Altice USA, Inc. (NYSE: ATUS)

Laura Abrishamkar, Spencer Kinkelaar, and George Vasilakis

Company

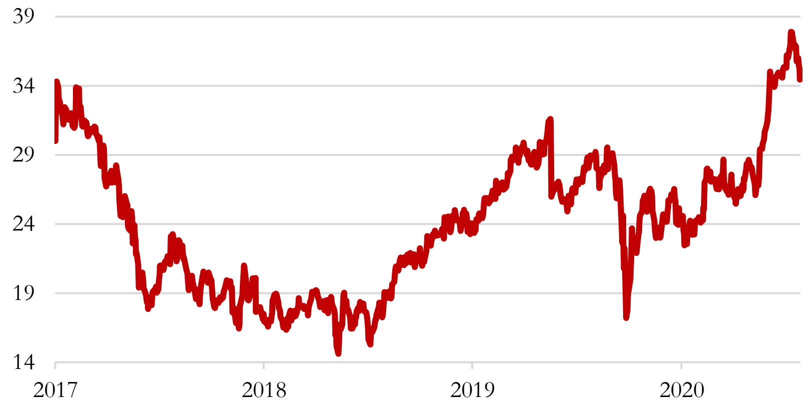
Altice

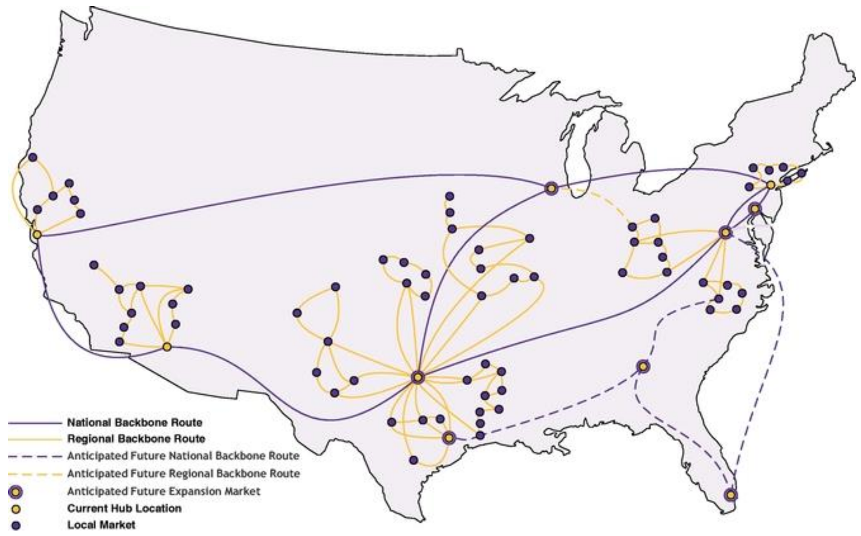
- 2018 spin-off of Altice Europe; controlled by multinational cable operator Patrick Drahi
- Holding company with 2 major assets
  - Optimum: New York tri-state
  - Suddenlink: south-central US
- Also offers mobile services based on TMUS network, news programming content, and advertising services
- 8.8MM homes passed and 4.9MM customer accounts

optimum.

suddenlink®

NYSE: ATUS





Basic Information	
Share price	$ 34.35
Market cap (MM)	18,576
Net debt	25,345
Enterprise value	43,921
LTM Multiples	
TEV/EBITDA	10.5x
FCFE yield	8.3%
LTM Financials	
Revenue	9,873
EBITDA	4,187
EBIT	2,048
UFCF	3,035
Interest	1,498
FCFE	1,537
EBITDA margin	42.4%
Operating margin	20.7%
Leverage	
Net debt/TEV	57.7%
Net debt/EBITDA	6.1x
Interest coverage	2.8x

Industry and Competition

Why We Like Cable

- Extremely high barriers to entry
- Oligopoly: usually only one or two high speed broadband providers in a market
- Scale economics; costs are mostly fixed—high operating leverage
- High margins and strong, steady cash flow
- Infrastructure asset that can support debt

Why Altice Specifically

- Lowest EBITDA and EBITDA-capex multiple cable operator (due to scale, not performance)
- Highest EBITDA/subscriber ratio due to asset quality and prime locations (New York)
- Most aggressive with balance sheet and buybacks; PE-like asset in public market
- We also like CHTR

