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Uniti Group (UWL)

Back on the fence

Recommendation
Hold (Buy)
Price
\$4.64
Target (12 months)
\$4.75 (previously \$4.50)

GICS Sector
Telecommunication Services

Expected Return

Capital growth	2.4%
Dividend yield	0.0%
Total expected return	2.4%

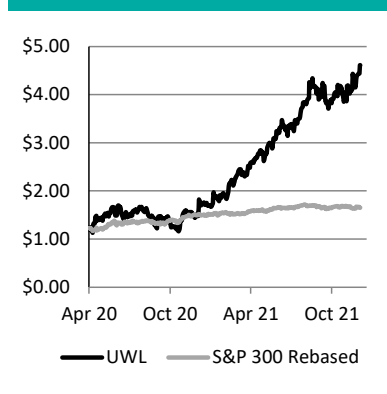
Company Data & Ratios

Enterprise value	\$3,445m
Market cap	\$3,192m
Issued capital	688.0m
Free float	90%
Avg. daily val. (52wk)	\$11.3m
12 month price range	\$1.62 - \$4.69

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	3.94	4.11	1.53
Absolute (%)	17.01	12.17	202.30
Rel market (%)	19.10	13.50	191.92

Absolute Price



SOURCE: IRESS

No change in forecasts

There is no change in our forecasts for Uniti which we last updated at the release of the FY21 result in August. We continue to forecast underlying EBITDA of \$146.3m in FY22 which equates to strong growth of 56% and is driven by a mix of organic growth and full 12 month contributions from acquisitions completed in 1HFY21 (i.e. Opticomm, Telstra Velocity and Harbour ISP). We note our forecast is slightly above the consensus forecast of \$144.5m which the company said it is “on track to meet or exceed” when it provided an operational update in mid November. We then forecast continued strong growth in underlying EBITDA of 16% in FY23 which is all organic (i.e. we assume no more acquisitions in our forecasts). Note we do not assume any shares are bought back under the recently announced share buy-back in our forecasts and wait for this to commence before looking to make any adjustments.

6% increase in PT to \$4.75

While there is no change in our forecasts we have updated each valuation used in the determination of our price target for market movements and time creep. We have also increased the multiple applied in our EV/EBITDA valuation from 20x to 22x given the strong share price performance of Aussie Broadband (ABB), the likely material debt reduction in 1HFY22 beyond the \$25m already announced in the operational update and/or a commencement of the share buy-back. The net result is a 6% increase in our PT to \$4.75 which has mostly been driven by an increase in the EV/EBITDA valuation.

Investment view: Downgrade to HOLD

At our updated PT of \$4.75 the total expected return is only 2% so we downgrade our recommendation from BUY to HOLD. The key risks to our downgrade are, firstly, a better than expected 1HFY22 result though the operational update suggests the company is on track to do slightly better than consensus but not significantly better. Secondly, a bid for the company and while we view this as likely at some stage there is no certainty it will occur. And thirdly, a market shift towards more defensive or infrastructure based stocks which we are perhaps already seeing.

Earnings Forecast

Year end 30 June	2021e	2022e	2023e	2024e
Total revenue (A\$m)	160.5	239.0	271.4	306.0
Underlying EBITDA (A\$m)	93.7	146.3	169.8	193.8
Underlying NPAT (A\$m)	49.3	79.3	96.1	113.9
EPS (diluted) (cps)	7.7	11.2	13.4	15.7
EPS growth (%)	-15%	45%	19%	17%
PER (x)	59.9	41.4	34.7	29.5
Price/CF (x)	34.9	28.0	24.0	21.3
EV/EBITDA (x)	36.8	23.0	19.3	16.5
Dividend (€ps)	0.0	0.0	1.5	3.5
Yield (%)	0.0%	0.0%	0.3%	0.8%
ROE (%)	6.0%	8.8%	9.5%	10.2%
Franking (%)	0%	0%	100%	100%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Earnings and Valuation Changes

No Change in Forecasts

There is no change in our forecasts for Uniti which we last updated at the release of the FY21 result in August. We continue to forecast underlying EBITDA of \$146.3m in FY22 which equates to strong growth of 56% and is driven by a mix of organic growth and full 12 month contributions from acquisitions completed in 1HFY21 (i.e. Opticomm, Telstra Velocity and Harbour ISP). We note our forecast is slightly above the consensus forecast of \$144.5m which the company said it is “on track to meet or exceed” when it provided an operational update in mid November. We then forecast continued strong growth in underlying EBITDA of 16% in FY23 which is all organic (i.e. we assume no more acquisitions in our forecasts). Note we do not assume any shares are bought back under the recently announced share buy-back in our forecasts and wait for this to commence before looking to make any adjustments.

