NEW ZEALAND EQUITY RESEARCH | TELECOMMUNICATIONS | INFRASTRUCTURE
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Chorus
1H21 — Share Price Jumping at Shadows

OUTPERFORM

MATT HENRY CFA
matthew.henry@forsythbarr.co.nz
+64 9 368 0115

We saw little significant new information in Chorus's (CNU) 1H21 result, and nothing that explained the share price weakness on the day. Perhaps (1) Vodafone NZ's announced launch of 5G fixed wireless access (FWA) broadband reignited concerns about the competitive threat to CNU — we continue to believe fibre and FWA can coexist non-detrimentally, or (2) higher near-term debt and capex have lowered expectations for the medium-term dividend path. We maintain the view CNU will generate strong free cash flow over the medium to long-term that could support a sustained dividend in the NZ50–60cps range. Rising bond yields are headwind for dividend stocks, but in CNU's case increased rates are also reflected in a higher regulatory WACC and allowable revenue. Maintain OUTPERFORM.

NZX Code	CNU
Share price	NZ$7.77
Target price	NZ$9.20
Risk rating	High
Issued shares	444.0m
Market cap	NZ$3,450m
Avg daily turnover	365.3k (NZ$2,823k)

Financials: Jun/	20A	21E	22E	23E
NPAT* (NZ$m)	52.0	43.6	40.4	48.6
EPS* (NZc)	11.8	9.8	9.0	10.8
EPS growth* (%)	-3.5	-16.8	-7.8	19.9
DPS (NZc)	24.0	25.0	30.0	35.0
Imputation (%)	100	100	75	28
*Based on normalised profits				

Valuation (x)	20A	21E	22E	23E
PE	66.0	79.4	86.1	71.8
EV/EBIT	25.6	28.7	29.6	27.7
EV/EBITDA	9.7	10.0	10.0	9.9
Price / NTA	4.8	5.3	5.9	7.0
Cash div yld (%)	3.1	3.2	3.9	4.5
Gross div yld (%)	4.3	4.5	5.0	5.0

A no major surprises result

Modest declines in CNU's revenue and EBITDA, down -2% and -3% respectively, reflect market share losses to fibre outside its ultra fast broadband (UFB) footprint and to fixed wireless. EBITDA is "tracking towards the lower half" of NZ$640–660m guidance, consistent with our expectation. Capex guidance increased NZ$30m to NZ$670–700m, reflecting (1) demand for greenfield fibre (from new houses) "ahead of expectations", and (2) greater mass market fibre connections. This is business as usual for CNU, with (positive, demand-driven) increases to capex and lower debt costs post re-financing the principal changes to our forecasts.

Prospect for a step change in dividend still in tact

A key question for investors remains the level of free cash flow (FCF) and dividend CNU will generate once its fibre network is complete in 2022. CNU reiterated it will transition to a FCF-based dividend policy from FY22, where FCF is defined as operating cash flows less maintenance capex of c.NZ$200m pa. Our forecasts suggest CNU can sustainably generate FCF (on this definition) of c.NZ65–70cps pa (albeit with partial tax paid due to depreciation tax shields), supporting a long-term dividend above NZ50cps. Higher near-term capex may flatten the gradient of dividend increases medium-term, but should not impact the longer-term payout.

Regulatory conclusion in sight

The most material driver of CNU's valuation remains the to-be-finalised regulatory process and the resulting maximum allowable revenue (MAR) for its fibre network. Positively, CNU's regulatory proposals/forecasts (capex, opex, fibre revenues) continue to appear (we require further clarification) higher than our assumptions, representing upside risk to our forecasts. Precedents do highlight the CC may not fully accept CNU's proposals and we have not revised our assumptions at this time. We will further review these risks in the near future. The CC's current schedule is to finalise the regulatory process in 3Q/4Q 2021.

