GLOBAL NETWORK FOR ADVANCED MANAGEMENT

2019-20 Global Network Investment Competition

cellnex

INVESTMENT REPORT

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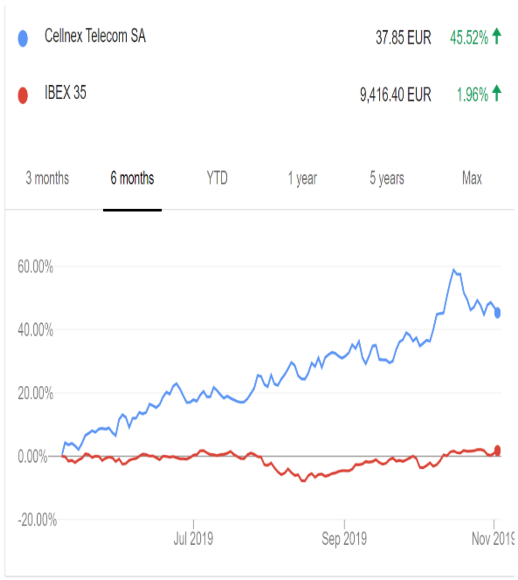
CELLNEX TELECOM SA

1. INVESTMENT HIGHLIGHTS

Share details:	
Company:	Cellnex Telecom SA
Code:	CLNX:SM
Sector:	Integrated telecoms
Exchange:	MCE

Rating:	OUTPEFORM
Market cap (m):	12,302.94
Price: earnings ratio:	655.3x
Forward p:e ratio (FY20):	329.8x
Current price:	€38.26
Target price:	€48.01
Upside:	26.9%
Risk:	High
12-month high:	€42.05
12-month low:	€18.82
Ave volume (30-day) (m):	1.20
Shares outstanding (m):	298.67
Financial year-end:	31-Dec

SHARE PRICE PERFORMANCE:



CELLNEX: THE QUANTUM LEAP

Date: 5th November 2019
Stock Rating: BUY
Current Price: €35.10
Price Target: €48.01
Upside: 26.9%

Our rating is underpinned on:

- **Market leadership position in Europe with room for further expansion.** Owns ~30% of independently owned towers in Europe and growing
- **Strong positioning for 5G**
- **A strong pipeline of deals in Europe**. Strong accretive deal flow while organically growing contracted free cash flows from existing long-term contracts
- **IFRS 16 -** a game changer as Cellnex's service contracts do not create liability in its customers' balance sheets. Higher incentive for MNOs to contract Cellnex
- **Downside risks** include unsustainability of the M&A growth strategy, regulatory challenges in new markets, and competition from other InfraCos

EXPECTED NEXT NEWS DUE:

Earnings announcement: 14 November 2019

FINANCIAL AND VALUATION METRICS:

Year	FY18A	FY19E	FY20E	FY21E
Revenue (€ m)	901	994	1,300	1,410
EBITDA	591	640	975	1,058
Net income (€ m)	(18)	87	236	261
EPS (€)	(0.05)	0.29	0.79	0.87
ROIC (%)	13.8%	23.8%	41.2%	37.0%
P/E (x)	(754.2)	130.3	48.0	43.3
EV/EBITDA (x)	24.5	22.8	15.3	14.0
Dividend (FY18A, €)	0.10	Net debt/equity (FY18A,%)		515%
Dividend yield (FY18A,%)	0.27%	Net debt (FY18A, € m)		3,166
BV/share (FY18A, €)	2.06	EV/Revenue (FY18A)		16.05

