

Chorus

Another Piece in the Regulatory Puzzle

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OUTPERFORM

Chorus (CNU) recently provided (for the first time) opex and capex estimates that feed into the (work-in-progress) regulatory framework for its ultrafast fibre broadband (UFB) network. These are initial estimates only and precedents do highlight the Commerce Commission (CC) may not fully accept CNU's proposals. It is, however, favourable relative to our assumptions, reducing the risk of a material divergence vs. our medium-term forecasts. Step-by-step, the UFB regulatory process is edging toward completion expected in 3Q/4Q 2021. Conclusion should provide clarity of strong free cash flow (we forecast a 7–8% FCF yield) funding a substantial lift in dividend once the UFB network is complete. Maintain OUTPERFORM.

NZX Code	CNU	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$7.82	NPAT* (NZ\$m)	52.0	35.3	39.6	39.2	PE	66.4	98.6	88.1	89.2
Target price	NZ\$9.20	EPS* (NZc)	11.8	7.9	8.9	8.8	EV/EBIT	25.6	28.5	28.5	27.9
Risk rating	High	EPS growth* (%)	-3.5	-32.6	11.9	-1.2	EV/EBITDA	9.7	10.0	9.9	9.9
Issued shares	444.0m	DPS (NZc)	24.0	25.0	30.0	35.0	Price / NTA	4.9	5.5	6.2	7.5
Market cap	NZ\$3,472m	Imputation (%)	100	100	75	22	Cash div yld (%)	3.1	3.2	3.8	4.5
Avg daily turnover	352.2k (NZ\$2,668k)	*Based on normalised profits					Gross div yld (%)	4.3	4.4	5.0	4.9

Higher fibre opex positive; more capex may impact timing of dividend

All-else-equal, the greater the weighting of CNU's costs allocated to the regulatory bucket, the higher the revenue and profits the company is able to earn.

Positively, CNU's proposed UFB opex weighting is higher than our assumptions (albeit the gap narrows over time). Precedents do highlight the CC may not fully accept CNU's proposal, and we have not revised our forecasts at this time, however, it does (1) reduce the risk of a material variance vs. our expectation, and (2) represent upside risk to the financial loss asset (i.e. the losses on the fibre network prior to the first regulatory period commencing 1 January 2022) which will be included in CNU's initial regulatory asset base.

CNU's total fibre capex (as opposed to weighting) was also higher than our forecasts. Fibre capex's impact on CNU's valuation is minimal, but does influence cash flow timing — higher spend should translate to higher allowable fibre earnings longer-term. It is also questionable whether it will all materialise. The largest portion of fibre capex is new installations for which CNU has proposed a "wash-up mechanism" to reflect the inherent uncertainty in this forecast. Whilst higher fibre capex would not materially impact our valuation, it would reduce medium-term FCF and potentially influence the dividend.

Edging toward regulatory clarity

The market continues to look forward and consider the potential significant FCF CNU will generate, and implications for the dividend, once its fibre network is complete in 2022. CNU has previously explicitly outlined it will transition to a FCF-based dividend policy from FY22. Higher capex would lower the available FCF, however, it would not impact our view of a NZ50–60cps sustainable dividend longer-term.

CNU remains a long-dated business with substantial operating and financial leverage, and therefore, any assessment of the company's fundamental value can vary materially depending on the UFB regulatory framework and, ultimately, on the maximum allowable revenue (MAR) its UFB network is able to earn. All-else-equal CNU's announcement today is a net positive step. Implementing the regime has been a very long process. The end is in sight, with a final decision scheduled in 3Q/4Q CY21.

Chorus Ltd (CNU)

Priced as at 18 Dec 2020 (NZ\$) **7.82**

12-month target price (NZ\$)*	9.20
Expected share price return	17.6%
Net dividend yield	3.5%
Estimated 12-month return	21.2%

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	1.21
WACC	5.3%
Terminal growth	1.7%

Spot valuations (NZ\$)	
1. DCF	9.42

DCF valuation summary (NZ\$m)	
Total firm value	6,683
(Net debt)/cash	(2,234)
Less: Capitalised operating leases	(266)
Value of equity	4,183

