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American Tower Corp AMT |

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Analyst Research Analyst Report Archive Top Rated Stocks in Sector

Acquisitions have diluted American Tower's position, but it's still a very strong player.



by
[Michael Hodel](#)
Strategist

Authors can be reached at [Analyst Feedback](#)

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Analyst Note 10/27/2016

American Tower remains largely on track to hit our full-year expectations. The firm posted 22% revenue growth in the third quarter on continued solid expansion in revenue per tower, a strengthening Brazilian real, and the Viom acquisition. American Tower also announced that it is placing its German towers into a 51%-owned joint venture with Dutch pension fund manager PGGM. The JV moves the firm's only European assets, which generate 1% of leasing revenue, into a structure that it hopes will foster additional asset purchases in Europe while raising about EUR 250 million in cash. We don't expect to change our \$105 fair value estimate or our narrow moat rating. We believe American Tower shares are overvalued, and we would prefer an investment in Crown Castle at current prices.

U.S. leasing revenue increased 3.6% year over year, roughly the same as the prior quarter. Recurring cash revenue, which excludes noncash straight-line revenue and decommissioning payments, increased 6.0%, with amendments to existing leases and contractual escalators driving most of this growth. The U.S. operating margin, excluding the benefit of noncash and nonrecurring revenue, expanded less than 1 percentage point to 73%, as an increase in overhead costs offset much of the benefit of leverage against direct site costs.

Outside the U.S., leasing revenue increased 63% primarily because of the Viom acquisition in India. However, the Brazilian business also turned in its best quarter in two years despite a slowdown in acquisition activity in the country. Dollar-denominated revenue in Brazil was up about 34% on strong growth in revenue per

Morningstar's

Analyst

Price 11-17-2016
106.32 USD

Consider Buy
73.5 USD

Stewardship Rating
Standard

Bulls Say

- The tower business strong recurring cash direct exposure to add new cell sites
- The REIT structure compromising its represents roughly
- The firm now has international market boosts its growth

Bears Say

- Despite diversification generate 60% of / disruption in spend resulting from the seriously hamper
- The firm's exposure exchange risk, exposure uncertainty.

tower and the strength of the real. Growth in Mexico, American Tower's third-largest international market, is also picking up in local terms, but the weak peso limited dollar-denominated revenue growth to 1%. With data demand in Mexico exploding amid a carrier price war, demand for tower space should remain robust.

- Net leverage stands a leaves the firm expos demand, perhaps res cells.

Investment Thesis 03/14/2016

The wireless tower industry provides access to fantastic cash flow. Long-term contracts and, more critically, high switching costs provide a solid base of future business. At the same time, we don't believe wireless carriers can escape the need to build denser cell site grids to add data capacity. Of the three publicly traded tower companies, American Tower has historically produced the strongest returns on capital, making it our favorite of the group. However, recent acquisitions, including the Verizon deal, have pushed returns lower. While we would happily own American Tower, we wouldn't pay up for the privilege relative to its two rivals.

American Tower earns the vast majority of its revenue by leasing out space on communications towers it owns or otherwise controls. Contracts with wireless carriers typically run 10 years or longer and include annual rent escalators. The majority of these wireless towers were acquired in chunks, primarily from the carriers themselves. Tower firms can manage towers more efficiently than the carriers, as independent ownership allows multiple carriers to locate on each structure without competitive concern. The tower companies also possess deep tower-management expertise that can be effectively leveraged across a far larger number of sites than a carrier could accomplish on its own.

American Tower has spent much of the past decade pursuing acquisitions outside the United States, and it is now the most geographically diversified of the three tower companies. This diversity mitigates the primary risk facing the tower companies: that a major carrier customer is acquired and no longer needs tower space. International markets also typically present stronger growth potential, as networks are less mature than in the U.S. Many of the markets that American Tower has entered present significant risks, however, including economic instability and currency exposure. On balance, we believe international exposure is a positive for American Tower, though revenue and cash flow will likely prove more volatile than at its peers.

