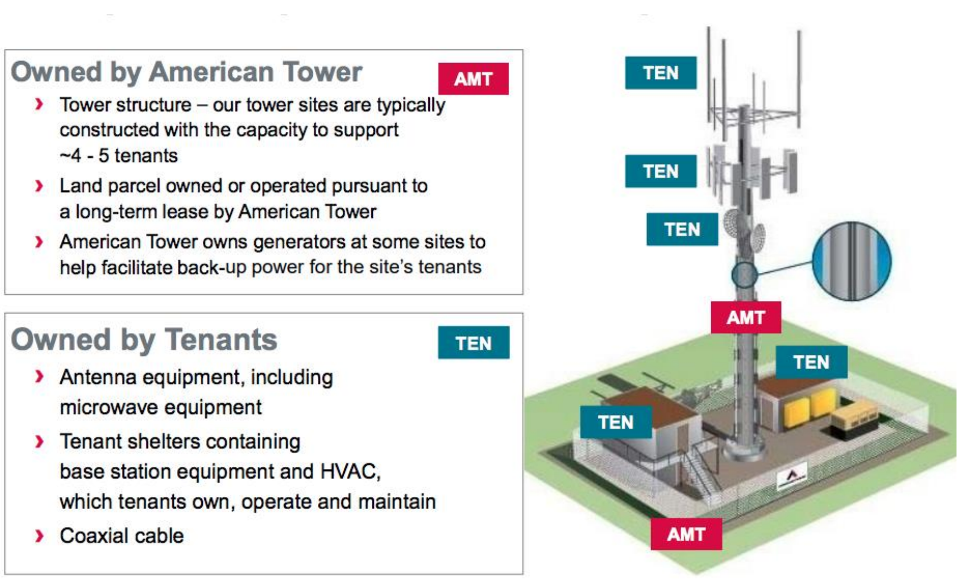
American Tower Corp. – AMT (5/23/19)

Description: American Tower is one of the largest global REITs in the world and is a leading independent owner, operator and developer of multitenant communications real estate with a portfolio of over 170,000 communications sites.

Ticker: AMT
Price: $200.67
Market Cap: $88.7B
Performance: +27.4% YTD

Analysis

AMT is one of those companies where no matter how long you wait for a dip it just never arrives. The company, which owns over 40,000 towers in the United States and over 128,000 towers internationally, has a very strong and secure business model. Let's discuss it a bit.



AMT owns the real estate and the base of the towers and then the company leases out the space to tenants which are usually nationwide telecom service providers like that of AT&T, Verizon, T-Mobile, and Sprint and international companies like Telefónica (Brazil, Chile, Colombia, Mexico and Peru), MTN Group Ltd. (Ghana, South Africa and Uganda), Grupo Iusacell, S.A. de C.V. (Mexico), Nextel International (Brazil, Chile, and Mexico) and Vodafone (India, Germany, Ghana, South Africa, and Uganda).

Where AMT really shines is when they are able to get multiple tenants at the same location. This is helpful for the company because its costs are mainly fixed and every additional tenant comes with very little marginal cost. For example, view the table below.

	One Tenant	Two Tenants(2)	Three Tenants(2)
Construction/Upgrade Costs ($ in US)	$275,000	-	-
Tenant Revenue	$20,000	$50,000	$80,000
Operating Expenses (incl. ground rent, prop taxes, etc.)	$12,000	$13,000	$14,000
Gross Margin	$8,000	$37,000	$66,000
Gross Margin (%)	40%	74%	83%
Gross Margin Conversion Rate (3)	-	97%	97%
Return on Investment (4)	3%	13%	24%

AMT generally expects a location startup cost to come in around $275,000 and with one tenant will witness 40% gross margins. Once more tenants get brought on the gross margins rise to 74% and 83% with each additional tenant. In some cases, AMT can have 4 or 5 tenants in one location.

The solid thing about AMT's business model is how low the churn rate is and how long the contracts are for. According to AMT's financials, churn averages somewhere between 1-2% (extremely low) and contracts are generally 5-10 years in length with a 3% lease escalator built into the contract. In other words, AMT is charging more every year and at that rate, has been outpacing inflation by a fair margin.