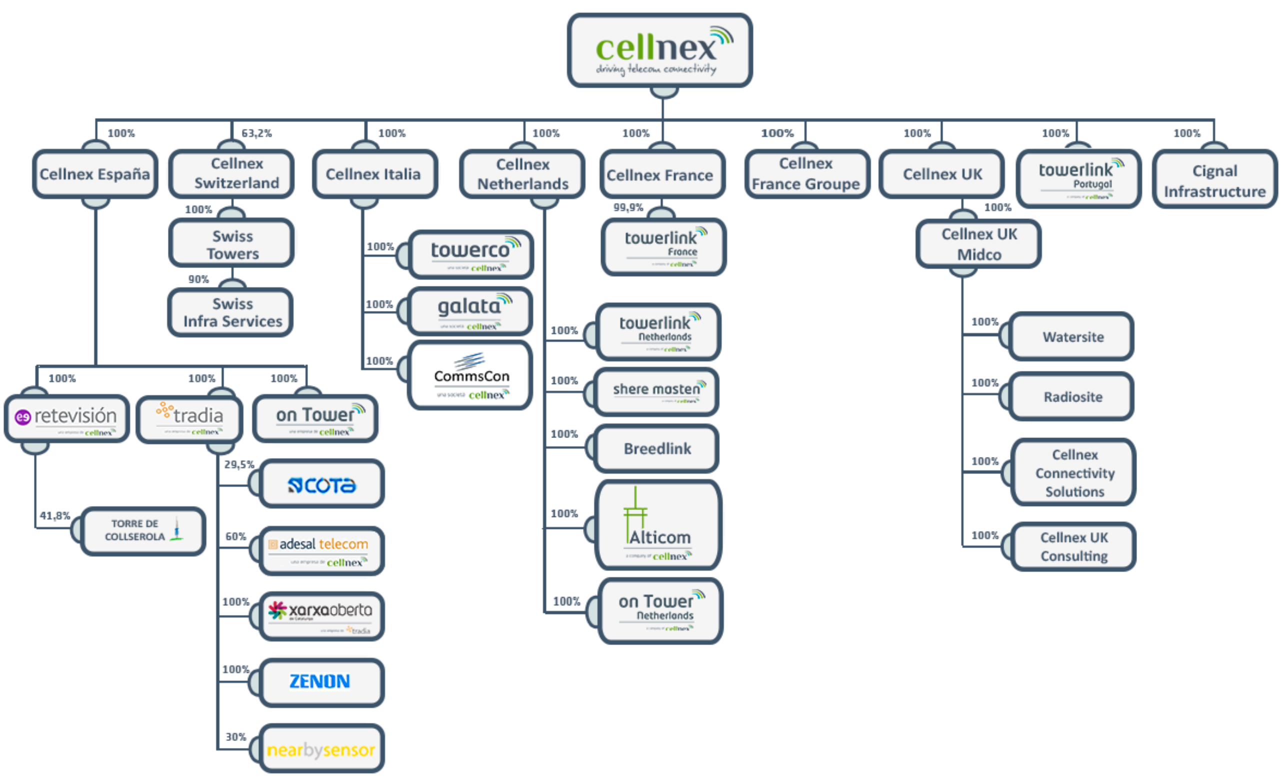
2. COMPANY OVERVIEW

Cellnex Telecom is an independent operator of wireless telecommunications and broadcast infrastructure across Europe. Its network comprises of 53,000 sites, including forecast roll-outs up to 2027 across Netherlands, United Kingdom, France, Switzerland, Ireland, Spain and the United Kingdom, which makes it the largest in Europe. It is listed on the Spanish Stock Exchange and is part of the IBEX 35, EuroStoxx 600 and MSCI Europe indices. It is also part of the FTSE4GOOD, CDP (Carbon Disclosure Project), Sustainalytics and "Standard Ethics" sustainability indexes. Cellnex is a 2015 spin-off from a Spanish infrastructure company, Abertis, although it started operations in 2000.

2.1. CORPORATE STRUCTURE

The diagram below shows the operational structure as of 30 June 2019:

Figure 1: Corporate structure



Source: Cellnex SA

2.2. BUSINESS MODEL

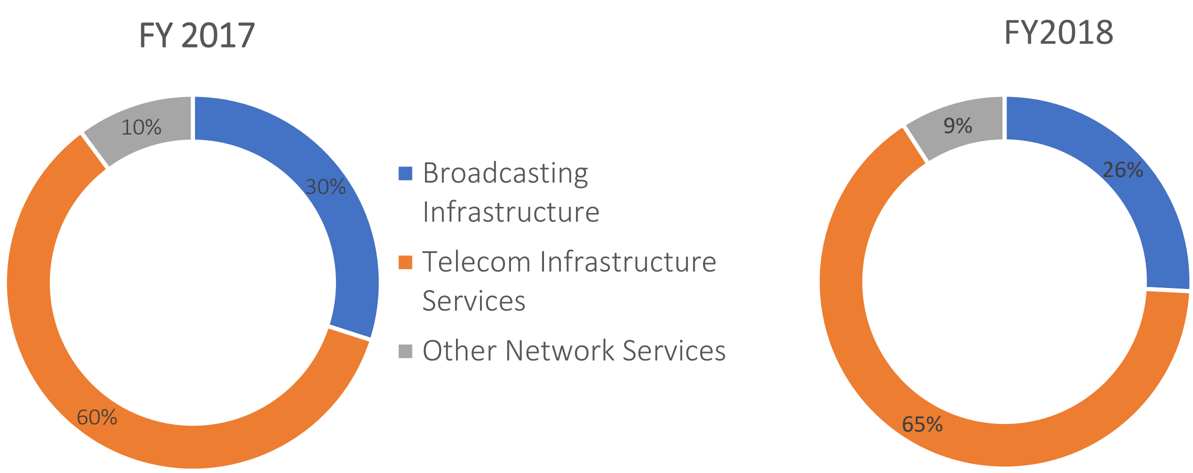
Cellnex's business model is based on the provision and sharing of telecommunications assets, for which it independently provides this infrastructure to its telecommunication and broadcasting customers. Its products and services are categorized into four segments:

a) Telecom Infrastructure Services – through its more than 35,000 PoPs (Point of Presence), have over 46,000 sites, Cellnex enables Mobile Network Operators (MNOs) and other broadband and wireless telecom network operators to provide communication services. This business is underpinned by anchor customers which have 10 to 20-year initial contract maturities with potential for renewals;

b) Broadcasting services – using more than 3,000 emitter centres, Cellnex distributes and broadcasting of digital television, radio or multi-screen environment content, and

c) Other - Smart cities, IoT and security, including the DAS (distributed antenna system) & Small Cells – networks. Cellnex uses DAS systems and provide DASaaS ("DAS as a Service") using an end-to-end approach.

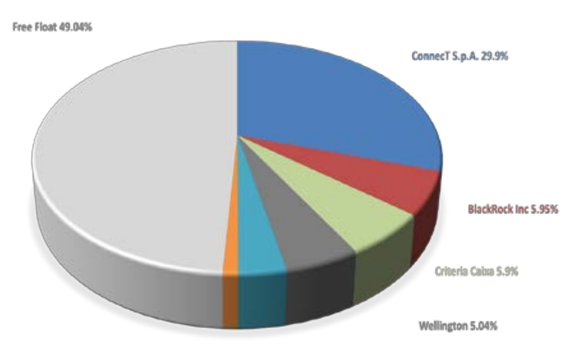
Figure 2: Revenue by business segment



Source: Cellnex SA, 2018 AFS

2.3. COMPANY OWNERSHIP

Figure 3: Shareholding structure (as of 30 June 2019)



Source: Cellnex Telecom SA

2.4. KEY MANAGEMENT

3. INDUSTRY OVERVIEW AND COMPETITIVE ANALYSIS

3.1. INDUSTRY ANALYSIS

The telecom tower market is made up of operator-led tower companies, mobile network operators (MNO) captive sites, independent tower companies and joint venture infrastructure companies (InfraCos). The presence of major players points to a concentrated global telecom tower market, with Cellnex Telecom SA, China Tower Corp. Ltd., Helios Towers Africa, American Tower Corporation, Crown Castle International, Bharti Infratel, and Indus Tower Limited on jostling for market dominance. As of 2017, independent tower companies owned 70% of the total 4.10 million round the world[1], with China having the highest number of ~2 million. Geographically, the global mobile application market has been segmented into four regions such as North America, Europe, Asia Pacific and the rest of the world.

The growing need for connectivity and seamless communication services is main driver for the demand for telecoms infrastructure. A growing number of service providers, Wi-Fi, internet providers, and broadband providers are expected to further boost the growth of global telecom tower market across the world.

Key trends to watch out for in the industry include:

- The global telecom towers market was valued at US$ 41.76 billion in 2018 and is projected to grow at CAGR of 7.2 % between 2019 and 2027[2].
- Growing demand for speedy connectivity and data usage and need for 5G connectivity.
- Regulatory drive towards tower sharing. Tower sharing increases efficient use of existing infrastructure
- The impact of the application of IFRS 16 on tower infrastructure arrangements[3]
- Telecommunications operators (telcos) divesting from their tower infrastructure investment to deleverage their balance sheets and focus on service provision.
- Growing trend across European MNOs towards outsourcing infrastructure assets to independent carrier-neutral operators such as Cellnex. Approximately 30% of European towers are owned by independent operators compared to over 90% in the USA. TowerXchange forecasts that 59.4% of Europe's towers will be owned by independent towercos by end-2021[4].