Economic Moat 03/14/2016

American Tower's narrow moat is based on the attractive locations of its towers, which we reflect as an efficient scale advantage, and the high switching costs its customers would face in moving equipment en masse from one tower vendor to others. These advantages are typically codified in long-term contracts with customers (typically 10 years or longer) that call for 2%-4% annual rent escalators. At the end of 2015, about 60% of our site leasing revenue forecast for 2016-20 was already under contract. The tower business model enables the

Competitors AMT

Name
American Tower Corp
AT&T Inc
Verizon Communicator Inc
China Mobile Ltd ADR
China Mobile Ltd
NTT DOCOMO Inc ADR

wireless telecom industry to operate more efficiently as multiple carriers co-locate on the same physical structure rather than build single-use tower sites. Carriers looking to expand or improve coverage are likely to first look for adequate existing structures in a particular area before investing the time and money needed to permit, build, and equip a new tower. Adding a tenant to an existing tower produces very high-margin incremental revenue with no or modest up-front capital needed.

Equipment is rarely removed from a tower once placed into service. Moving equipment to another tower is an expensive endeavor and risks service disruption or changes in coverage that could anger customers. Thus, decisions to remove equipment are heavily deliberated and typically only made in conjunction with major network overhauls. Churn typically totals 1%-2% of rental revenue annually, with carrier acquisitions accounting for a large portion of lost business. Conversely, carriers frequently seek to add additional equipment to existing sites to upgrade technologies or add antennas to utilize additional spectrum bands. With the expansion of LTE networks in recent years, this amendment activity has driven strong revenue growth.

Land ownership represents a key risk to American Tower's competitive position. Historically, towers have been built on third-party sites, with ground rent representing the largest operating expense for the tower owner. American Tower has spent more than \$600 million over the past decade in an attempt to better control the land beneath its towers. Today, the firm owns or otherwise controls the land under about one fourth of its U.S. towers (30% before the Verizon transaction). Where land can't be purchased, American Tower has worked to extend ground leases far into the future. In the U.S., the average lease term now extends 22 years, and new leases typically carry a 30-year term. Only about 10% of U.S. ground leases expire over the next five years, and 90% of tower sites are owned by single-site landlords. Outside the U.S., however, the vast majority of towers reside on leased land.

Heavy customer concentration and the risk of technological change also limit our moat rating on American Tower. Even with the firm's efforts to diversify internationally, the four nationwide U.S. carriers still account for nearly 60% of site leasing revenue, with AT&T and Verizon accounting for 19% and 17%, respectively. We estimate that payments to the three publicly traded tower companies now represent about a fifth of Verizon's total recurring cost of serving wireless customers, making tower rent a very important expense to manage.

Also, new network architectures like small cells and distributed antenna systems may reduce demand for traditional tower sites in the future. American Tower has limited exposure to the small cell and DAS markets. With the move to deploy small cells, individual traditional sites may decline in importance. This dynamic could enable the carriers to more easily play tower vendors off of each other, threatening to withhold new business or selectively move equipment to other towers to negotiate better rates over time.

Valuation 03/14/2016

Our \$105 fair value estimate equals about 21 times trailing adjusted funds from operations per share, versus an average trading level of about 22 times over the past three years. We expect cash revenue per domestic tower will increase by a bit more than 5% annually beyond 2016, with growth this year suffering as American Tower continues to absorb the Verizon deal and carrier activity remains on the soft side. Annual contract escalators, contract amendments, and co-location activity should drive this result. Modest portfolio expansion should also add slightly to overall domestic revenue growth. We expect the Verizon deal will continue to pressure the domestic tower gross margin in 2016, resulting from the lower tenancy, and thus lower gross margins, on the Verizon portfolio. As the tenants are added to Verizon towers (and legacy towers to a lesser degree), the gross margin should improve, though we don't expect a return to the level seen in 2014 over the next few years. We forecast greater than 40% international leasing revenue growth in 2016, with stabilizing currencies allowing the benefit of acquisitions made in 2015 and the planned Viom deal to have a greater impact on results. Viom contributes about three fourths of our growth estimate for the year. Over the longer term, we expect international growth will settle between 7% and 8% annually, assuming stable currency rates. International gross margins will likely suffer as a result of the Viom transaction, but recently acquired assets should provide ample opportunity to improve profitability over time. Our model assumes that American Tower slows the pace at which it has been building new towers, allowing capital spending to decline sharply over the next few years. Free cash flow increases sharply as a result.

