by 94% y-o-y
- Adjusted service EBITDA grew 4% y-o-y, with margin expanding 3.7ppts
- Maintain AFF growth forecast of c.5% for FY8/22
- Maintain BUY with a TP of HK\$13.6 for its attractive dividend yield of c.9%

Price Relative



Forecasts and Valuation

FY Aug (HK\$m)	2021A	2022F	2023F	2024F
Turnover	11,464	12,248	13,232	13,912
EBITDA	2,550	2,580	2,839	3,064
Pre-tax Profit	325	547	831	1,042
Net Profit	207	420	648	825
Net Profit Gth (Pre-ex) (%)	112.9	103.2	54.2	27.2
EPS (HK\$)	0.16	0.32	0.49	0.63
EPS Gth (%)	112.9	103.2	54.2	27.2
Diluted EPS (HK\$)	0.14	0.28	0.44	0.56
DPS (HK\$)	0.77	0.81	0.88	1.02
BV Per Share (HK\$)	3.74	3.24	2.84	2.45
PE (X)	57.0	28.1	18.2	14.3
P/Cash Flow (X)	5.0	5.9	5.5	5.0
P/Free CF (X)	6.6	8.3	7.5	6.6
EV/EBITDA (X)	8.5	8.4	7.6	7.0
Net Div Yield (%)	8.5	9.0	9.8	11.3
P/Book Value (X)	2.4	2.8	3.2	3.7
Net Debt/Equity (X)	1.8	2.0	2.3	2.7
ROAE(%)	3.4	8.1	14.4	21.1
AFF	1,132	1,192	1,303	1,505
AFF Gth (%)	1.6	5.4	9.3	15.4
AFF Rev (%)		0.1	0.0	New
Consensus EPS (HK\$)		0.38	0.50	0.57
Other Broker Recs:		B:5	S:0	H:3

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Surfing on digitalisation wave

Investment Thesis

Attractive dividend yield of c.9%. HKBN offers an attractive dividend yield of c.9% and a decent adjusted free cash flow (AFF) CAGR of c.10% in FY8/21-FY8/24.

Unlocking cost synergies from the integration of WTT and Jardine OneSolution (JOS) with HKBN's enterprise business, which accounts for c.60% of its total service revenue. The integration also allows HKBN to cross-sell different services and offer one-stop solutions for digital transformation to an enlarged customer base.

Expect market share gain in residential broadband market through Disney+. HKBN's partnership with Disney+ could help it gain market share in new housing and from small residential broadband service providers.

Valuation:

Our target price (TP) of HK\$13.6 is based on a dividend discount model (DDM), assuming a 7.9% cost of equity and a 1% terminal growth rate.

Where we differ:

Positive on medium-term outlook. The market expects HKBN's growth to slow down after WTT's integration in FY8/21. However, we believe enterprises will speed up investments in digitalisation in a post-COVID-19 world, supporting stronger growth for HKBN, which offers one-stop digitalisation solutions.

Key Risks to Our View:

Price war. Competitors irrationally undercutting HKBN's prices for a prolonged period is a negative for HKBN.

Protracted COVID-19 impact will increase uncertainties in the economic environment and limit information technology (IT) spending by enterprises.

At A Glance

Issued Capital (m shrs)	1,312
Mkt Cap (HKm/US\$m)	11,808 / 1,505
Major Shareholders (%)	
CPP Investment Board	13.9
MBK Partners K.K.	11.1
TPG Capital, L.P.	11.1
GIC Private Limited	7.0
Free Float (%)	57.0
3m Avg. Daily Val. (US\$m)	3.19
GICS Industry: Communication Services / Telecommunication Services	



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HKBN Ltd.**WHAT'S NEW****1HFY8/22 AFF beat expectations while maintaining a full-year AFF forecast****1HFY8/22 results highlights**

Total revenue increased by 9.2% y-o-y to HK\$6,803m, mainly driven by strong sales of smartphone products. Service revenue decreased by 8.5% y-o-y to HK\$3,515m, mainly due to a decrease in low margin wholesale IDD as well as an impact from the disposal of HKBN JOS Singapore and Malaysia.

Enterprise customers increased by 1k y-o-y to 106k. Enterprise ARPU declined by 4% y-o-y to HK\$2,905. Residential broadband subscribers grew by 3k y-o-y to 889k. Residential ARPU decreased by 2% y-o-y to HK\$187, excluding the one-month service fee waiver to customers in FY8/21.