FORSYTH BARR

Chorus Ltd (CNU)

Priced as at 22 Feb 2021 (NZ$)	**7.77**

12-month target price (NZ$)*	**9.20**
Expected share price return	18.4%
Net dividend yield	3.6%
Estimated 12-month return	22.1%

Key WACC assumptions	
Risk free rate	2.30%
Equity beta	1.21
WACC	5.7%
Terminal growth	1.7%

Profit and Loss Account (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Sales revenue	970	959	948	946	950
Normalised EBITDA	**636**	**648**	**647**	**653**	**663**
Depreciation and amortisation	(393)	(402)	(422)	(432)	(427)
Normalised EBIT	**243**	**246**	**225**	**221**	**236**
Net interest	(165)	(173)	(164)	(164)	(168)
Associate income	0	0	0	0	0
Tax	(25)	(21)	(18)	(16)	(20)
Minority interests	0	0	0	0	0
Normalised NPAT	**53**	**52**	**44**	**40**	**49**
Abnormals/other	0	0	0	0	0
Reported NPAT	**53**	**52**	**44**	**40**	**49**
Normalised EPS (cps)	12.2	11.8	9.8	9.0	10.8
DPS (cps)	23.0	24.0	25.0	30.0	35.0

Growth Rates	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Revenue (%)	-2.0	-1.1	-1.1	-0.3	0.5
EBITDA (%)	-2.6	1.9	-0.1	0.9	1.6
EBIT (%)	-8.6	1.2	-8.5	-1.7	6.9
Normalised NPAT (%)	-37.6	-1.9	-16.1	-7.3	20.1
Normalised EPS (%)	-39.7	-3.5	-16.8	-7.8	19.9
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**	**653**	**663**
Working capital change	4	(17)	(7)	(8)	(6)
Interest & tax paid	(151)	(158)	(148)	(142)	(159)
Other	(13)	(20)	0	0	0
Operating cash flow	**476**	**453**	**491**	**504**	**499**
Capital expenditure	(808)	(759)	(666)	(478)	(358)
(Acquisitions)/divestments	0	0	0	0	0
Other	146	139	117	106	28
Funding available/(required)	**(186)**	**(167)**	**(57)**	**132**	**170**
Dividends paid	(49)	(76)	(82)	(109)	(146)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	**(235)**	**(243)**	**(139)**	**23**	**24**

Balance Sheet (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Working capital	(220)	(144)	(137)	(129)	(123)
Fixed assets	4,598	4,824	5,033	5,064	4,987
Intangibles	198	215	235	233	223
Right of use asset	225	228	227	226	225
Other assets	184	235	235	235	235
Total funds employed	**4,985**	**5,358**	**5,593**	**5,629**	**5,547**
Net debt/(cash)	1,959	2,325	2,442	2,396	2,348
Lease liability	246	257	268	279	290
Other liabilities	1,801	1,849	1,994	2,134	2,186
Shareholder's funds	979	927	889	821	723
Minority interests	0	0	0	0	0
Total funding sources	**4,985**	**5,358**	**5,593**	**5,629**	**5,547**

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

Spot valuations (NZ$)	
1. DCF	8.82

DCF valuation summary (NZ$m)	
Total firm value	6,418
(Net debt)/cash	(2,234)
Less: Capitalised operating leases	(266)
Value of equity	3,918

Valuation Ratios	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
EV/EBITDA (x)	9.5	9.7	10.0	10.0	9.9
EV/EBIT (x)	24.9	25.6	28.7	29.6	27.7
PE (x)	63.7	66.0	79.4	86.1	71.8
Price/NTA (x)	4.4	4.8	5.3	5.9	7.0
Free cash flow yield (%)	-9.6	-8.9	-5.1	0.7	4.1
Net dividend yield (%)	3.0	3.1	3.2	3.9	4.5
Gross dividend yield (%)	4.1	4.3	4.5	5.0	5.0

Capital Structure	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Interest cover EBIT (x)	1.5	1.4	1.4	1.3	1.4
Interest cover EBITDA (x)	3.9	3.7	4.0	4.0	3.9
Net debt/ND+E (%)	71.8	74.3	76.0	77.5	79.5
Net debt/EBITDA (x)	3.9	4.1	4.4	4.3	4.2

Key Ratios	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Return on assets (%)	4.3	4.4	3.8	3.8	4.1
Return on equity (%)	5.4	5.6	4.9	4.9	6.7
Return on funds employed (%)	3.9	4.1	3.4	3.4	3.8
EBITDA margin (%)	65.6	67.6	68.2	69.1	69.8
EBIT margin (%)	25.1	25.7	23.7	23.4	24.9
Capex to sales (%)	83.3	79.1	70.2	50.6	37.7
Capex to depreciation (%)	267	238	201	141	107
Imputation (%)	100	100	100	75	28
Pay-out ratio (%)	189	204	255	332	323