A summary of our key forecasts is shown below.

Figure 1 - Key forecasts						
Year end 30 June	FY22e	Change	FY23e	Change	FY24e	Change
Total revenue (A\$m)	239.0	49%	271.4	14%	306.0	13%
Underlying EBITDA	146.3	56%	169.8	16%	193.8	14%
Underlying NPAT	79.3	61%	96.1	21%	113.9	18%
Diluted EPS	11.2c	45%	13.4c	19%	15.7c	17%
DPS	0.0c	NM	1.5c	NM	3.5c	NM

SOURCE: BELL POTTER SECURITIES ESTIMATES

6% Increase in PT to \$4.75

While there is no change in our forecasts we have updated each valuation used in the determination of our price target for market movements and time creep. We have also increased the multiple applied in our EV/EBITDA valuation from 20x to 22x given the strong share price performance of Aussie Broadband (ABB), the likely material debt reduction in 1HFY22 beyond the \$25m already announced in the operational update and/or a commencement of the share buy-back. There are, however, no changes in the key assumptions we apply in the DCF which are an 8.6% WACC and 5.0% terminal growth rate.

The change in each valuation and the impact on our PT calculation is shown below.

	Old (as at 1-Oct-21)			New (as at XX-Dec-21)		
	Valuation per share	% weighting	Price target	Valuation per share	% weighting	Price target
Methodology						
EV/EBITDA	\$3.97	50%	\$1.99	\$4.38	50%	\$2.19
DCF	\$5.04	50%	\$2.52	\$5.13	50%	\$2.56
Total			\$4.50			\$4.75

SOURCE: BELL POTTER SECURITIES ESTIMATES

The figure shows a low double digit percentage increase in the EV/EBITDA valuation and a more modest low single digit percentage increase in the DCF. The net result is a 6% increase in our PT to \$4.75 which is only a 2% premium to the share price so we downgrade our recommendation from BUY to HOLD.

Uniti Group

Company Description

Uniti Group (Uniti) is a provider of telecommunications services, specialising in fixed-wireless, fibre and telco services. The objective of the company is to provide an alternative solution to the nbn on a national scale and, by operating at costs lower than accessing the nbn, can deliver products that are competitively priced when compared with products provided by nbn retail service providers.

Investment Thesis

We downgrade our recommendation on Uniti from BUY to HOLD. Our investment thesis is based on:

- **Valuation:** Our 12 month price target on Uniti is \$4.75. The price target is generated from a blend of two valuation methodologies we apply to the company: EV/EBITDA and DCF. The price target is a 2% premium to the current share price and the total expected return is the same given there is no forecast dividend.
- **Quality board and management:** In our view Uniti has a high quality senior management team and board of directors with extensive experience in the telecommunications industry. For instance, CEO Michael Simmons has over 30 years' experience in the telecommunications sector and was the CEO of both SP Telemedia and Vocus. Similarly, recently appointed director Vaughan Bowen was the founder of M2 Group which was established over 20 years ago.
- **Good cash flow:** Uniti operates businesses that generate good cash flows and has said it will only target acquisitions which also generate good cash flow. The cash flow will be used to fund both organic growth – mainly through investment in the company's network – and also targeted acquisitions.

Key Risks

Key downside risks to our estimates and valuation include (but are not limited to):

- **Competition risk:** Uniti faces competition from a number of alternative suppliers of broadband internet connectivity services, including resellers of nbn and mobile operators currently delivering 4G cellular services and soon 5G cellular services in these markets. If there is a temporary or permanent shift in the competitive landscape then this could have a negative impact on the financial performance of the company.
- **Supplier risk:** Uniti sources equipment and services from various third parties and a disruption in the supply of, or prices associated with, any of these may have a negative impact on the business.
- **Regulatory risk:** Uniti Wireless uses class license spectrum in the delivery of its services and, in order to do so, is subject to and must comply with laws, regulations and government policies. If changes occur to existing policies and legislation around the use of class licence spectrum – as well as other areas such as declared services – then this could have an adverse impact on the company.