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	970	959	951	948	944
Normalised EBITDA	636	648	647	659	661
Depreciation and amortisation	(393)	(402)	(420)	(429)	(426)
Normalised EBIT	243	246	227	230	235
Net interest	(165)	(173)	(178)	(175)	(180)
Associate income	0	0	0	0	0
Tax	(25)	(21)	(14)	(16)	(16)
Minority interests	0	0	0	0	0
Normalised NPAT	53	52	35	40	39
Abnormals/other	0	0	0	0	0
Reported NPAT	53	52	35	40	39
Normalised EPS (cps)	12.2	11.8	7.9	8.9	8.8
DPS (cps)	23.0	24.0	25.0	30.0	35.0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	-2.0	-1.1	-0.8	-0.3	-0.4
EBITDA (%)	-2.6	1.9	-0.1	1.9	0.2
EBIT (%)	-8.6	1.2	-7.6	1.4	1.8
Normalised NPAT (%)	-37.6	-1.9	-32.2	12.2	-1.0
Normalised EPS (%)	-39.7	-3.5	-32.6	11.9	-1.2
Ordinary DPS (%)	4.5	4.3	4.2	20.0	16.7

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	636	648	647	659	661
Working capital change	4	(17)	(6)	(13)	(4)
Interest & tax paid	(151)	(158)	(163)	(153)	(167)
Other	(13)	(20)	0	0	0
Operating cash flow	476	453	479	494	490
Capital expenditure	(808)	(666)	(621)	(489)	(391)
(Acquisitions)/divestments	0	0	0	0	0
Other	146	139	103	106	43
Funding available/(required)	(186)	(74)	(39)	111	141
Dividends paid	(49)	(76)	(98)	(108)	(145)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	(235)	(150)	(137)	3	(4)

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	(220)	(144)	(138)	(125)	(121)
Fixed assets	4,598	4,824	4,994	5,037	4,991
Intangibles	198	215	231	232	225
Right of use asset	225	228	227	226	225
Other assets	184	235	235	235	235
Total funds employed	4,985	5,358	5,549	5,604	5,555
Net debt/(cash)	1,959	2,325	2,440	2,414	2,394
Lease liability	246	257	268	279	290
Other liabilities	1,801	1,849	1,977	2,116	2,182
Shareholder's funds	979	927	864	796	690
Minority interests	0	0	0	0	0
Total funding sources	4,985	5,358	5,549	5,604	5,555

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	9.6	9.7	10.0	9.9	9.9
EV/EBIT (x)	25.0	25.6	28.5	28.5	27.9
PE (x)	64.1	66.4	98.6	88.1	89.2
Price/NTA (x)	4.4	4.9	5.5	6.2	7.5
Free cash flow yield (%)	-9.6	-6.1	-4.1	0.1	2.8
Net dividend yield (%)	2.9	3.1	3.2	3.8	4.5
Gross dividend yield (%)	4.1	4.3	4.4	5.0	4.9

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	1.5	1.4	1.3	1.3	1.3
Interest cover EBITDA (x)	3.9	3.7	3.6	3.8	3.7
Net debt/ND+E (%)	71.8	74.3	76.5	78.1	80.5
Net debt/EBITDA (x)	3.9	4.1	4.4	4.3	4.3

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	4.3	4.4	3.9	3.9	4.0
Return on equity (%)	5.4	5.6	4.1	5.0	5.7
Return on funds employed (%)	3.9	4.1	3.4	3.5	3.7
EBITDA margin (%)	65.6	67.6	68.1	69.5	70.0
EBIT margin (%)	25.1	25.7	23.9	24.3	24.9
Capex to sales (%)	83.3	69.4	65.3	51.5	41.4
Capex to depreciation (%)	267	209	188	145	117
Imputation (%)	100	100	100	75	22
Pay-out ratio (%)	189	204	315	338	399

Operating Performance	2019A	2020A	2021E	2022E	2023E
Revenue (NZ\$m)					
Copper	468	369	275	190	129
Fibre	368	466	557	642	704
Other	134	124	119	116	112
Total revenue	970	959	951	948	944

Expenses (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Labour costs	74	80	77	75	73
Network maintenance	75	64	61	60	59
Other network costs	33	29	30	25	26
IT costs	50	47	48	49	50
Other	102	91	88	80	76
Total expenses	334	311	304	289	283

Connections (000s)	2019A	2020A	2021E	2022E	2023E
Copper	840	664	457	309	213
Fibre	610	751	887	990	1,055