Optimum Service Area

- ~75% penetration of homes passed
- Primary competition: Verizon Fios FTTH (50% overlap)
- Frontier (overlap in CT only—slower speeds and more DSL)
- RCN (overbuilder)
- ~70% of NY households have access to at most 2 ISPs
- Lower growth region

Suddenlink Service Area

- Estimated ~45% penetration of homes passed
- Primary competition: satellite providers
- Area of focus for FTTH buildout and primary source of revenue growth

Cord-Cutting A Net Positive for Cash Flow

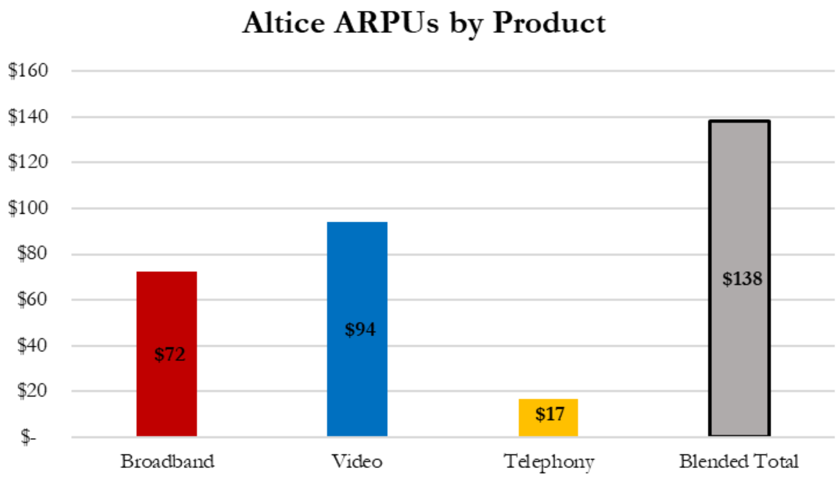
De-Bundling

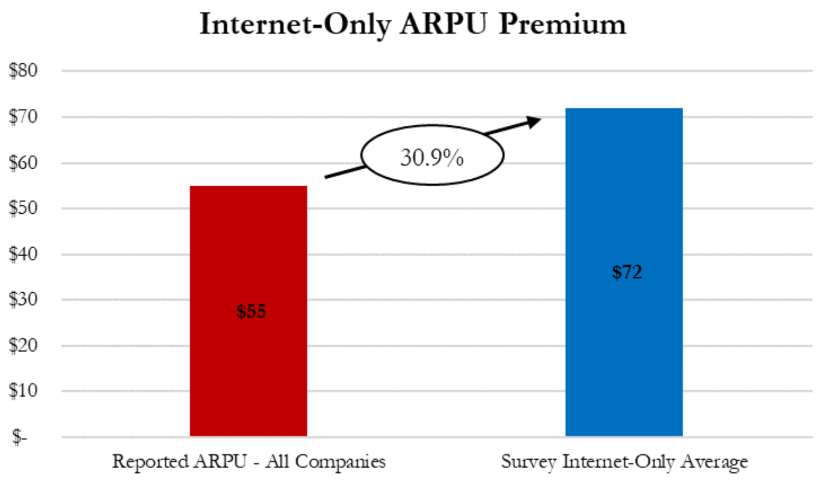
- Intuition would suggest that cutting the cable cord in favor of streaming is bad for distribution company revenues
- Yet, video margins are so low that de-bundling results in higher cash flow after eliminating the bundle discount

Broadband-Only Pay More

- Broadband-only customers also pay significantly more for Internet service than do bundle customers
- Customers that cut video are far more likely to stream and use savings to pay up for bandwidth
- Altice One is one way to win

Video Cord-Cutting and De-Bundling		
Monthly ARPU	$	94
Programming costs		(69)
Other direct costs		(17)
Gross contribution margin	**$**	**9**
Bundle discount		20
Per-user net cash flow	**$**	**11**