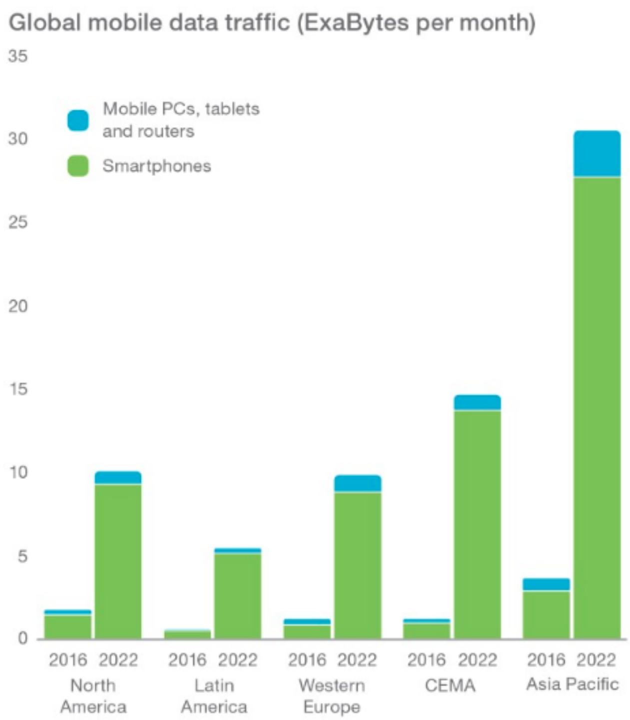
There are many drivers on the horizon that will play directly into the hand of AMT. Most prominently are the following:

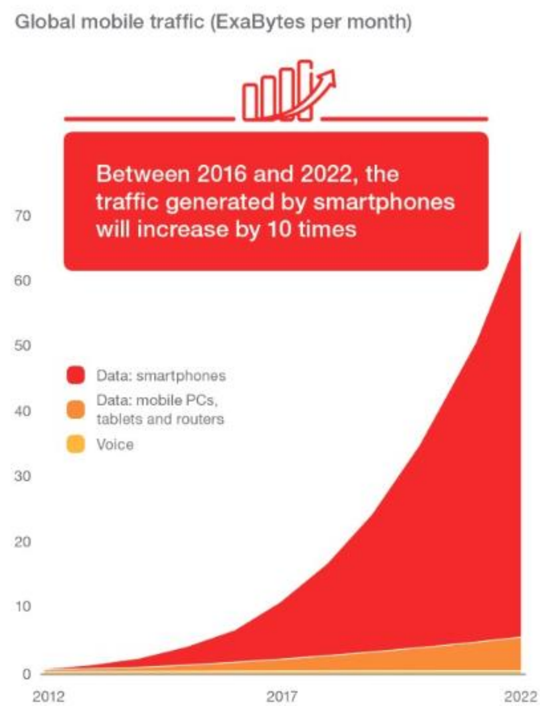
1. Increase in data usage
    a. Via more devices
    b. Via greater usage of devices
    c. Via greater data needed to meet demand. Example, email 10 years ago vs. streaming Netflix – big difference

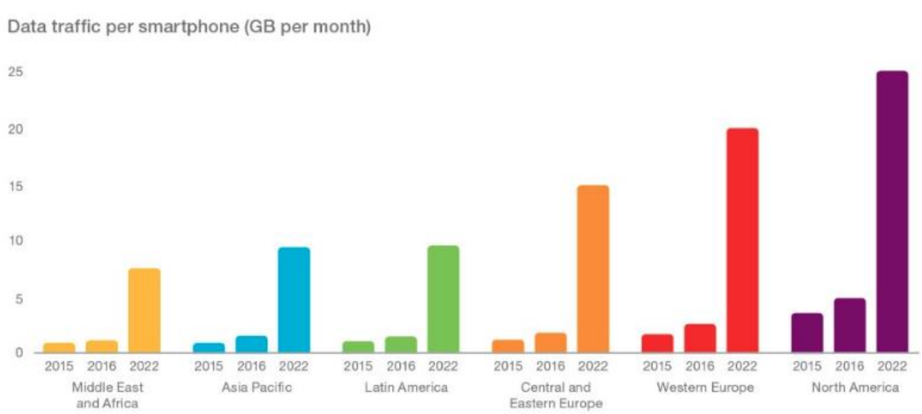
2. Growth of 5G and IoT (Internet of Things) with increase need for connectivity
3. Competition amongst telecoms to provide better coverage in more areas

Because it is so vital to AMT's business, let's cover some research we've found on data usage and its trends.