Adjusted service EBITDA increased 4% y-o-y to HK\$1,119m y-o-y, and service EBITDA margin expanded 3.7ppts to 31.8%, due to a decrease in low-margin wholesale IDD services.

Adjusted free cash flow (AFF) rose 94% y-o-y to HK\$758m, higher than market expectations, due to decrease in capital expenditure, interest and premium paid on the senior notes redemption. The company declared an interim dividend of HK\$0.40 per share, representing a 3% y-o-y growth. The company paid out 78% of AFF (including distribution to Vendor Loan Notes) in 1HFY8/22 (vs. 148% in 1HFY8/21).

Outlook

In the enterprise market, we expect HKBN to cut prices in order to gain market share. Upselling of system integration services could partly offset telecom service ARPU pressure, given system integration customers on average consume 10 times more compared to the standalone telecom

service. HKBN has already partnered with many multi-nationals such as Cisco, Microsoft, and AWS.

HKBN has secured c.140k customers with Disney+ bundles since the launch in Nov 2021, while the management postponed the 1m broadband subscribers target by six to nine months. Besides, HKBN partners with 3HK as an MVNO to resell its 5G services for the 1m residential households. This could be another growth driver for HKBN's residential business.

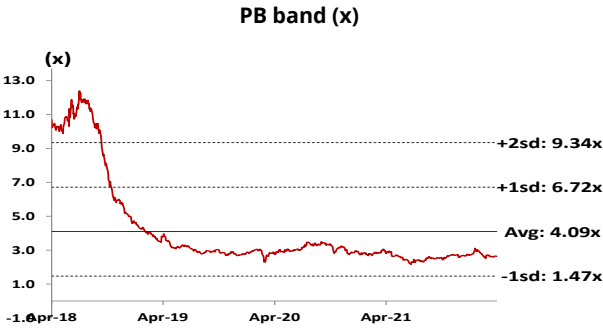
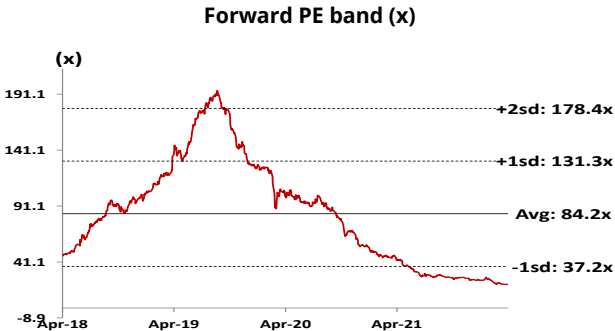
We expect the AFF to normalise in 2HFY8/22, given that the strong AFF growth in 1HFY8/22 was largely due to a c.200m decrease in interest and premium paid on senior notes redemption after repurchasing all remaining portion of the senior notes. We forecast AFF to grow by 5%, 9%, and 15% for FY8/22, FY8/23, and FY8/24, respectively. Overall, we remain positive in the company's medium term outlook, and are confident that HKBN is able to achieve the target of an accumulative AFF of HK\$2.70 per share for FY8/22-FY8/24 as set in its Co-Ownership Plan IV. Maintain BUY for its attractive dividend yield of c.9% with a decent dividend CAGR of c.10% in FY8/21-FY8/24, with a TP of HK\$13.6.

Company Background

HKBN is a broadband service provider in Hong Kong which was previously under City Telecom (now renamed HKTV [1137 HK]) founded by Ricky Wong in 1992. In 2012, HKBN was sold to CVC Capital Partner in a management buyout and was listed in 2014. It has become the second largest player in the residential as well as enterprise broadband markets with market shares of c.34% and c.37%, respectively. The company has a dividend policy of paying out 90%-100% of adjusted free cash flow (AFF).

HKBN Ltd.

Historical PE and PB band



Source: Thomson Reuters, DBS HK

HKBN Ltd.**Key Assumptions**

FY Aug	2020A	2021A	2022F	2023F	2024F
Residential broadband sub (k)	886.0	886.0	930.0	1,000.0	1,020.0
Residential broadband ARPU (HK\$)	187.0	190.0	188.0	186.0	188.0
Mobile sub base (k)	275.0	254.0	254.0	255.0	256.0
Mobile ARPU (HK\$)	110.0	111.0	112.1	113.2	114.4

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Aug	2020A	2021A	2022F	2023F	2024F
Revenues (HK\$ m)					
Residential revenue	2,447	2,465	2,480	2,586	2,710
Enterprise revenue	4,708	4,966	4,586	4,702	4,839
Product revenue	2,298	4,033	5,182	5,944	6,363
Total	9,453	11,464	12,248	13,232	13,912