Broadband Also Less Capital Intensive

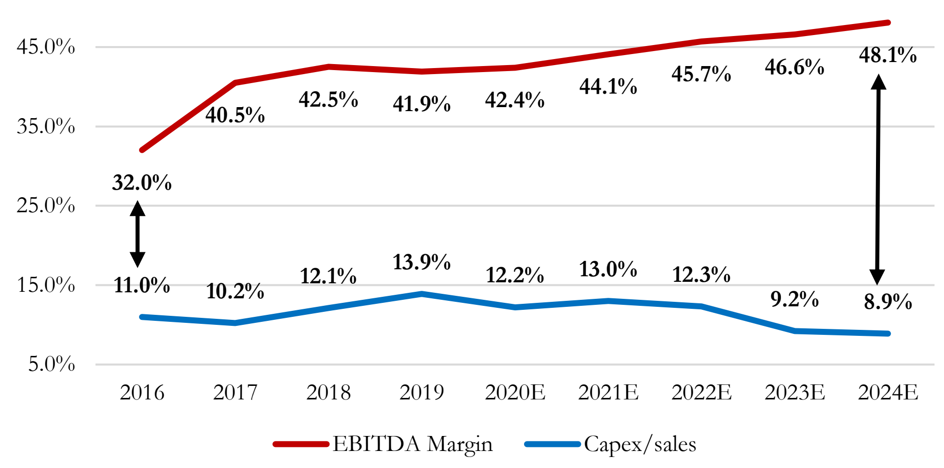
Superior Broadband Economics

- In addition to the economics of de-bundling and higher ARPUs, broadband has higher incremental margins
- Broadband's especially high operating leverage will sustain margin expansion and support profitability despite the decline of traditional products
- Broadband also requires less capex than traditional cable Video

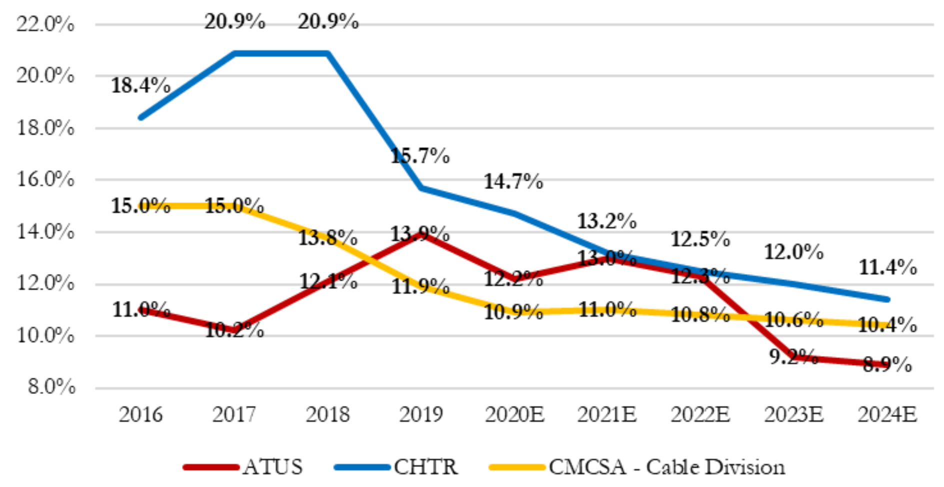
8x Operating Leverage Due to Incremental Margins

	Revenue Mix	Revenue Growth	Incremental Margin	EBIT Growth
Broadband	37.3%	14.6%	75%	
Video	37.6%	-8.7%	25%	
Telephony	4.9%	-20.9%	25%	
Business and other	20.2%	5.6%	50%	
		1.0%	48.7%	8.0%

