

Zayo Group Holdings (ZAYO)

Current Price: \$32.86 Target Price: \$35.00

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Introduction –

Zayo Group Holdings engages in providing bandwidth infrastructure services in the U.S., Europe, and Canada. They offer fiber solutions, transport, enterprise networks, all streams, and many others. Dark fiber solutions is a main source of their revenue. This accounts for about 33% of their revenue. Dark fiber cables are cables that companies can use for their own private use and decreases the number of users on the bandwidth making the internet connection much faster. They currently have 130,865 route miles along with 12.2 million fiber miles. They own 51 data centers across North America and Europe while serving over 400 markets. They are also a leader in providing small cell networks for companies who are trying to expand their networks in highly concentrated areas. This is also a main technology in making a path for 5G to become available. The company was founded by John Louis Scarano and Daniel P. Caruso. The company was founded in November of 2007 and is currently headquartered in Boulder, Colorado



Recommendation –

We recommend a **BUY** for ZAYO because it is a major player in the dark fiber solution which will be aiding the 5G movement over the next few years. The communications infrastructure sector is currently \$12.5B and expected to grow to \$58.7B by 2024. This sector is the future of business, because it lays out the infrastructure for new technological advances to be used. ZAYO is specifically helping to layout the infrastructure for 5G which will change technology forever by allowing data to be downloaded 20 times faster than 4G. 5G will impact subsectors like Internet of Things (IoT) is counting on 5G technology for

many of the products they want to launch as soon as possible. IoT needs 5G to be able to function at full capacity, so there is a rush to get 5G to market, which we believe will cause a surge in Zayo's growth opportunities and valuation. Zayo is trading 35% lower than their all-time high in July 2018 due to missed earnings in November 2018 earnings call. We believe that the stock will rise back to its high within the next year. Because of these factors we believe Zayo is a buy and our target price for the stock is \$35.

Investment Thesis –

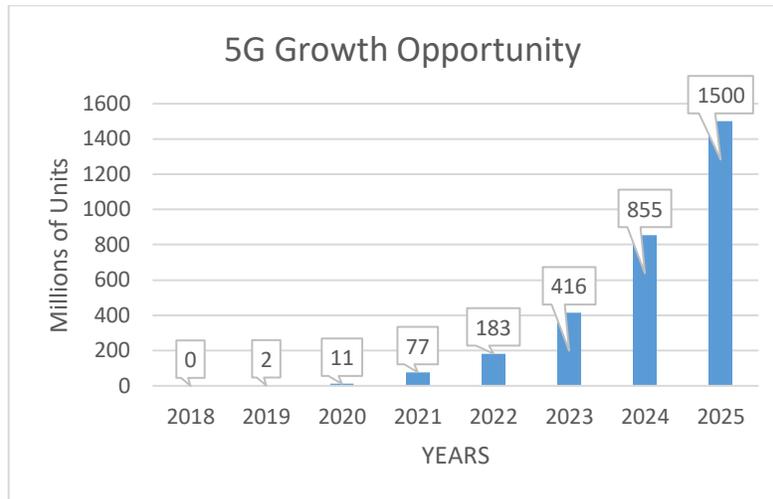
Zayo has been growing quickly over the past couple years. Much of this is to do with the acquisitions of many of its smaller competitors. These acquisitions have grown Zayo's market rapidly and open their doors to many new customers. Most of the customers they have sign a contract that is typically anywhere from 1 year in length or even up to 20 years. This leads to a very consistent influx of cash which also makes 90% of their revenue come from these monthly payments on their contracts. They have been able to increase their profits over the past few years by 18% or 404 million dollars while keeping their expenses relatively the same. The only main increase in expense has been from the acquisitions of new companies. Our main factors for our thesis is that Zayo will beat its earnings expectations and grow its EPS are as follows:

Small Cells: Small cells are the leading product in the rolling out of 5G. Normal cell towers are too far apart and aren't capable of holding a 5G connection between these towers. Small cells are cells that are put up either on buildings or telephone poles. These are much smaller cells that are easier to put up and cost less than the normal towers. Having enough small cells will make 5G capable of being used wherever we need. The small cells may not be able to handle a lot of service at once but can run 5G speeds unlike normal cell towers. Small cells will be able to ping off each other making 5G more reliable and faster with more small cells being put up. It will start in bigger cities and then grow out from there.

Dark Fiber Solutions: Dark fiber solutions is a key part of Zayo's business. It accounts for 33% of their revenue source leading all other revenue sources. They have been able to grow this part of their business consistently for the past couple years. They have also been able to lower their expenses on the cables after finding that they could depreciate the cables over 33 years instead of 20. Dark fiber cables are cables that are being put into the ground but have not been used yet. If these cables are not lit, then the full amount of bandwidth is available to whoever needs these cables. This makes the cables faster and more dependable. Currently large players like Verizon, T-Mobile, and AT&T are trying to get more dark fiber cables to be able to handle the current demand for 4G but also to get ready for the upcoming 5G wireless network. Zayo was recently chosen by a global tech company to provide dark fiber solution to connects it key markets. It represents one of the biggest dark fiber contracts.