3.2. COMPETITIVE GROWTH STRATEGY ANALYSIS

[1] http://www.globenewswire.com/news-release/2019/09/12/1914557/0/en/Telecom-Towers-Market-to-grow-at-4-56-CAGR-During-2019-2024-Insights-on-Drivers-and-Restraints-Value-Chain-Fuel-Type-Installation-Type-of-Towers-Company-Profiles-and-Outlook-Orbis-.html

[2] https://www.bloomberg.com/press-releases/2019-07-24/global-telecom-towers-market-is-expected-to-witness-a-cagr-of-7-2-during-the-forecast-period-2019-2027

[3] https://staff.blog.ui.ac.id/martani/files/2017/07/ey-leases-a-summary-of-ifrs-16-and-its-effects-may-2016.pdf

[4] https://www.towerxchange.com/towerxchange-forecast-that-59-4-of-europes-towers-will-be-owned-by-towercos-by-q421/

An integral part of the Group´s strategy is to continue driving growth through the acquisition of assets, entities or minority interests, joint ventures, mergers and other arrangements in the countries where the Group currently operates and in new markets. The company's M&A strategy in new markets follows a three-stage process: Introduction - in a given country which allows to get a direct relationship with the customers and identify new opportunities for growth; scaling up - aiming to growth the business in that country to gain a dominant market position; and then consolidation – consolidate nationwide footprint and further entrench partnerships and cooperation programs with customers.

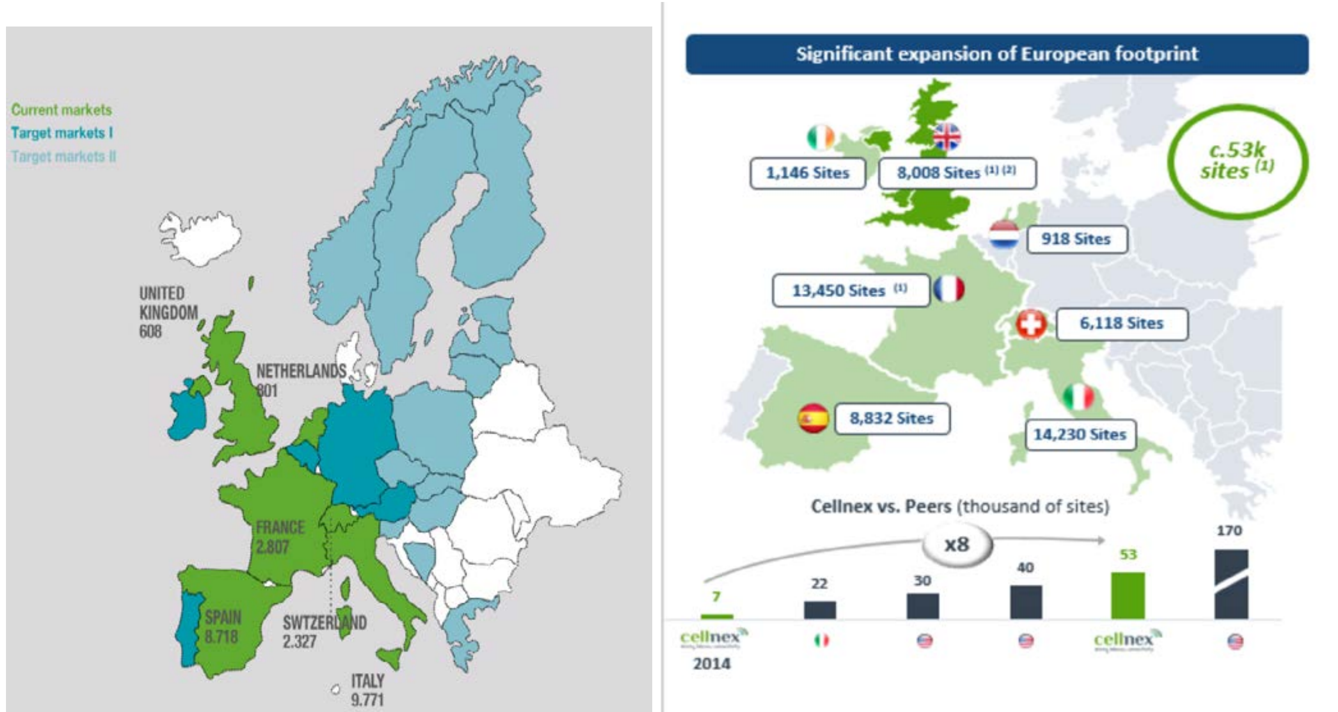
From its IPO in May 2015, Cellnex has grown the number of sites in Europe from 7,400 locations in a single country, Spain to 45,000 sites including forecast roll-outs up to 2027 planned in the six countries in Europe in which the company operates: Spain, France, Italy, Switzerland, the Netherlands and the United Kingdom. We see rapid growth in Europe as Cellnex positions itself as having the most comprehensive pan-European coverage if it is to persuade telco operators to sign up with them. This growth pan-Europe has massive portfolio synergistic benefits. Recent acquisitions are summarized in the table below.
Figure 4: Cellnex's tower acquisitions since 2015 :

