

Chorus

Regulatory Tick Box: One ✓, One X

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OUTPERFORM

Chorus's (CNU) latest drip feed of regulatory details provided one tick (its estimated initial regulatory asset base (RAB) valuation), and one cross (a cut to its estimated regulated opex) relative to our forecasts. Whilst the lower opex was modest relative to our prior base case, it does highlight that even at this late stage in the regulatory process the outcome remains uncertain, with potential material valuation ramifications. Our base case remains CNU can ramp toward a dividend north of NZ50cps over the medium-term, appealing relative to other defensive stocks in the NZ market. We maintain OUTPERFORM, but acknowledge the steepening yield curve is headwind for CNU's stock price — its regulated earnings are formulated using short-term (low) rates, not necessarily consistent with how equity investors view a long-term asset.

NZX Code	CNU	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$7.30	NPAT* (NZ\$m)	52.0	43.6	40.4	50.5	PE	62.0	74.6	80.9	64.8
Target price	NZ\$8.10	EPS* (NZc)	11.8	9.8	9.0	11.3	EV/EBIT	24.7	27.8	28.6	26.5
Risk rating	High	EPS growth* (%)	-3.5	-16.8	-7.8	24.7	EV/EBITDA	9.4	9.7	9.7	9.5
Issued shares	444.0m	DPS (NZc)	24.0	25.0	30.0	35.0	Price / NTA	4.6	5.0	5.6	6.5
Market cap	NZ\$3,241m	Imputation (%)	100	100	75	30	Cash div yld (%)	3.3	3.4	4.1	4.8
Avg daily turnover	354.1k (NZ\$2,798k)	*Based on normalised profits					Gross div yld (%)	4.6	4.8	5.3	5.3

Confirmation of RAB a positive; cut to UFB opex a disappointment

CNU provided (for the first time) an estimated valuation of its initial regulatory asset base (RAB), and (we suspect more significant for analysts) materially lowered (by c.NZ\$25m pa) its estimate of opex applicable to the UFB.

The RAB feeds into the regulatory framework which determines the maximum allowable revenue (MAR) CNU is able to earn on its ultrafast fibre broadband (UFB) network. CNU's NZ\$5.5b RAB assessment is effectively in line with our NZ\$5.4b estimate.

The key uncertain variable in the RAB is the financial loss asset, i.e. the losses on the fibre network prior to the first regulatory period commencing 1 January 2022. Both this financial loss asset and future MAR can be materially influenced by the share of CNU's costs allocated to the UFB. CNU cut its (base case) estimate of this figure. We had not factored in CNU's previous forecasts, but viewed them as upside risk — the new estimates were modestly below our forecasts. CNU has submitted a proposal to the Commerce Commission (CC) for higher opex. (Even though we view the logic as sound) we believe the likelihood of this being accepted is low given cost allocation methodology has already been addressed by the CC.

End of long and winding regulatory road in sight ... but we're not there yet

Given CNU is a long-dated business with substantial operating and financial leverage, any assessment of the company's fundamental value can still vary materially depending on the UFB regulatory outcome. The good news is the end is in sight — the next (& key) step is the Commerce Commission's draft approval of CNU's RAB and initial revenue path scheduled for 31 May.

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. Our base case remains CNU can ramp toward a dividend north of NZ50cps over the medium-term.

Chorus Ltd (CNU)

Priced as at 26 Mar 2021 (NZ\$) **7.30**

12-month target price (NZ\$)*	8.10
Expected share price return	11.0%
Net dividend yield	3.9%
Estimated 12-month return	14.9%

Key WACC assumptions

Risk free rate	2.30%
Equity beta	1.21
WACC	5.7%
Terminal growth	1.2%

Spot valuations (NZ\$)

1. DCF	7.67
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DCF valuation summary (NZ\$m)

Total firm value	5,905
(Net debt)/cash	(2,234)
Less: Capitalised operating leases	(266)
Value of equity	3,405

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	970	959	948	946	950
Normalised EBITDA	636	648	647	653	666
Depreciation and amortisation	(393)	(402)	(422)	(432)	(427)
Normalised EBIT	243	246	225	221	239
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	51
Abnormals/other	0	0	0	0	0
Reported NPAT	53	52	44	40	51
Normalised EPS (cps)	12.2	11.8	9.8	9.0	11.3
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	2.0
EBIT (%)	-8.6	1.2	-8.5	-1.7	8.2
Normalised NPAT (%)	-37.6	-1.9	-16.1	-7.3	24.9
Normalised EPS (%)	-39.7	-3.5	-16.8	-7.8	24.7
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	666
Working capital change	4	(17)	(7)	(8)	(8)
Interest & tax paid	(151)	(158)	(148)	(142)	(160)
Other	(13)	(20)	0	0	0
Operating cash flow	476	453	491	504	498
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	169
Dividends paid	(49)	(76)	(82)	(109)	(146)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	(235)	(243)	(139)	23	23

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	(220)	(144)	(137)	(129)	(121)
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	5,550
Net debt/(cash)	1,959	2,325	2,442	2,396	2,349
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	725
Minority interests	0	0	0	0	0
Total funding sources	4,985	5,358	5,593	5,629	5,550

* 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)	9.2	9.4	9.7	9.7	9.5
EV/EBIT (x)	24.1	24.7	27.8	28.6	26.5
PE (x)	59.8	62.0	74.6	80.9	64.8
Price/NTA (x)	4.1	4.6	5.0	5.6	6.5
Free cash flow yield (%)	-10.2	-9.4	-5.4	0.8	4.3
Net dividend yield (%)	3.2	3.3	3.4	4.1	4.8
Gross dividend yield (%)	4.4	4.6	4.8	5.3	5.3