5G: 5G is the main driver behind picking this company to succeed. 5G is coming and many telecommunications companies are trying to be the first to get there. 5G is growing in demand is expected by many to be available within the next two years. To be able to understand what 5G is and why so many people want it is important to know. Currently, the top available networks offer 4G LTE. The upgrade from 4G LTE to 5G could lead to 20x faster internet and connection and efficiency. The only problem with 5G is that its coverage is much less than that of 4G. Therefore, small cells will be a key player in this market as well. Small cells are easier, more affordable, and quicker to put up than original

cell towers. Zayo is a key player in the market of small cells which makes them a key player when it comes to making 5G available.



Valuation –

We derived our target price by analyzing DCF and multiples valuation methods and weighting them at 70% and 30% respectively. We weighted the DCF model heavier because we feel it better represents the individual revenue growth potential of Zayo within the 5G boom. For DCF we assumed a 6% WACC and 2% for the perpetuity growth rate. The WACC is composed of 52.5% equity at a cost of 8.7% and 47.5% debt which costs 2.5%. With these variables we got a valuation of \$38.13. Zayo has an estimated P/E for the current year of 48.91 and the industry average is 62.94. This suggests a 28.6% increase in the current stock price providing a target price of \$36.38. By weighting these two valuations we came up with a target price of \$37.60.

Risks –

Too Fast of Growth: Zayo has been buying many new companies. These acquisitions have led to Zayo growing at a very fast rate which may be hard to sustain and keep up with. The management team has a lot on their plate dealing with these acquisitions and making sure they go smoothly. Although the fast growth is a lot to handle and may be a risk to look for in the future, Zayo has been able to successfully handle the growth to this point and should be able to continue their growth with minimal worries.

Competition: Right now, there many different companies in this sector competing to be the first in the 5G world. This race is heating up and becoming more and more serious has many telecommunications have shifted their focus to 5G. Zayo has a lot of infrastructure already down and ready to use which helps them with this 5G race. Many companies are seeing a backlog in 4G making it hard for them to work on getting ahead in 5G. As competition heats up for the race to 5G, Zayo needs to be at the top of their game and filling out more contracts for their 5G infrastructure. One way they are attacking this risk and problem is by acquiring new companies to take over their contracts making it easier to fill their contracts then trying to get them to switch.

Failure of Physical Infrastructure: Infrastructure failure is something Zayo should be constantly aware of. If their infrastructure fails with things such as cables getting corroded or small cells going down, they will need to be able to find the source of the problem and fix it right away. Many of businesses rely on Zayo’s infrastructure to be up and running all the time as they use it to conduct their business. This has not been a problem in the past and Zayo has taken cautionary procedures to be able prevent this from happening. This makes their infrastructure more reliable and problems easier to fix

New Entrants: Along with competition, Zayo needs to be aware of new entrants to this market. This is a very low risk to Zayo as it takes lots of capital to be able to get into this market and to build a name that is trustworthy. New entrants would lead to an increase competition that could potentially take away market share from Zayo. Starting a new company in such a competitive market is very hard to do so any company that can fight its way into this space should be one that is watched carefully by Zayo and other companies in this sector.

Probability		Too Fast of Growth	
		Competition	Failure of Physical Infrastructure
		New Entrants	
		Significance	

Management –

Zayo group has a newer management team surrounding their founder, Chairman and CEO, Daniel Caruso. He also founded Envysion and Level 3 Communications which was later acquired by Century Link. Many of the executives have been with the Zayo between one and three years, however, come from Level 3 Communications or Century Link. Even though some of the executives are newer to Zayo, most of the team has worked together in the past at Envysion, Level 3, or Century Link which are all in a similar space. Daniel Caruso owns 8,558,937 shares of Zayo which is currently worth approximately \$235 million. This is good for shareholders because the CEO has a lot of skin in the game and wants to increase the share value as much as possible. Daniel currently only takes a \$17,500 salary and receives

most of his pay in shares of Zayo in accordance with their performance. In 2018 he received \$7,317,761 in stock awards.

Daniel Caruso helped found Level 3 Communications which later sold to Century Link for \$34 billion. This is relevant because Zayo may also be taken private in the months to come. In a recent article by Goldman Sachs, it is explained that there is currently an offer on the table to take Zayo off the market in the mid-\$30s price range. Because of this news on March 7th, the stock has been up from around \$24 when the news was announced to \$28.15 on March 11th. If the company is sold at \$35 per share, which Goldman Sachs estimates a 70% chance of happening, investors will see a return of 24% in the short term.

Peer Analysis –

Company	Ticker	Price Per Share	MKT Cap	Sales (2018)	EPS	P/E
Zayo	ZAYO	\$28.11	\$8,997.10	\$2,606.50	\$0.48	\$81.84
RingCentral	RNG	\$105.21	\$8,547.80	\$673.60	-\$0.30	-
Equinix	EQIX	\$436.03	\$28,459.40	5,071.70	\$5.35	\$65.95
Cognent Communications	CCOI	\$49.55	\$2,296.50	\$520.20	\$.609	\$81.26