Table 1 - Financial summary

Uniti Group (UWL)						Share price:	\$4.64	Target price:	\$4.75		
						No. of issued shares:	688.0m	Market cap:	\$3,192m		
Profit & Loss (A\$m)						Valuation data					
Year end 30 Jun	2020	2021	2022e	2023e	2024e	Year end 30 Jun	2020	2021	2022e	2023e	2024e
Revenue	58.2	160.5	239.0	271.4	306.0	NPAT (A\$m)	26.4	49.3	79.3	96.1	113.9
Change	149%	176%	49%	14%	13%	Diluted EPS (cps)	9.1	7.7	11.2	13.4	15.7
Cost of sales	-13.8	-34.4	-47.8	-54.3	-61.2	Change	NM	-15%	45%	19%	17%
Gross profit	44.4	126.1	191.2	217.1	244.8	P/E ratio (x)	50.9	59.9	41.4	34.7	29.5
Gross margin	76.2%	78.6%	80.0%	80.0%	80.0%	CFPS (cps)	7.5	13.3	16.6	19.3	21.7
Expenses (excl. D&A, int.)	-17.8	-32.3	-44.9	-47.3	-51.0	Price/CF (x)	62.1	34.9	28.0	24.0	21.3
% of revenue	-30.7%	-20.2%	-18.8%	-17.4%	-16.7%	DPS (cps)	0.0	0.0	0.0	1.5	3.5
EBITDA (underlying)	26.5	93.7	146.3	169.8	193.8	Yield	0.0%	0.0%	0.0%	0.3%	0.8%
Depreciation	-4.0	-9.0	-13.5	-14.8	-16.0	Franking	0%	0%	0%	100%	100%
Amortisation	-2.9	-12.5	-18.7	-20.6	-22.1	EV/Revenue	51.6	21.5	14.1	12.1	10.4
EBIT	19.7	72.3	114.1	134.4	155.7	EV/EBITDA (x)	113.3	36.8	23.0	19.3	16.5
Net interest expense	-0.6	-8.0	-8.4	-6.3	-3.9	NTA per share (cps)	49.8	-10.9	4.0	18.9	34.7
Pre-tax profit	19.1	64.3	105.8	128.2	151.8	Price/NTA (x)	9.3	-42.4	115.3	24.5	13.4
Income tax expense	7.3	-15.0	-26.4	-32.0	-38.0	Performance ratios					
NPAT	26.4	49.3	79.3	96.1	113.9	Year end 30 Jun	2020	2021	2022e	2023e	2024e
Cash Flow (A\$m)						EBITDA margin	45.6%	58.4%	61.2%	62.6%	63.3%
Year end 30 Jun	2020	2021	2022e	2023e	2024e	Return on assets	5.8%	4.1%	6.5%	7.7%	9.0%
EBITDA	26.5	93.7	146.3	169.8	193.8	Return on equity	6.3%	6.0%	8.8%	9.5%	10.2%
Change in working capital	-4.9	-1.4	-0.3	2.4	2.6	Payout ratio	0.0%	0.0%	0.0%	10.8%	21.5%
Gross cash flow	21.6	92.4	146.0	172.3	196.4	Effective tax rate	38.3%	-23.4%	25.0%	25.0%	25.0%
Interest received	0.3	0.5	0.0	0.0	0.0	Leverage ratios					
Interest paid	-0.6	-5.6	-2.1	-1.6	-1.0	Year end 30 Jun	2020	2021	2022e	2023e	2024e
Tax paid	0.2	-2.6	-26.4	-32.0	-38.0	Net debt/(cash) (A\$m)	-187.2	253.3	173.3	93.2	5.7
Operating cash flow	21.6	84.6	117.4	138.7	157.4	Net debt/equity	NM	31%	19%	NM	NM
Payments for PPE	-7.5	-26.4	-32.5	-35.0	-37.5	Gearing	NM	24%	16%	NM	NM
Payments for acquisitions	-165.5	-620.7	-10.0	-25.0	-20.0	Net debt/EBITDA (x)	NM	2.7	1.2	NM	NM
Payments for IP	-0.7	-1.2	0.0	0.0	0.0	Net interest cover (x)	33.1	9.1	13.7	21.5	39.8
Investing cash flow	-176.5	-654.9	-42.5	-60.0	-57.5	Segmentals (A\$m)					
Proceeds from loans/grants	0.0	305.6	0.0	0.0	0.0	Year end 30 Jun	2020	2021	2022e	2023e	2024e
Proceeds from issue of shares	328.3	179.2	5.0	5.0	5.0	Revenue					
Payment of share issue costs	0.0	0.0	0.0	0.0	0.0	Consumer & Business Enablem	24.0	43.6	54.5	58.6	61.5