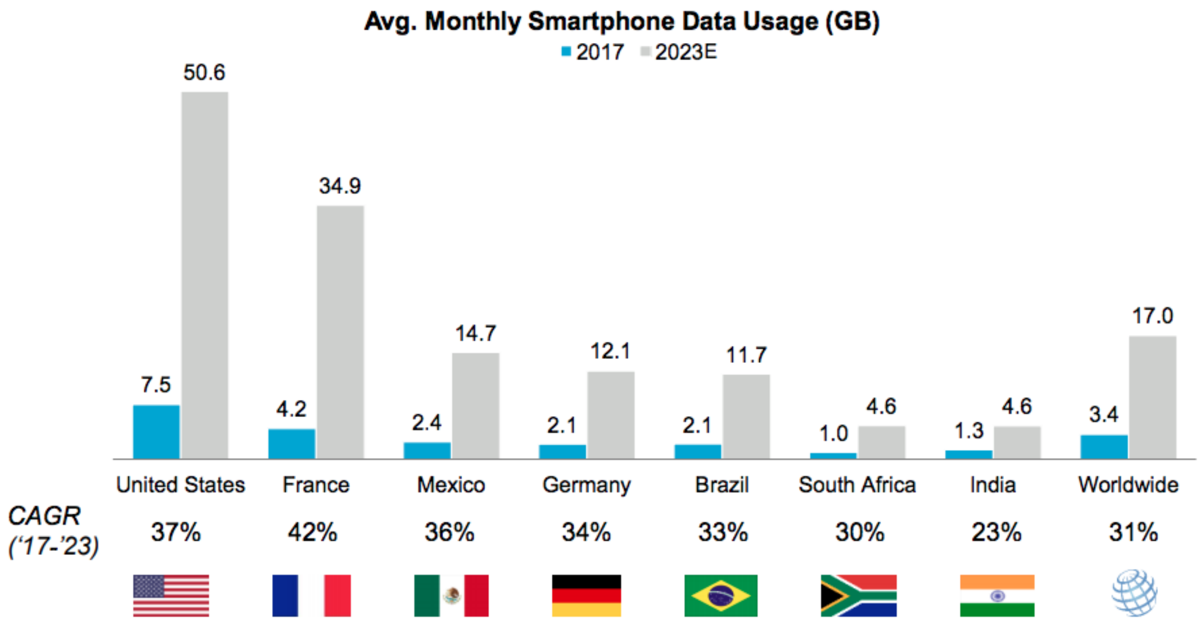
Studies show between 2016 and 2022, the traffic generated by smartphones will increase by 10X. By 2022, there will be 12 times more mobile data traffic in Central & Eastern Europe and Middle East & Africa (CEMA). In addition, total mobile data traffic is expected to rise at a compound annual growth rate (CAGR) of around 45% with countries like China alone set to add 440 million mobile broadband subscriptions between the end of 2016 and 2022.







Here is another study we found which is in-line with the data from 2016-2022, this chart below breaks down the estimates per country from 2017-2023.



Growth is going to be coming from all over the world. What fascinates us the most is the fact that the United States has been at the forefront and is expected to grow the second fastest off a MUCH larger base. A single U.S. smartphone that used 7.5GB per month in 2017 is expected to average 50.6GB by 2023! This is insane and only leads us to believe that the rest of the world is going to follow suit over the years. When you look at countries like India and even more established ones like Germany, the upside is huge. Right now, it's going to take companies like AMT to continue building.

Not many people know this but when we look at 5G many people forget that it will require a substantial amount of towers. Some large like the ones AMT currently owns but also many that are more localized than currently. In order to provide 5G service on a large scale, analysts say carriers will need to add at least 250,000 new small cell sites nationwide. However, though these small cell technologies perform similar functions, they're not your typical cell tower. While most current cell towers are large, freestanding behemoths as AMT has, the cell towers of the future are smaller devices which companies aim to mount onto lampposts, rooftops, traffic lights and other appropriate spots around cities and towns. Why is this? Because 5G uses shorter radio wavelengths, the towers needed to pick them up can be smaller than their predecessors. This makes them easier to place in great numbers. However, these new cell towers are also causing conflict between telecom companies and local governments and municipalities, since they need to be installed on a large amount of public property.

We actually view this as a plus and minus for AMT. For one, we know that the towers currently in place will be needed for 5G but we aren't 100% sure how AMT plays into the smaller towers especially if they're going to be on public property.

According to AMT management on their most recent call they said:

"And when it comes to 5G, we firmly believe that a substantial portion of that network investment will be oriented toward macro towers, utilizing sub-6 gigahertz spectrum to serve the needs of the 85% of the U.S. population that is living outside of urban areas. This is likely to include spectrum assets like 600 megahertz, 2.5 gigahertz, CBRS and the C-band, among others.