Date	Tower owner pre-acquisition	Location	No. of towers	Deal value(€'m)
2019	Salt Mobile SA	Switzerland	2,800	700.0
2019	Iliad	France	5,700	1,400.0
2019	Iliad	Italy	2,200	600.0
2017	MasMovil Ibercom	Spain	551	36.0
2017	Alticom B.V.	Netherlands	30	133.0
2017	Swiss Towers AG	Switzerland	2,239	232.2
2017	Bouygues Telecom	France	3,000	854.0
2016	Bouygues Telecom	France	270	67.0
2016	Share Group Ltd.	United Kingdom	1,004	393.0
2016	Bouygues Telecom	France	230	80.0
2016	CommCon	Italy	949	18.7
2016	Protelindo Netherlands	Netherlands	261	109.0
2015	Wind (VimpelCom)	Italy	7377	693.0
2015	TowerCo	Italy	212	94.6

Sources: Company reports, TowerXchange

Cellnex announced on October 8, 2019, the acquisition of 100% of Arqiva's Telecoms division for £2 billion, which will give Cellnex 8,300 sites in the UK, with corresponding 2020 EBITDA and RLFCF of £170 m and £105m respectively. Post-acquisition, Cellnex will increase to ~54,000. Cellnex highlights that it is evaluating market opportunities amounting to c.€7 billion.

Figure 5: Cellnex's Continental Europe growth strategy



Source: Cellnex Telecom SA 2018 AFS

4. FINANCIAL ANALYSIS AND OUTLOOK

4.1. KEY ASSUMPTIONS

Revenue drivers

- PoP organic growth 3.5% per annum until 2023, thereafter 2.0%
- PoP M&A growth 5% p.a. (2019-2027), thereafter 3.5%
- 2020 growth is driven by the Arqiva's Telecoms acquisition, which will add c.7.400 sites
- Average revenue per PoP €26,450

				1	2	3	4	5	6	7	8	9	10
Points of Presence (PoPs)	[Year]	2017	2018	2019E	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F
Opening number of PoPs (1 Jan)	[n]	24,698	30,149	33,860	37,585	49,142	53,319	57,851	62,769	66,221	69,863	73,705	77,759
Organic	[n]	988	1,477	1,185	1,315	1,720	1,866	2,025	1,255	1,324	1,397	1,474	1,555
Growth rate (%)	[%]	*4.0%*	*4.9%*	*3.5%*	*3.5%*	*3.5%*	*3.5%*	*3.5%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*
M&A	[n]	4,463	2,234	2,540	10,242	2,457	2,666	2,893	2,197	2,318	2,445	2,580	2,722
Growth rate (%)	[%]	*18.1%*	*7.4%*	*7.5%*	*27.3%*	*5.0%*	*5.0%*	*5.0%*	*3.5%*	*3.5%*	*3.5%*	*3.5%*	*3.5%*
Closing number of PoPs (31 Dec)	[n]	30,149	33,860	37,585	49,142	53,319	57,851	62,769	66,221	69,863	73,705	77,759	82,036
Annual growth rate (%)	[%]	*22.1%*	*12.3%*	*11.0%*	*30.7%*	*8.5%*	*8.5%*	*8.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*