FCF Margin Expansion



Capex/Sales Declines with Broadband Transition



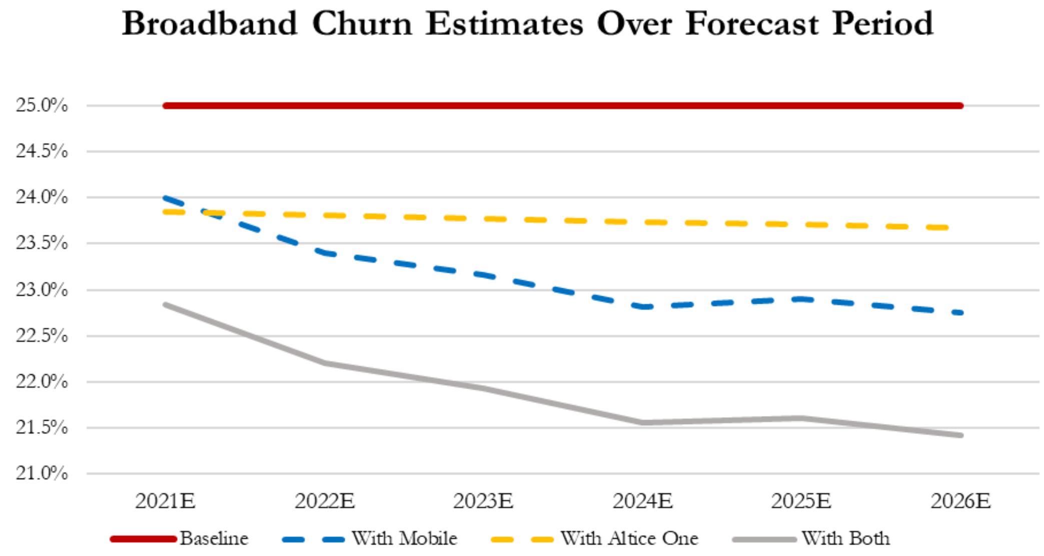
Reduced Churn → High-Margin Incremental Revenue

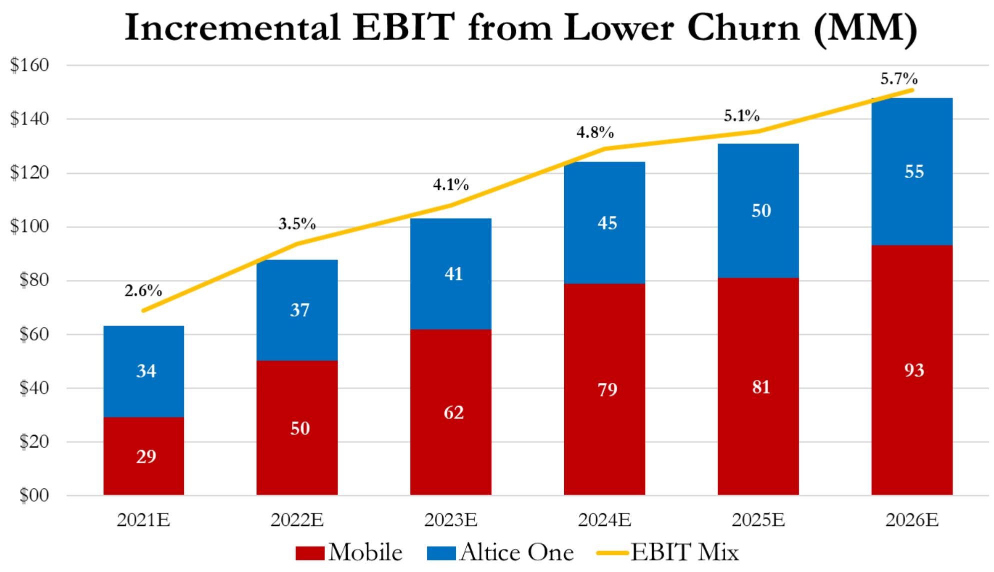
Mobile and Altice One Impact on Broadband

- Recent rollouts of ATUS's mobile initiative (MVNO agreement with TMUS) and Altice One (an Internet-enabled set top box and gateway) should meaningfully reduce overall churn
- Incremental customers have an outsized EBIT impact as variable costs for additional broadband households are minimal (especially for already-acquired customers)

Churn Reduction

- Mobile and broadband customers are far stickier than broadband-only
- Altice One's impact on reducing churn is lower, but its penetration is far higher than mobile
- The model has been proven with CHTR and CMCSA
  - Likely will have greater impact in more competitive Optimum market (higher baseline churn)
  - ATUS mobile pricing (~$25 ARPU) more competitive than CHTR and CMCSA (~$40 ARPU)





Recent Deal Highlights Public Market Discount

Stonepeak Infrastructure Partners to Acquire Astound Broadband from TPG

- Valued around ~$8,000/broadband sub or ~13x EBITDA
- Especially interesting because two of Astound's largest assets, RCN and Grande, are overbuilders, and it is hard to be an overbuilder in a sticky oligopoly business
- This is what first piqued our interest in ATUS
  - Most public cable incumbents trade below the private transaction value for an overbuilder
  - When the deal was announced in early November, ATUS traded around $27, or ~9x EBITDA
  - We admit that the current valuation is less timely, but still actionable