All these bands, largely deployed on macro tower assets, will likely be utilized to achieve the capacity and the broad coverage needed to serve the topographic and demographic realities of the United States population.

Importantly, we view our approximately 40,000-site macro tower portfolio as extremely well positioned to capture a significant portion of this activity during the evolution from 4G to 5G, similar to past network technology cycles."

In other words, AMT expects a large portion of 5G to be carried out via their macro towers. We also found supporting dialogue from Ericsson. "Tower climbers are really the backbone behind the network. They climb infrastructures, whether its rooftops or major towers, and they actually assemble and construct the equipment on top of these cell towers that we all use every day," said Kevin Zvokel, head of networks at Ericsson North America.

Ericsson said global mobile data traffic is expected to grow eight times by the end of 2023, so there's a real need for more efficient technologies. The company predicts that by 2023, 20% of the global population will be covered by 5G, with 1 billion 5G subscriptions, 9 billion mobile subscriptions, and 20 billion connected internet of things devices. Even Ericsson, which has 350,000 towers in North America, expects that number to rise to 1M in the next four years.

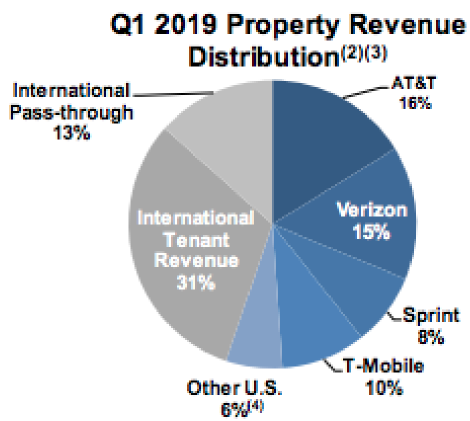
Now that we've discussed a lot of upsides to AMT we want to turn it over to some concerns/downsides:

1. A large portion of AMT's customers and revenue, specifically within the U.S., comes from 4 major carriers

   There is a strong possibility, according to recent statements from the DOJ, that the merger will get approved between T-Mobile and Sprint and this could hurt AMT as the two companies can now share towers. When looking through AMT's conference call transcript we found the following statement addressing this:

“Moreover, whether there are three national wireless players or four in the U.S., the number of subscribers will remain consistent and these subscribers will continue to expand their data usage. Therefore, in either a four or three carrier market, we would continue to expect 30% to 40% annual mobile data usage growth, roughly $30 billion of industry CapEx annually and further deployment of 4G and 5G equipment on towers. Consequently, we expect to generate continued solid U.S. organic growth and attractive returns over our planning cycle.”

Overall, management doesn’t see it being a headwind but we still believe it is especially when you factor in that Sprint alone was 8% of total revenues in Q1. Even though it shouldn’t be a problem, we also have to remember that companies like AT&T are also heavily levered and while we don’t think collecting payments from these companies is going to be a problem it is something that needs to be monitored continuously if you’re going to be an AMT investor because of how much the 4 major players make up revs (~50%).



2. AMT has a large amount of debt at which currently stands at $25.4B and has a current ratio (current assets/current liabilities) of 0.5x.

   AMT is heavily levered. Looking at their balance sheet, long-term debt has floated around $18B for the last several years but has risen significantly here in 2019. In addition, current liabilities of $4.4B outweigh current assets of $2.04B – highlighting some liquidity constraints.

   For the quarter ended March 31, 2019, the Company’s Net Leverage Ratio was 4.5x net debt (total debt less cash and cash equivalents) to Q1 2019 annualized Adjusted EBITDA – which is pretty steep. Looking further into it, on February 14, 2019, the company entered into a loan agreement for a new $1.3 billion unsecured term loan. The company used the net proceeds of this new term loan, together with cash on hand, to repay all outstanding indebtedness under its 2018 term loan.

Also on March 15, 2019, the company issued $650.0 million aggregate principal amount of 3.375% senior unsecured notes due 2024 and $600.0 million aggregate principal amount of 3.950% senior unsecured notes due 2029. The company used the net proceeds to repay existing indebtedness under its 2013 credit facility and its 2014 credit facility.

3. Large political and currency risk with the amount of business they do internationally

If we look at the DXY (Dollar Index weighed against a diversified basket of currencies) we see the dollar has been gaining strength steadily over the year.

In fact, the company trimmed their guidance in their most recent report due to FX exposures.