ARPU (NZ\$/month)	2019A	2020A	2021E	2022E	2023E
UCLL	31.0	31.5	31.7	32.3	33.0
UBA	10.9	10.7	10.7	10.9	11.1
Fibre (average)	47.5	48.9	50.0	51.4	52.4

Figure 1. Price performance


Source: Forsyth Barr analysis

Figure 2. Substantial shareholders

Shareholder	Latest Holding
L1 Capital Partners Pty	9.8%
The Vanguard Group	6.5%
UniSuper Limited	6.5%
Commonwealth Bank of Australia	5.5%

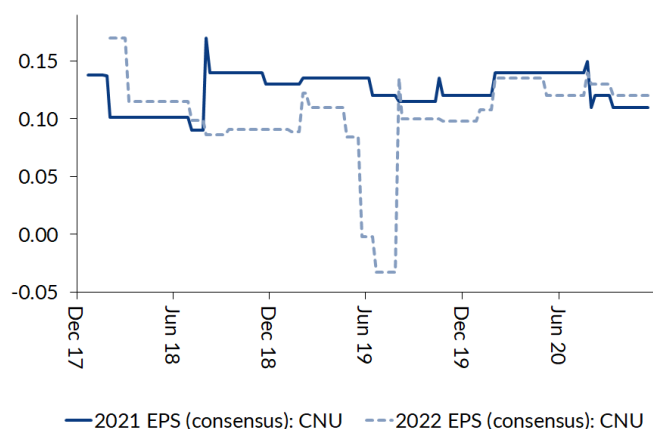
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 3. International valuation comparisons

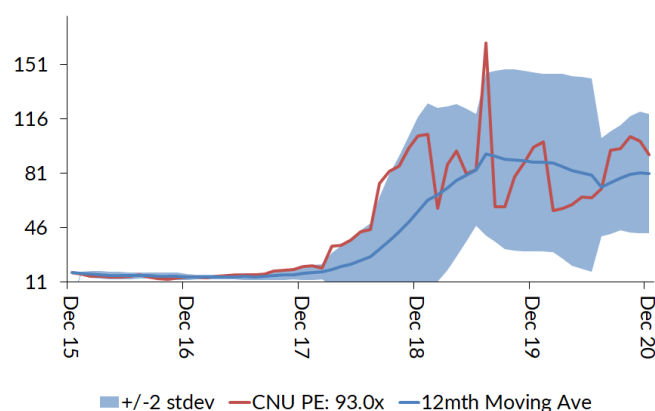
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect CNU's balance date - June)										
Chorus	CNU NZ	NZ\$7.82	NZ\$3,472	>50x	>50x	9.5x	9.3x	27.1x	26.7x	3.8%
SPARK NZ *	SPK NZ	NZ\$4.41	NZ\$8,167	19.9x	19.1x	8.6x	8.3x	15.1x	14.4x	5.7%
VECTOR *	VCT NZ	NZ\$4.20	NZ\$4,182	28.1x	27.6x	12.0x	11.5x	21.9x	21.2x	3.9%
AUSNET SERVICES	AST AT	A\$1.83	A\$6,868	21.3x	23.5x	13.1x	13.3x	21.6x	22.2x	5.3%
SPARK INFRASTRUCTURE GROUP	SKI AT	A\$2.13	A\$3,702	43.4x	>50x	5.9x	6.1x	15.5x	17.3x	5.7%
TELSTRA CORP	TLS AT	A\$3.02	A\$35,918	22.9x	21.7x	7.1x	7.4x	17.6x	17.9x	4.9%
TPG CORP	TPM AT	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
VOCUS GROUP	VOC AT	A\$3.91	A\$2,429	23.1x	21.0x	9.2x	8.8x	17.8x	16.8x	1.0%
BT GROUP PLC	BT/A LN	£1.37	£13,611	7.1x	6.9x	4.4x	4.3x	10.4x	10.0x	5.5%
NETLINK NBN TRUST	NETLINK	S\$0.97	S\$3,761	41.1x	39.4x	15.6x	15.8x	40.3x	39.0x	5.1%
SP										
Compc Average:				25.9x	22.8x	9.5x	9.4x	20.0x	19.9x	4.7%
CNU Relative:				n/a	n/a	0%	-1%	35%	34%	-18%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compc metrics re-weighted to reflect headline (CNU) companies fiscal year end

Figure 4. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 5. One year forward PE (x)


Source: Forsyth Barr analysis

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