4.2. FORECASTS

The Telecom Infrastructure Services revenues are estimated based on Points of Presence (PoP) for each period and using average revenue per PoP based on 2017 and 2018 numbers which aiming to reflect the most recent pricing point. Cellnex enjoys long-term contracts and as such the price per PoP is not expected to change significantly in the medium term. Other operating income and expenses are defined as a percentage of revenues based on the average weight it represented for the years of 2017 and 2018, to achieve target profitability. The acquisition of the Arqiva's Telecoms will add ~7,400 PoPs in 2020. (*Please refer to appendix*)

It should be noted that these forecasts are subject to new M&A deals that Cellnex may announce – we did not model future M&A activity. However, we note that outside of M&A activity, Cellnex has consistent organic EBITDA growth. We think Cellnex can deliver organic top line of at least 4%, but we were conservative and settled at 2%.

5. VALUATION AND SENSITIVITY ANALYSIS

5.1. COST OF CAPITAL

Cellnex's beta relative to the IBEX is ~0.60, less than peers at ~0.80. Given a stream of recent M&A activity, Cellnex is currently sitting at a debt to equity ratio of 7.34, which supports a lower WACC as the cost of capital is skewed cost of debt. We used CAPM to determine cost of equity at 5.2%. Using a cost of debt of 1.65%, calculated using the company's average cost of debt of 2.2% and the tax rate of 25%, our WACC came in at 2.16%. There is justification for this low WACC – long term annuity revenue streams, and an expectation that the low interest rate environment is expected to stay on for longer.

Celllnex is in a high growth phase and its dividend policy is towards reinvesting capital in the business. Our sustainable (terminal growth rate) came in at ~0.8%. We think this is very conservative.

5.2. DISCOUNTED CASHFLOW VALUATION

DCF Valuation		2017	2018	2019E	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F
Revenue	€'m	792	901	994	1,300	1,410	1,530	1,660	1,751	1,848	1,949	2,056	2,170
EBITDA	€'m	500	591	640	975	1,058	1,147	1,245	1,314	1,386	1,462	1,542	1,627
EBIT	€'m	129	113	195	394	427	464	503	531	560	591	623	658
Tax	€'m	(32)	(28)	(49)	(98)	(107)	(116)	(126)	(133)	(140)	(148)	(156)	(164)
Working Capital	€'m		2	-	-	-	-	-	-	-	-	-	-
Capital expenditure	€'m	-	(664)	(104)	(136)	(148)	(161)	(174)	(184)	(194)	(205)	(216)	(228)
FCF	€'m	**96**	**(577)**	**42**	**159**	**172**	**187**	**203**	**214**	**226**	**238**	**252**	**265**
Terminal Value	€'m												**19,200**
Discount factor				1.00	0.98	0.96	0.94	0.92	0.90	0.88	0.86	0.84	0.83
PV FCF	€'m			**42**	**156**	**165**	**176**	**186**	**193**	**199**	**205**	**212**	**16,063**

WACC	%	2.16%
g	%	0.77%
PV of cashflows	€'m	**17,597**
Less Net debt	€'m	(3,257)
Equity value	€'m	**14,340**
Shares	million	298.67
Price target	€	**48.01**
Current price	€	**37.85**
Potential up-side	%	**26.9%**

*Our DCF assumes a constant revenue per POP. In practice, contracts may have an inflator applied, however, as this is contract specific, we feel any estimation may be inaccurate and impact our price target unjustly.

Our growth rate is calculated using a return on equity figure of 0.94%, which is the average of the past 2 years, and the retention ratio of 81.67%, calculated using the current dividend and a 10% year on year increase for two years, in-keeping with the company's dividend policy. The company currently has a high retention rate which is reflective of the company's aggressive growth policy, with reinvestment a major focus of the firm. We acknowledge that the growth rate leads to a lower terminal value relative to other analysts, who use industry averages, however, given the current phase the company is in we feel a more conservative approach is required.

The current capital structure is bias towards debt, however, relative to peers this is not an outlier and it sites very close to the industry average. Management are comfortable with the current debt levels and acknowledge in the short term this may increase slightly, but they are acutely aware that it must be kept under control as any major increase may lead to a downgrade and an increased servicing costs.

Our assumptions, although conservative on multiple fronts, lead to a price target that offers a protentional 26% upside relative to the current market price and is thus reflective of a strong buy.