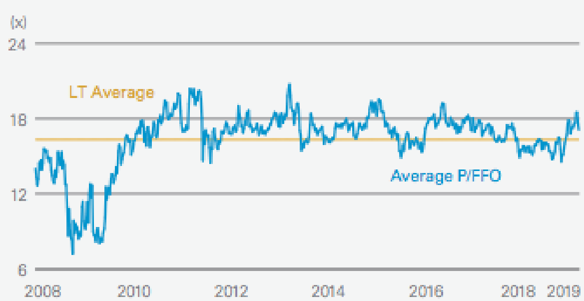
2019 Outlook *($ in millions)*	**Full Year 2019**			**Midpoint Growth**
Total property revenue[1]	$7,135	to	$7,285	(1.4)%
Net income	1,560	to	1,660	27.3%
Adjusted EBITDA	4,420	to	4,520	(4.2)%
Consolidated AFFO	3,375	to	3,475	(3.2)%

"The company's outlook reflects estimated unfavorable impacts of foreign currency exchange rate fluctuations to property revenue, Adjusted EBITDA and Consolidated AFFO, of approximately $13 million, $14 million and $12 million, respectively, as compared to the Company's prior 2019 outlook."

Moving onto a valuation standpoint, what many people do wrong when looking at real estate investment trusts, which is what AMT is, they automatically look at P/E and PEG ratios. This is not how REITs should be evaluated. While financials are important, when it comes to REITS FFO (Funds from Operations) is what is king.

AMT trades at an $88B valuation and expects $3.375B - $3.475B in consolidated Adjusted FFO. This implies AMT trades at P/FFO of 25.7x when using the middle point. How does this stack up to other REITs?

Price-to-Funds from Operations (P/FFO)



As of 30 April 2019

The REIT market as represented is a basket of 53 large and investable REITs across all sectors, as identified and selected by SNL Financial. The basket also includes companies that over time have gone private or merged in order to avoid survivor bias in the historical data.

Source: SNL Financial

After the strong price performance over the last few months, current REIT P/FFO valuations of 17.1x are slightly above long-term averages of 16.3x P/FFO. With the first quarter 2019 earnings season almost complete, initial results can be viewed as decent for many of the sectors with affirmation of 4%–5% earnings growth expectations for 2019. The main outlier to this trend is the retail sector, which continues to deal with the changing nature of retail, tenant churn, and the additional needed capital expenditures in order to reposition properties. Overall, the vast majority of REITs' reporting to date have either met or beat analyst estimates for Q1, but still seem to be conservative on 2019 guidance. The results continue to demonstrate that REIT earnings are more "local economy dependent" rather than "global economy dependent" given REITs' lower earnings volatility than other sectors.

Note: P/FFO is the standard REIT equivalent of the price-to-earnings (P/E) ratio.

AMT currently trades at a premium to the average REITs whose P/FFO is around 17.1x right now and vs. the long-term average of 16.3x. The reason AMT commands a bit of a premium is because AMT is positioned to benefit from an explosive industry trend and has little direct competition with Crown Castle International (CCI) being their main competitor. For reference, CCI trades at 21.55x P/FFO.

In fact, CCI is expecting FFO to grow 7% in 2019 vs. AMT who is expected to grow theirs around 3.2%.

AMT and CCI are both great ways of playing the space but are also different investments with advantages and disadvantages. Being a REIT, AMT's dividend is a bit on the weak side at a 1.8% yield while CCI has a 3.5% dividend yield, nearly double.

On the other side of the spectrum, AMT has been able to grow faster over the last 5 years with a rev CAGR of 16.2% vs. CCI's 12.2%.

Performance wise, AMT just can't be topped. We looked at a dozen different time tables and AMT has outperformed CCI and the S&P500 considerably.

On the 1-YR chart, AMT has outperformed the S&P500 by over 10x and CCI by 2x. On the 3-YR chart, AMT has outperformed the S&P500 by 2.5x and CCI by nearly 2x.

On the 5-YR chart AMT has tripled the S&P500 return and outperformed CCI by 50%. On the 10-YR chart, AMT has delivered returns of nearly 700% vs. the S&P500 at 221% and CCI at 577%.

Overall, this is not a stock that dips unless the markets are in an absolute free fall and we're not talking about Q4 of last year. That's not nearly enough to stop AMT. When the markets fell over 14% from October 1st to December 31st last year, AMT gained 10%. Not outperformed the S&P500 by 10%, but gained 10%, outperforming by over 24%.

As we always say, you can diversify a little more by adding CCI, especially if you're looking more for yield. Either way, these two REITs have some serious tailwinds both domestically and internationally as businesses and consumers alike have shown zero slowdown in data consumption and demand. CUBE may look to enter into a position in either, or both, REITs upon completing this research.