Operating Performance	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Revenue (NZ$m)					
Copper	468	369	287	208	151
Fibre	368	466	547	626	692
Other	134	124	115	111	107
Total revenue	**970**	**959**	**948**	**946**	**950**
Expenses (NZ$m)					
Labour costs	74	80	77	75	73
Network maintenance	75	64	63	61	61
Other network costs	33	29	25	25	26
IT costs	50	47	48	49	50
Other	102	91	88	82	77
Total expenses	**334**	**311**	**301**	**292**	**287**
Connections (000s)					
Copper	840	664	479	344	254
Fibre	610	751	853	968	1,027
ARPU (NZ$/month)					
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	51.5	52.7

1H21 result summary

Figure 1. Result summary

NZ$m	1H20	1H21	% chg	Forbar	% diff
Revenue					
Copper	194	151	-22.2%	144	4.8%
Fibre	223	262	17.5%	269	-2.7%
Other	66	60	-9.1%	58	3.3%
Total revenue	**483**	**473**	**-2.1%**	**471**	**0.3%**
Operating expenses					
Labour	(39)	(38)	-2.6%	(39)	-3.2%
Network maintenance	(34)	(34)	0.0%	(31)	9.5%
Other network costs	(12)	(13)	8.3%	(11)	13.3%
IT costs	(23)	(25)	8.7%	(24)	3.7%
Other	(43)	(40)	-7.0%	(44)	-9.3%
Total operating expenses	**(151)**	**(150)**	**-0.7%**	**(150)**	**0.0%**
EBITDA	**332**	**323**	**-2.7%**	**321**	**0.5%**
Depreciation & amortisation	(198)	(209)	5.6%	(207)	0.7%
EBIT	**134**	**114**	**-14.9%**	**114**	**0.0%**
Interest	(88)	(77)	-12.5%	(88)	-12.4%
Net profit before tax	**46**	**37**	**-19.6%**	**26**	**41.5%**
Tax	(15)	(13)	-13.3%	(8)	72.8%
Net profit after tax	**31**	**24**	**-22.6%**	**19**	**28.8%**
Normalised profit	**31**	**24**	**-22.6%**	**19**	**28.8%**
Normalised EPS (cps)	7.2	5.4	-24.1%	4.2	28.8%
Dividend (cps)	10.0	10.5	5.0%	10.5	0.0%
Capex	357	353	-1.1%	328	7.6%
Connections					
Copper	739	557	-24.6%	739	-24.6%
Fibre	693	813	17.3%	693	17.3%
Total	1,432	1,370	-4.3%	1,432	-4.3%

Source: Forsyth Barr analysis, Company reports

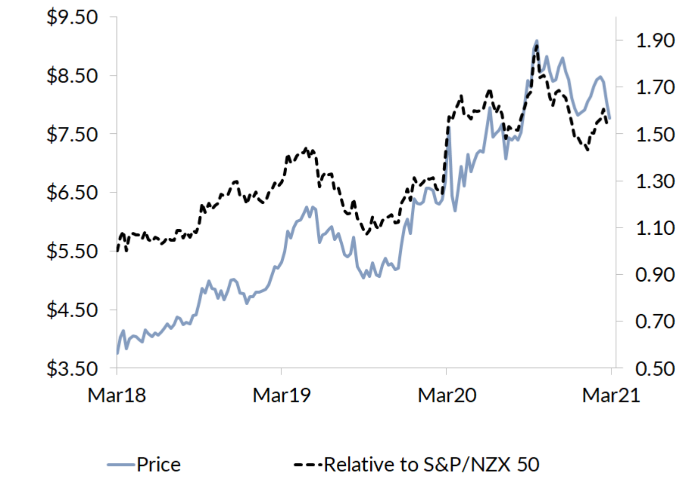
Earnings changes

Figure 2. Earnings changes

	FY21E			FY22E			FY23E		
NZ$m	Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	951	948	-0.3%	944	946	0.1%	944	950	0.6%
EBITDA	647	647	0.0%	655	653	-0.3%	661	663	0.4%
EBIT	227	225	-1.0%	226	221	-2.3%	235	236	0.8%
Adjusted NPAT	36	44	22.8%	37	40	8.9%	40	49	22.9%
Adjusted EPS (cps)	8.0	9.8	22.8%	8.3	9.0	8.8%	8.8	10.8	22.8%
Dividend (cps)	25.0	25.0	0.0%	30.0	30.0	0.0%	35.0	35.0	0.0%