"The combined entity of **RCN and Grande will challenge incumbent telco and cable operators** by focusing on providing high-quality and more reliable communications services along with better value and customer service than incumbent competitors."
– TPG Press Release, 2016

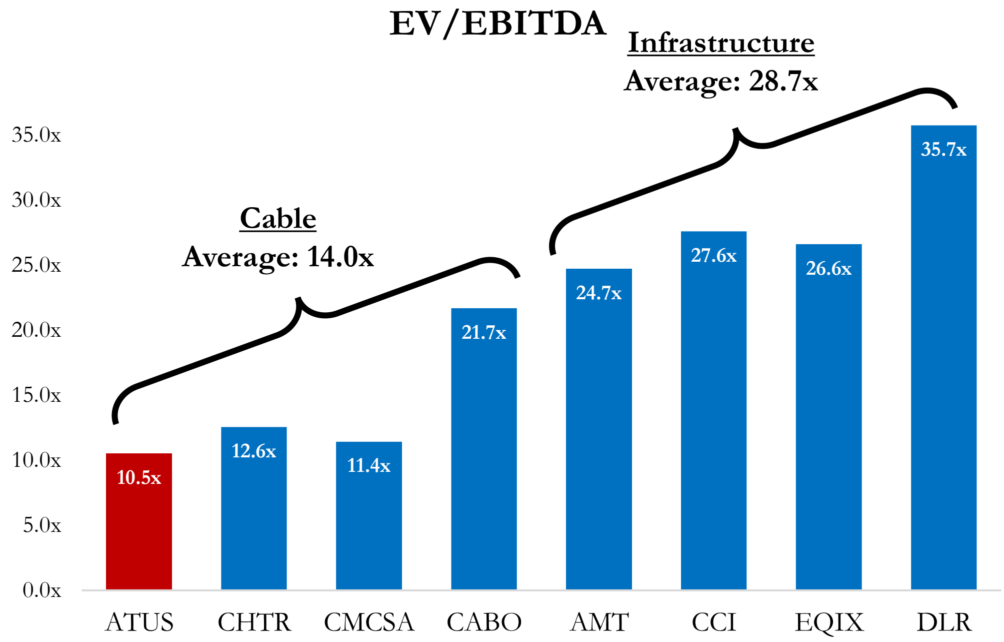
	ATUS	CABO	CHTR
Share price	$ 34.35	$1,982.69	$ 623.09
TEV (MM)	43,921	13,040	209,725
Broadband subs	4	1	27
LTM EBITDA	4,187	636	17,523
EV @ $8,000/sub	34,908	6,272	214,456
EV @ 13x EBITDA	54,434	8,262	227,799
Implied share price	$ 53.79	$1,189.61	$ 713.52
Upside	**56.6%**	**-40.0%**	**14.5%**

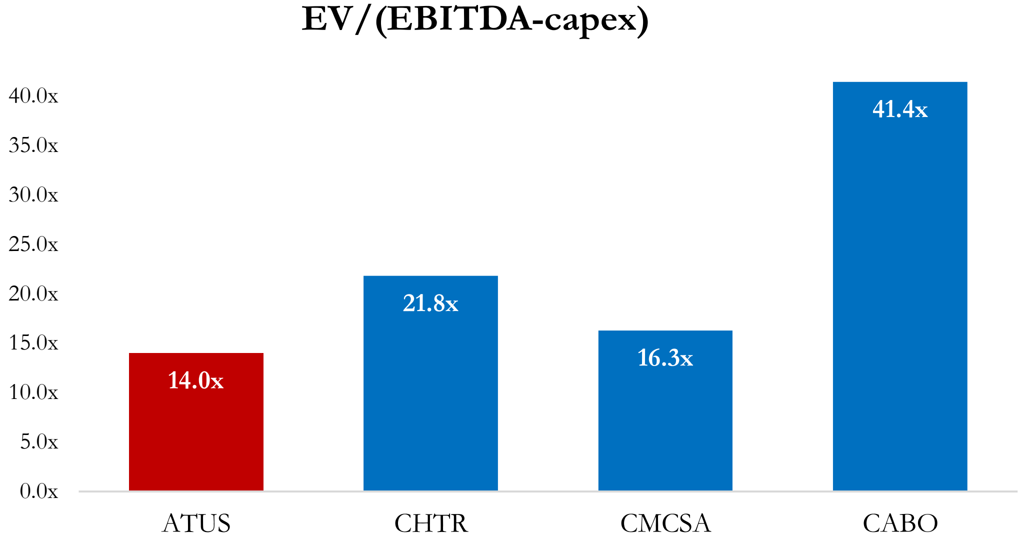
ATUS at Discount to Cable Peers, Internet Infrastructure