Risk 03/14/2016

American Tower faces the same risks as its tower rivals, with major carrier consolidation the biggest threat on the horizon. Recent mergers in the U.S. have involved relatively small carriers such as MetroPCS and Leap, limiting the impact on the demand for tower space overall. A more significant deal, like a Sprint merger with T-Mobile, would probably have far deeper implications for tower demand, while also concentrating negotiating power in the hands of fewer customers. American Tower's geographic diversity (about a third of revenue is earned outside the U.S.) would mitigate the impact of consolidation in any one market. However, Brazil and India, two of the largest markets the firm serves, are ripe for consolidation.

Changes in consumer demand for wireless services and next-generation technology deployments could also affect demand for wireless data services and thus space on wireless towers. For example, small cells, including Wi-Fi networks, could significantly alter the wireless network landscape, reducing demand for traditional tower sites. A relatively large debt load leaves American Tower exposed to unforeseen shifts in tower demand.

Land is by far the most critical input in the tower business model. American Tower owns the land under less than one fourth of its tower sites. Unfavorable negotiations with landlords could sharply cut into margins or force the firm to take a tower down. However, ground leases typically run for 20 years or more: American Tower's average remaining lease term is 22 years in the U.S.

Rising interest rates could also present a problem for American Tower. While its debt maturity schedule is well spaced over the next decade, refinancing at higher rates would probably pressure cash flow growth. Higher interest rates could also cause investors to demand a higher yield for holding American Tower shares, pushing its stock price lower.

Management 03/14/2016

We rate American Tower's stewardship of shareholder capital as Standard. James Taiclet was appointed CEO in October 2003 and chairman in February 2004 after joining the company in 2001 as COO. American Tower's other senior executives also have fairly long tenures with the firm; the most recent addition to the ranks was CFO Tom Bartlett, who joined the firm in 2009. Eight of the firm's 10 directors were appointed between 2003 and 2007, with experience particularly concentrated in the telecom industry. The two recent additions--the CEO of a retail REIT and a former official in the State Department--broaden the board's expertise. One board member does cause some concern: Carolyn Katz also serves on the NII Holdings board. American Tower has acquired tower portfolios in Brazil and Mexico from NII over the past couple of years. We also think separating the chairman and CEO duties would enhance corporate stewardship, though the firm has appointed a lead independent director.

Overall, we believe American Tower has been a reasonably good steward of shareholder capital, with the majority of cash flow directed to acquisitions over the past decade. Acquisitions have diluted returns on invested capital, but we estimate American Tower will continue to perform at least as well as its peers over the next few years on this measure. Only the recent Verizon transaction seems to have come at a particularly rich price. In addition, aggressive acquisitions have enabled the firm to take advantage of low borrowing costs. Share repurchases represent the second largest use of cash over the past decade, though most of this activity occurred before the financial crisis. The dividend, which management hopes to increase 20% annually, should consume a growing share of future cash flow.

Overview

Profile:

American Tower is the largest independent owner of wireless communication sites. The company operates more than 100,000 tower sites, including more than 40,000 in the United States, 15,000 in India, 18,000 in Brazil, and 9,000 in Mexico. Other

operations are located in Germany and throughout Latin America and Africa. American Tower's portfolio will continue to grow with the planned acquisition of a stake in Viom Networks, which owns 42,000 sites in India. Major customers include wireless carriers such as AT&T, Sprint, Verizon, and T-Mobile US.

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