Source: Forsyth Barr analysis

Figure 3. Price performance



Source: Forsyth Barr analysis

Figure 4. Substantial shareholders

Shareholder	Latest Holding
L1 Capital Partners Pty	9.8%
The Vanguard Group	6.5%
UniSuper Limited	6.5%
BNP PARIBAS SA	6.0%
Commonwealth Bank of Australia	5.5%

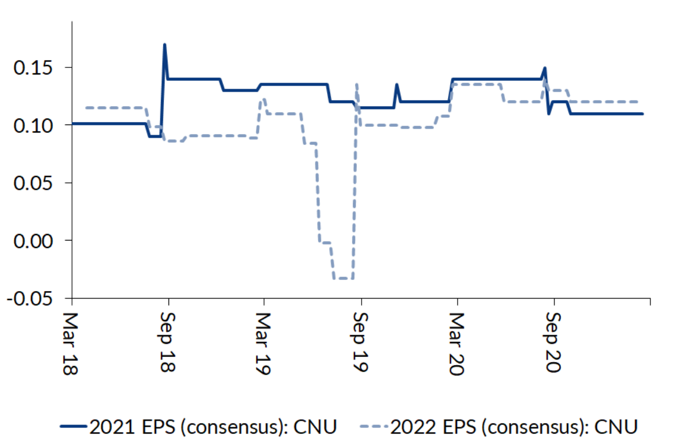
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 5. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect CNU's balance date - June)			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Chorus	**CNU NZ**	**NZ$7.77**	**NZ$3,450**	**>50x**	**>50x**	**9.5x**	**9.4x**	**27.2x**	**27.7x**	**3.9%**
SPARK NZ *	SPK NZ	NZ$4.66	NZ$8,630	21.0x	20.2x	9.0x	8.7x	15.8x	15.1x	5.4%
VECTOR *	VCT NZ	NZ$4.22	NZ$4,202	28.2x	27.7x	12.0x	11.5x	22.0x	21.3x	3.9%
AUSNET SERVICES	AST AT	A$1.69	A$6,424	19.3x	21.2x	12.8x	12.9x	21.0x	21.6x	5.8%
SPARK INFRASTRUCTURE GROUP	SKI AT	A$2.09	A$3,633	41.3x	>50x	6.4x	7.3x	15.3x	17.1x	5.9%
TELSTRA CORP	TLS AT	A$3.30	A$39,248	23.1x	23.1x	7.4x	7.6x	18.7x	18.5x	5.1%
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$4.95	A$3,075	30.4x	27.0x	10.8x	10.4x	21.1x	19.9x	0.8%
BT GROUP PLC	BT/A LN	£1.27	£12,634	6.6x	6.4x	4.2x	4.1x	10.1x	9.7x	5.8%
NETLINK NBN TRUST	NETLINK SP	S$0.95	S$3,702	39.6x	40.5x	15.4x	15.8x	39.8x	38.5x	5.2%
			Compco Average:	**26.2x**	**23.7x**	**9.8x**	**9.8x**	**20.5x**	**20.2x**	**4.7%**
EV = Current Market Cap + Actual Net Debt			**CNU Relative:**	**n/a**	**n/a**	**-3%**	**-4%**	**33%**	**37%**	**-18%**

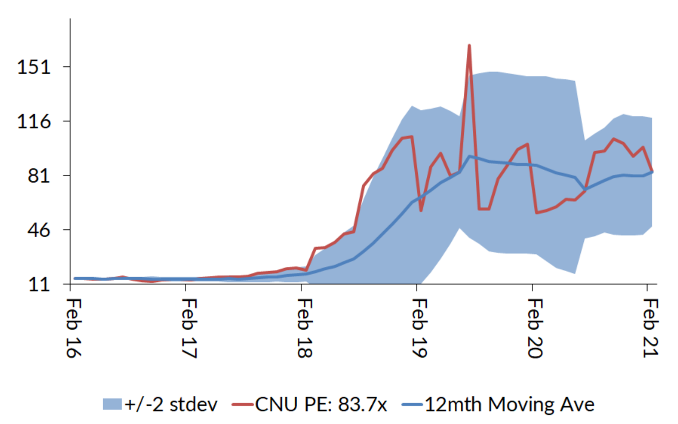
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (CNU) companies fiscal year end

Figure 6. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)



Source: Forsyth Barr analysis

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