Source: Company, DBS HK

HKBN Ltd.
Income Statement (HK\$ m)

FY Aug	2020A	2021A	2022F	2023F	2024F
Revenue	9,453	11,464	12,248	13,232	13,912
Cost of Goods Sold	(4,926)	(6,951)	(7,865)	(8,605)	(9,033)
Gross Profit	4,527	4,513	4,383	4,627	4,879
Other Opng (Exp)/Inc	(3,911)	(3,677)	(3,584)	(3,495)	(3,541)
Operating Profit	616	836	799	1,132	1,338
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	0	(32)	(32)	(25)	(20)
Net Interest (Exp)/Inc	(524)	(479)	(221)	(276)	(276)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	92	325	547	831	1,042
Tax	5	(118)	(127)	(183)	(218)
Minority Interest	1	0	0	0	0
Preference Dividend	0	0	0	0	0
Net Profit	97	207	420	648	825
Net Profit before Except.	97	207	420	648	825
EBITDA	2,441	2,550	2,580	2,839	3,064
Growth					
Revenue Gth (%)	85.1	21.3	6.8	8.0	5.1
EBITDA Gth (%)	51.0	4.5	1.2	10.0	7.9
Opg Profit Gth (%)	9.1	35.6	(4.3)	41.6	18.2
Net Profit Gth (%)	(54.7)	112.9	103.2	54.2	27.2
Margins & Ratio					
Gross Margins (%)	47.9	39.4	35.8	35.0	35.1
Opg Profit Margin (%)	6.5	7.3	6.5	8.6	9.6
Net Profit Margin (%)	1.0	1.8	3.4	4.9	5.9
ROAE (%)	1.4	3.4	8.1	14.4	21.1
ROA (%)	0.5	0.9	2.0	3.1	4.1
ROCE (%)	3.3	2.9	3.4	5.2	6.4
Div Payout Ratio (%)	1,146.5	547.0	283.6	201.1	182.4
Net Interest Cover (x)	1.2	1.7	3.6	4.1	4.8

Source: Company, DBS HK

Interim Income Statement (HK\$ m)

FY Aug	1H2020	2H2020	1H2021	2H2021	1H2022
Revenue	4,457	4,996	6,230	5,234	6,803
Cost of Goods Sold	(2,227)	(2,700)	(3,926)	(3,025)	(4,500)
Gross Profit	2,231	2,296	2,303	2,210	2,303
Other Oper. (Exp)/Inc	(1,864)	(2,046)	(1,888)	(1,789)	(1,804)
Operating Profit	366	250	415	421	499
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	(2)	1	0	(31)	(10)
Net Interest (Exp)/Inc	(285)	(239)	(324)	(155)	(105)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	80	12	91	235	385
Tax	52	(47)	(42)	(76)	(80)
Minority Interest	0	0	0	0	0
Net Profit	132	(35)	49	158	304
Net profit bef Except.	132	(35)	49	158	304
Growth					
Revenue Gth (%)	100.9	72.9	39.8	4.8	9.2
Opg Profit Gth (%)	9.5	8.5	13.3	68.4	20.3
Net Profit Gth (%)	(33.7)	N/A	(63.3)	N/A	526.7
Margins					
Gross Margins (%)	50.0	46.0	37.0	42.2	33.9
Opg Profit Margins (%)	8.2	5.0	6.7	8.0	7.3
Net Profit Margins (%)	3.0	(0.7)	0.8	3.0	4.5