Payment of lease liabilities	-1.0	-1.8	0.0	0.0	0.0	Wholesale & Infrastructure	22.4	105.4	171.8	199.0	229.7
Repayment of loans	-2.5	-44.7	-75.0	-85.0	-100.0	Specialty Services	21.0	30.8	34.7	38.1	41.0
Other financing activities	0.0	0.0	0.0	0.0	0.0	Total revenue	67.6	180.9	262.0	296.7	333.2
Dividends paid	0.0	0.0	0.0	-3.5	-17.5	Intercompany sales	-9.4	-20.5	-23.0	-25.3	-27.2
Financing cash flows	324.8	438.4	-70.0	-83.5	-112.5	Consolidated revenue	58.2	160.5	239.0	271.4	306.0
Net change in cash	170.0	-131.8	4.9	-4.8	-12.5	EBITDA					
Cash at start of period	19.1	189.2	57.3	62.3	57.4	Consumer & Business Enablem	4.8	4.5	5.5	5.9	6.2
Cash at end of period	189.2	57.3	62.3	57.4	44.9	Wholesale & Infrastructure	14.5	78.6	131.4	154.2	178.0
Balance Sheet (A\$m)						Specialty Services	11.8	20.0	22.5	23.8	24.6
Year end 30 Jun	2020	2021	2022e	2023e	2024e	Unallocated	-4.5	-9.3	-13.1	-14.1	-15.0
Cash	189.2	57.3	62.3	57.4	44.9	Total EBITDA	26.5	93.7	146.3	169.8	193.8
Current receivables	6.0	15.4	23.9	27.1	30.6	EBITDA margin					
Inventories	0.2	0.0	0.0	0.0	0.0	Consumer & Business Enablem	19.9%	10.2%	10.0%	10.0%	10.0%
Other current assets	3.1	3.7	3.7	3.7	3.7	Wholesale & Infrastructure	65.0%	74.5%	76.5%	77.5%	77.5%
PPE	46.5	234.0	255.5	281.9	308.5	Specialty Services	56.0%	64.8%	65.0%	62.5%	60.0%
Intangibles - Goodwill	176.0	808.6	813.6	826.1	836.1	Total EBITDA margin	39.2%	51.8%	55.8%	57.2%	58.2%
Intangibles - Other	30.0	81.3	65.1	50.8	33.7	Interims (A\$m)					
Right of use asset	3.0	3.8	3.8	3.8	3.8	Year end 30 Jun	1HFY21	2HFY21	1HFY22e	2HFY22e	
Total assets	454.1	1,205.6	1,229.3	1,252.4	1,262.7	Revenue	54.6	105.9	114.9	124.1	
Payables	13.1	33.7	41.8	47.5	53.6	Cost of sales	-12.4	-22.0	-23.3	-24.5	
Current provisions	3.2	2.6	2.6	2.6	2.6	Gross profit	42.2	83.9	91.6	99.5	
Current int. bearing liabs.	0.0	0.0	0.0	0.0	0.0	Gross margin	77.3%	79.2%	79.8%	80.2%	
Current contract liabs.	2.3	3.6	3.6	3.6	3.6	Expenses (excl. D&A, int.)	-12.9	-19.4	-21.6	-23.2	
Current contingent consid.	4.4	9.4	9.4	9.4	9.4	EBITDA (underlying)	29.3	64.5	70.0	76.3	
Non-current provisions	0.1	0.5	0.5	0.5	0.5	Depreciation	-2.9	-6.1	-6.6	-6.9	
Non-current int. bearing liabs.	0.0	261.9	186.9	101.9	1.9	Amortisation	-3.6	-8.8	-9.1	-9.6	
Non-current contract liabs.	0.0	0.0	0.0	0.0	0.0	EBIT	22.7	49.6	54.3	59.8	
Non-current contingent consid.	2.7	45.3	45.3	45.3	45.3	Net interest expense	-1.4	-6.6	-4.8	-3.5	
Total liabilities	32.4	389.8	322.9	243.6	149.6	Pre-tax profit	21.3	43.0	49.5	56.3	
Issued capital	421.8	777.9	782.9	787.9	792.9						
Reserves	6.1	14.9	21.2	25.9	28.8						
Retained earnings/(losses)	-6.2	23.0	102.3	195.0	291.3						
Total shareholders' equity	421.7	815.9	906.5	1,008.8	1,113.1						

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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