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	4.0
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

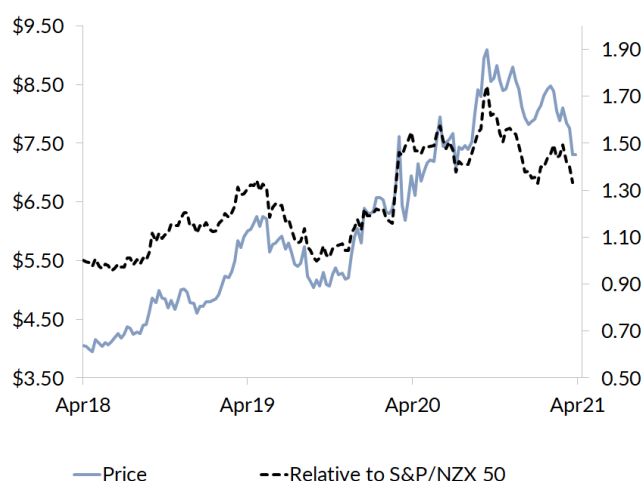
Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	4.3	4.4	3.8	3.8	4.1
Return on equity (%)	5.4	5.6	4.9	4.9	7.0
Return on funds employed (%)	3.9	4.1	3.4	3.4	3.9
EBITDA margin (%)	65.6	67.6	68.2	69.1	70.1
EBIT margin (%)	25.1	25.7	23.7	23.4	25.2
Capex to sales (%)	83.3	79.1	70.2	50.6	37.7
Capex to depreciation (%)	267	238	201	141	107
Imputation (%)	100	100	100	75	30
Pay-out ratio (%)	189	204	255	332	311

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	58
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	284

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

Figure 1. Price performance


Source: Forsyth Barr analysis

Figure 2. Substantial shareholders

Shareholder	Latest Holding
L1 Capital Partners Pty	9.8%
The Vanguard Group	7.5%
UniSuper Limited	6.5%
BNP PARIBAS SA	6.0%
Commonwealth Bank of Australia	5.5%

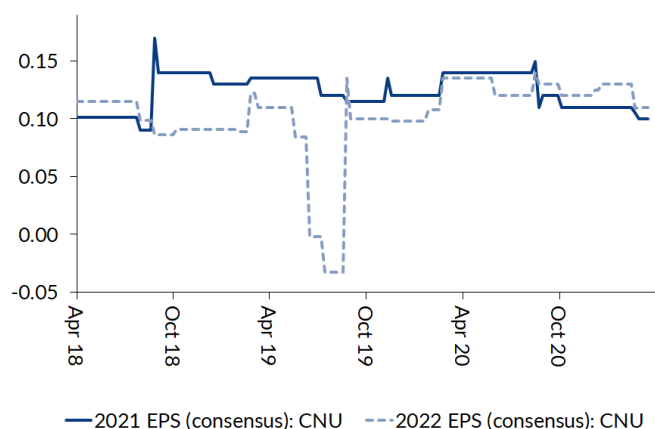
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 3. International valuation comparisons

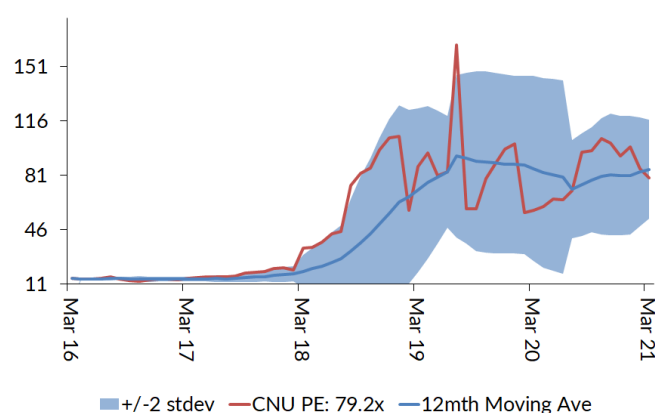
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect CNU's balance date - June)										
Chorus	CNU NZ	NZ\$7.30	NZ\$3,241	74.6x	>75x	9.1x	9.1x	26.3x	26.8x	4.1%
SPARK NZ *	SPK NZ	NZ\$4.41	NZ\$8,167	22.9x	21.8x	8.7x	8.6x	17.0x	16.0x	5.7%
VECTOR *	VCT NZ	NZ\$4.20	NZ\$4,182	25.2x	27.7x	11.6x	11.4x	20.8x	20.9x	3.9%
AUSNET SERVICES	AST AT	A\$1.83	A\$6,956	21.0x	23.0x	13.2x	13.3x	21.6x	22.2x	5.3%
SPARK INFRASTRUCTURE GROUP	SKI AT	A\$2.18	A\$3,826	45.8x	55.9x	33.4x	6.2x	41.2x	19.4x	5.8%
TELSTRA CORP	TLS AT	A\$3.33	A\$39,605	23.3x	23.3x	7.7x	7.7x	19.2x	18.3x	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\$5.44	A\$3,379	34.9x	30.2x	11.4x	11.0x	23.0x	21.3x	0.8%
BT GROUP PLC	BT/A LN	£1.45	£14,415	7.5x	7.1x	4.5x	4.4x	10.6x	10.2x	5.0%
NETLINK NBN TRUST	NETLINK	S\$0.95	S\$3,702	39.2x	39.3x	15.4x	15.7x	39.2x	37.9x	5.2%
SP										
Compc Average:				27.5x	28.5x	13.2x	9.8x	24.1x	20.8x	4.6%
CNU Relative:				171%	n/a	-31%	-7%	9%	29%	-11%

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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