Source: Company, DBS HK

HKBN Ltd.**Balance Sheet (HK\$ m)**

FY Aug	2020A	2021A	2022F	2023F	2024F
Net Fixed Assets	4,112	3,901	3,760	3,577	3,371
Invt in Associates & JVs	0	0	0	0	0
Other LT Assets	15,098	14,251	13,699	13,262	12,830
Cash & ST Invt	717	1,527	1,476	1,531	1,632
Inventory	155	111	113	115	117
Debtors	1,357	1,073	1,030	1,051	1,072
Other Current Assets	685	905	917	928	940
Total Assets	22,124	21,768	20,995	20,465	19,963
ST Debt	1,311	481	400	400	400
Creditors	831	936	983	1,032	1,083
Other Current Liab	2,490	2,447	2,530	2,616	2,707
LT Debt	9,120	10,831	10,831	10,831	10,831
Other LT Liabilities	1,911	1,535	1,455	1,389	1,323
Shareholder's Equity	6,460	5,538	4,796	4,197	3,617
Minority Interests	0	0	0	0	0
Total Cap. & Liab.	22,124	21,768	20,995	20,465	19,963
Non-Cash Wkg. Capital	(1,125)	(1,294)	(1,452)	(1,554)	(1,661)
Net Cash/(Debt)	(9,714)	(9,786)	(9,756)	(9,700)	(9,600)
Debtors Turn (avg days)	37.0	38.7	31.3	28.7	27.9
Creditors Turn (avg days)	70.4	61.6	57.6	53.3	52.8
Inventory Turn (avg days)	10.8	9.2	6.7	6.0	5.8
Asset Turnover (x)	0.4	0.5	0.6	0.6	0.7
Current Ratio (x)	0.6	0.9	0.9	0.9	0.9
Quick Ratio (x)	0.4	0.7	0.6	0.6	0.6
Net Debt/Equity (X)	1.5	1.8	2.0	2.3	2.7
Net Debt/Equity ex MI (X)	1.5	1.8	2.0	2.3	2.7
Capex to Debt (%)	5.2	5.1	5.1	5.1	5.1
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

Cash Flow Statement (HK\$ m)

FY Aug	2020A	2021A	2022F	2023F	2024F
Pre-Tax Profit	92	325	547	831	1,042
Dep. & Amort.	1,691	1,568	1,246	1,181	1,204
Tax Paid	(163)	(232)	(198)	(239)	(274)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	(265)	(125)	(107)	(164)	(158)
Other Operating CF	824	818	494	541	537
Net Operating CF	2,179	2,354	1,983	2,150	2,351
Capital Exp.(net)	(539)	(572)	(570)	(570)	(570)
Other Invt.(net)	0	0	0	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(362)	(12)	5	4	5
Net Investing CF	(901)	(584)	(565)	(566)	(565)
Div Paid	(1,080)	(1,139)	(1,162)	(1,248)	(1,404)
Chg in Gross Debt	275	566	(81)	0	0
Capital Issues	0	0	0	0	0
Other Financing CF	(461)	(355)	(225)	(281)	(281)
Net Financing CF	(1,266)	(928)	(1,469)	(1,529)	(1,685)
Currency Adjustments	1	9	0	0	0
Chg in Cash	14	850	(51)	56	101
Opg CFPS (HK\$)	1.86	1.89	1.59	1.77	1.91
Free CFPS (HK\$)	1.25	1.36	1.08	1.21	1.36

Source: Company, DBS HK

HKBN Ltd.

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	29-Oct-21	HK\$8.96	HK\$14.00	Buy
2:	5-Jan-22	HK\$9.50	HK\$13.60	Buy

Source: DBS HK

Analyst: Tsz Wang Tam
Harry Zhuang

DBS HK 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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DBS Bank (Hong Kong) Limited

13th Floor One Island East, 18 Westlands Road, Quarry Bay, Hong Kong

Tel: (852) 3668-4181, Fax: (852) 2521-1812

HKBN Ltd.

DBS Regional Research Offices

HONG KONG

DBS Bank (Hong Kong) Ltd

Contact: Carol Wu

13th Floor One Island East,
18 Westlands Road, Quarry Bay, Hong Kong

Tel: 852 3668 4181

Fax: 852 2521 1812

e-mail: dbsvhk@dbs.com

SINGAPORE

DBS Bank Ltd

Contact: Janice Chua

12 Marina Boulevard,
Marina Bay Financial Centre Tower 3
Singapore 018982

Tel: 65 6878 8888

e-mail: groupresearch@dbs.com

Company Regn. No. 196800306E

INDONESIA

PT DBS Vickers Sekuritas (Indonesia)

Contact: Maynard Priajaya Arif

DBS Bank Tower
Ciputra World 1, 32/F
Jl. Prof. Dr. Satrio Kav. 3-5
Jakarta 12940, Indonesia

Tel: 62 21 3003 4900

Fax: 6221 3003 4943

e-mail: indonesiaresearch@dbs.com

THAILAND

DBS Vickers Securities (Thailand) Co Ltd

Contact: Chanpen Sirithanarattanakul

989 Siam Pivat Tower Building,
9th, 14th-15th Floor

Rama 1 Road, Pathumwan,

Bangkok Thailand 10330

Tel. 66 2 857 7831

Fax: 66 2 658 1269

e-mail: research@th.dbs.com

Company Regn. No 0105539127012

Securities and Exchange Commission, Thailand