Cable as an Infrastructure Asset

- Cable and fiber are key infrastructure assets
- Fiber is necessary for both 5G small cells and increasing demand for bandwidth and speed
- Relatively low risk of disruption or cyclicality (misconception of 5G being broadband killer and Internet is now a near-necessity utility)
- Infrastructure names trade at significant premium (tickers listed are REITs and not perfectly comparable); multiples will not equalize, but such a discrepancy suggests cable is unloved

	ATUS	CHTR	CMCSA	CABO
Video/data customers	89%	68%	84%	65%
EV/EBITDA	10.5x	12.0x	11.4x	20.5x
EV/(EBITDA-capex)	14.0x	21.8x	16.3x	41.4x





Valuation

EV/2021 EBITDA Valuation

Multiple	Implied Share Price	Multiple	Implied Upside
8.0x	$ 25.11	8.0x	-27.1%
9.0x	$ 33.19	9.0x	-3.7%
10.0x	$ 41.28	10.0x	19.8%
11.0x	$ 49.37	11.0x	43.3%
12.0x	$ 57.45	12.0x	66.8%
13.0x	$ 65.54	13.0x	90.2%
14.0x	$ 73.62	14.0x	113.7%
15.0x	$ 81.71	15.0x	137.2%
16.0x	$ 89.80	16.0x	160.7%

- At almost 60% LTV, ATUS equity is highly sensitive to multiples—any multiple expansion would be extremely accretive
- At the same time, we seem limited downside at current multiples

DCF Valuation

	2020	2021E	2022E	2023E	2024E	2025E	2026E
Revenue	9,895	10,068	10,270	10,424	10,710	10,978	11,198
Growth		1.8%	2.0%	1.5%	2.8%	2.5%	2.0%
EBITDA	**4,420**	**4,553**	**4,780**	**4,948**	**5,244**	**5,454**	**5,610**
Margin	44.7%	45.2%	46.5%	47.5%	49.0%	49.7%	50.1%
D&A	2,148	2,291	2,247	2,228	2,264	2,321	2,355
EBIT	**2,272**	**2,262**	**2,533**	**2,720**	**2,980**	**3,134**	**3,255**
Tax rate	26.0%	26.0%	26.0%	26.0%	26.0%	26.0%	26.0%
Capex	1,173	1,378	1,490	1,322	1,243	966	983
UFCF	**2,656**	**2,587**	**2,632**	**2,918**	**3,226**	**3,673**	**3,781**

- Strong asset base results in low cost of debt
- CAPM cost of equity with generous 10% ERP is ~12.5%, in line with low double digit IRR hurdles for infrastructure PE fund
- 8.3% FCFE yield exceeds yield target of most real asset funds
- Very reasonable valuation

CAPM	
Debt	24,392
WA cost of debt	3.2%
ETR	26.0%
Market cap	18,576
30-year yield	1.9%
ERP	10.0%
Beta	1.05
Cost of equity	12.4%
WACC	**6.68%**