6. RISK ANALYSIS

The key downside risks to the valuation include:

- Risks related to execution of Cellnex's acquisition strategy:
  - diversion of management's attention from existing business
  - the risk of overpaying for acquired assets resulting high impairments
  - competition for telecom assets. Cellnex losing out deals to competitors could delay the company's aggressive growth projectile. The tower market also is attracting significant interest from private equity firms
  - risks of failing to integrate acquired companies
- Reduced leasing opportunity as ongoing consolidation in the telecoms sector may lead to fewer operators
- Network sharing by MNOs may reduce demand for Cellnex's infrastructure as well as assets to acquire.
- The share price is already pricing in significant growth upside, which if Cellnex fails to deliver, could result in a significant de-rating of the stock.

7. APPENDICES

CELLNEX TELECOM SA

CONSOLIDATED INCOME STATEMENT		2017	2018	2019E	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F
Broadcasting Infrastructure	€'m	237	233	276	361	391	425	461	486	513	541	571	602
Telecom Infrastructure Services	€'m	474	586	623	814	883	958	1,040	1,097	1,157	1,221	1,288	1,359
Other Network Services	€'m	81	82	96	125	136	147	160	168	178	187	198	209
Total Revenue	€'m	**792**	**901**	**994**	**1,300**	**1,410**	**1,530**	**1,660**	**1,751**	**1,848**	**1,949**	**2,056**	**2,170**
Y-o-Y growth			*13.8%*	*10.3%*	*30.7%*	*8.5%*	*8.5%*	*8.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*
Operating costs	€'m	(292)	(311)	(355)	(325)	(353)	(382)	(415)	(438)	(462)	(487)	(514)	(542)
Y-o-Y growth	€'m		6.3%	14.2%	-8.3%	8.5%	8.5%	8.5%	5.5%	5.5%	5.5%	5.5%	5.5%
EBITDA	€'m	**500**	**591**	**640**	**975**	**1,058**	**1,147**	**1,245**	**1,314**	**1,386**	**1,462**	**1,542**	**1,627**
EBITDA margin	%	*63.1%*	*65.5%*	*64.3%*	*75.0%*	*75.0%*	*75.0%*	*75.0%*	*75.0%*	*75.0%*	*75.0%*	*75.0%*	*75.0%*
Non-Recurring Expenses	€'m	(20)	(75)	-	-	-	-	-	-	-	-		-
Depreciation & Amortization	€'m	(352)	(403)	(444)	(581)	(630)	(684)	(742)	(783)	(826)	(871)	(919)	(970)
EBIT	€'m	129	113	195	394	427	464	503	531	560	591	623	658
EBIT margin	%	*16.2%*	*12.5%*	*19.6%*	*30.3%*	*30.3%*	*30.3%*	*30.3%*	*30.3%*	*30.3%*	*30.3%*	*30.3%*	*30.3%*
Net financial cost/income	€'m	(109)	(149)	(79.69)	(79.69)	(79.69)	(79.69)	(79.69)	(79.69)	(79.69)	(79.69)	(79.69)	(79.69)
Profit of Companies Accounted for Using the Equity Method	€'m	0	0	0	0	0	0	0	0	0	0	0	0
EBT	€'m	20	(36)	116	314	348	384	424	451	480	511	544	578
Income Tax	€'m	4	18	(29)	(79)	(87)	(96)	(106)	(113)	(120)	(128)	(136)	(144)
Consolidated Profit	€'m	**24**	**(18)**	**87**	**236**	**261**	**288**	**318**	**338**	**360**	**383**	**408**	**433**
Attributable to Non-Controlling Interests	€'m	2	3										
Net Profit Attributable to the Parent Company	€'m	26	(15)	87	236	261	288	318	338	360	383	408	433

Average cost of debt	%	2.20%
Income tax rate	%	25.0%
Cost of debt	**%**	**1.65%**
Risk Free rate	%	0.32%
Unlevered beta	n	0.59
Risk Premium	%	8.18%
Cost of equity	**%**	**5.15%**
Weight of debt	%	85.48%
Weight of equity	%	14.52%
WACC	**%**	**2.16%**
Sustainable growth rate	%	**0.77%**
Return of equity	%	0.94%
Retention ratio	%	81.67%