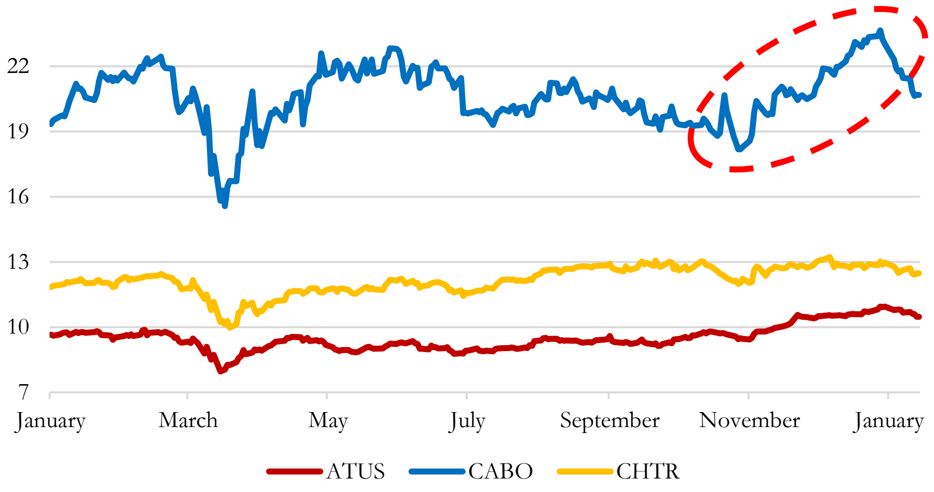
PV of forecast	14,854
Terminal growth	2.5%
PV of terminal	41,574
TEV	**56,428**
Debt	24,392
Cash	2,106
Equity value	**34,142**
Shares	563
Implied price	$ 60.64
Current price	$ 34.35
Upside	**76.5%**

Bonus Pair Trade: Short Cable One

The Only "SMID Cap" Cable Company Is Too Big For Its Britches

- CABO is the only cable operator in small and mid cap indices such as the S&P 400, making it the only investable asset of its kind for investors with such a mandate
- With a market cap in excess of $12B, CABO is now large enough to be in the S&P 500
- CABO is a good business with similar likeable elements; it is slightly higher growth and has a strong broadband-only business, but we see no justification for such a multiple premium
- Valuation shorts are always difficult, but a pair trade with such a large multiple differential (~10x) is less risky
- Another aspect where timeliness may have weakened since we recognized the opportunity, but we still think there is a clear value mismatch between the two securities

TEV/EBITDA for Large Pure-Play Cable Operators



	ATUS	CABO	CHTR
Share price	$ 34.35	$1,982.69	$ 623.09
TEV (MM)	43,921	13,040	209,725
Broadband subs	4	1	27
Total subs	5	1	31
LTM EBITDA	4,187	636	17,523
EBITDA/sub	831	646	566
EV/broadband sub	10,066	16,632	7,824
EV/sub	8,713	13,252	6,780
EV/EBITDA	**10.5x**	**20.5x**	**12.0x**

Catalysts and Risks

Catalysts

- Tender offers and buybacks: repurchased more than $2B in equity (~12% of shares) in 2020
- More transactions could drive multiple expansion
- Accretive M&A, especially if multiples expand and the stock is no longer so undervalued

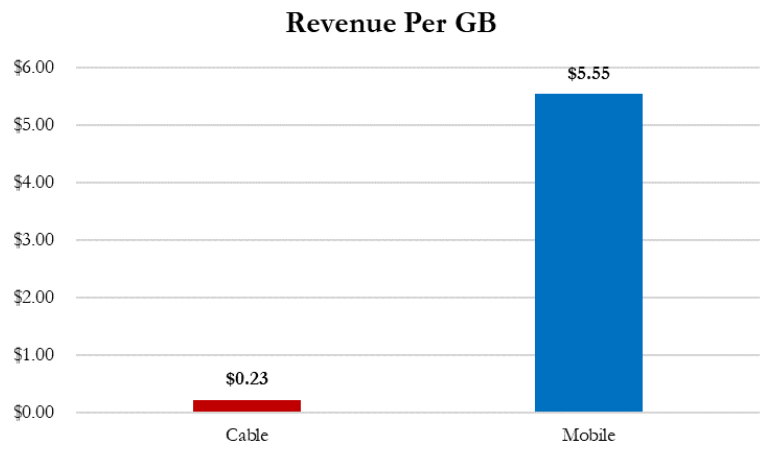
Risks

- FCC return to Title II (net neutrality): will take time and is only headline risk; no real appetite to regulate wireline pricing
- FCC Rural Digital Opportunity Fund plus cheaper fiber may stimulate overbuilding
- Controlling shareholder; however, we think he is a net benefit and prefer him to say, Brian Roberts

Why 5G to the Home Will Not Replace Broadband

- The price of broadband is similar to the price of a singular mobile plan, but homes use ~50x+ the data
- In a capacity constrained network, 50 phones is far more valuable than 1 home

US broadband homes (MM)	105
Data consumption/home (GB)	500
Total monthly consumption (MM GB)	52,500
US smartphone subscribers	283
Data consumption/phone	8
Total monthly consumption	2,264
Broadband usage multiple	**23.2x**



Conclusion

Summary

1. **Cord Cutting Is Good for Cable Cash Flow**
   - De-bundling removes the drag of video distribution
   - Broadband-only customers pay more
   - Broadband is less capital intensive
   - Margin expansion + capex reduction = cash flow generation
2. **New Businesses Reduce Churn**
3. **Long-Duration Real Asset**
   - Overbuilders are currently selling for a premium in private markets
   - Broadband is perhaps the most essential form of infrastructure in a digital economy
   - Attractively priced asset by the IRR and cash flow yield standards of private capital infrastructure investors
   - Significant equity price leverage to multiple expansion; two turns in expansion would result in ~70% upside due to wise capital structure
   - Limited downside in excellent utility-like company; low multiple in an otherwise crazy market environment
4. **Hedge Exogenous Risks and Multiple Differential by Shorting CABO**

Appendix: Churn Assumptions

Breakdown of Churn Impact

Est. Baseline Broadband Churn	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
Homes Passed (mm)	9.10	9.19	9.28	9.38	9.47	9.56
ATUS Internet Homes	4.36	4.49	4.63	4.77	4.91	5.06
Mobile						
Mobile penetration (% of homes)	5.0%	8.0%	10.5%	12.5%	14.0%	15.0%
Homes w/ ATUS Mobile (mm)	0.218	0.360	0.486	0.596	0.687	0.759
Churn for mobile customers	5.0%	5.0%	7.5%	7.5%	10.0%	10.0%
Customers retained: Mobile (mm)	**0.044**	**0.072**	**0.085**	**0.104**	**0.103**	**0.114**
Altice One						
New Internet Sign-ups	1.09	1.12	1.16	1.19	1.23	1.26
A1 New Sign-up Penetration (%)	95.0%	96.0%	97.0%	98.0%	99.0%	100.0%
A1 New Sign-up Penetration (mm)	1.04	1.08	1.12	1.17	1.22	1.26
Non-Churned Homes	3.27	3.37	3.47	3.58	3.68	3.79
A1 Core Penetration (%)	30.0%	31.5%	33.0%	34.5%	36.0%	37.5%
A1 Core Penetration (mm)	0.98	1.06	1.15	1.23	1.33	1.42
Homes w/ Altice One (mm)	2.02	2.14	2.27	2.40	2.54	2.69
Churn for A1 Subs	22.5%	22.5%	22.5%	22.5%	22.5%	22.5%
Customers retained: A1 (mm)	**0.050**	**0.054**	**0.057**	**0.060**	**0.064**	**0.067**
Impact						
Customers retained: Total (mm)	**0.094**	**0.125**	**0.142**	**0.164**	**0.167**	**0.181**
Monthly ARPU (Assuming BB only)	$ 70.00	$ 72.80	$ 75.71	$ 78.74	$ 81.89	$ 85.17
EBIT margin (for incr. BB customer)	80%	80%	80%	80%	80%	80%
Annual EBIT increase (mm)	**$ 63.22**	**$ 87.64**	**$103.03**	**$124.22**	**$ 131.01**	**$147.97**

Appendix: DCF Assumptions

Implied Share Price

		WACC				
		5.68%	6.18%	6.68%	7.18%	7.68%
Terminal Growth	3.00%	$ 116.59	$ 89.91	$ 70.67	$ 56.18	$ 44.91
	2.75%	$ 105.61	$ 82.44	$ 65.34	$ 52.24	$ 41.93
	2.50%	$ 96.35	$ 75.98	$ 60.64	$ 48.73	$ 39.23
	2.25%	$ 88.44	$ 70.34	$ 56.48	$ 45.57	$ 36.77
	2.00%	$ 81.60	$ 65.37	$ 52.76	$ 42.71	$ 34.54

Implied Upside

		WACC				
		5.68%	6.18%	6.68%	7.18%	7.68%
Terminal Growth	3.00%	239.4%	161.7%	105.7%	63.5%	30.8%
	2.75%	207.4%	140.0%	90.2%	52.1%	22.1%
	2.50%	180.5%	121.2%	76.5%	41.9%	14.2%
	2.25%	157.5%	104.8%	64.4%	32.7%	7.1%
	2.00%	137.6%	90.3%	53.6%	24.3%	0.5%