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A Zebra Can't Change its Stripes: AMT's Latest Purchase from NIHD

AMT recently announced that it had agreed to acquire a total of 4,456 towers from NII Holdings, Inc. (NASDAQ: NIHD) for approximately $811 million, which is a blended average price of $182,000 per tower. This valuation is in the range of 15x to 21x EBITDA, even the low end of which is a worryingly high multiple for any tower portfolio – particularly one as risky as this one. Including required capex, that multiple increases about one turn (i.e. 16x to 22x). We discussed the possibility of this transaction happening in our initial report, and raised red flags about certain aspects of it.[1,2] This transaction appears to be yet another low quality, growth at any price transaction AMT management is making merely because it can (and is compensated to do). On a not unrelated note, last week, CEO James Taiclet pocketed approximately $4 million in profits from exercising options for 100,000 shares and immediately selling all of the stock.

Our analysis of the most recent NIHD transaction follows.

- The valuation of this transaction is in the range of 15x to 21x EBITDA, which is very frothy. AMT disclosed that it expects gross margin from the transaction of $55 million. AMT reports gross profit prior to expensing depreciation, so we assume the $55 million is also prior to expensing depreciation. We estimate that SG&A for this portfolio under AMT should be $17 million. AMT's direct SG&A in its international markets generally runs 15% of revenue net of pass through. We estimate that pass through revenue is 25% of gross revenue in Mexico and Brazil, making our estimate of revenue, net of pass through, $112 million.[3] If our estimates are correct, then the multiple AMT is paying is 21x EBITDA.

- This transaction is risky for AMT from both counterparty bankruptcy risk and consolidation risk perspectives. Our industry sources had previously opined that due to these risks, there was limited interest in this portfolio at this multiple, aside from AMT's interest. Therefore it is likely that the above market rents AMT will collect from NIHD do not compensate for these risks.

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[1] July 17, 2013 report, pp. 16-17.
[2] We continue to be concerned by AMT and NIHD sharing an audit committee chair, particularly given the discrepancies in reported values of previous transactions between the two companies, which AMT has not yet explained. We suggest investors ask AMT management to address these discrepancies – particularly given the approximate $250 million discrepancy we identified in the reported Site Sharing purchase consideration in Brazil.
[3] For FY2012, pass though costs as a percentage of operating revenue was 19% and 27% in Brazil and Mexico, respectively. For the LTM period, we estimate that the average was approximately 25%.

NIHD (Moody's: B3, six notches below investment grade) presents counterparty risks because it is possible the company could enter bankruptcy for a second time, which could lead to restructuring or abrogation of the contracts. AMT disclosed that NII International Telecom S.C.A., a Luxembourg subsidiary of NIHD, is providing "certain credit support with respect to the obligations of Nextel Brazil". The Luxembourg subsidiary issued $900 million of senior notes in early 2013 that are due in 2019. It is likely that the credit support is subordinate to the notes. AMT should release additional details regarding this credit support.

Another feasible (and more likely) outcome is that NIHD will need to sell itself in order to avert failure. The likely buyer in that scenario would be an existing significant customer of AMT (e.g., American Movil, Telefonica). Such a buyer would have leverage to negotiate the rents closer to market. (As we explained in our initial report, carriers have largely retained leverage over tower operators in international markets.) Further, there would almost certainly be network overlap and tower decommissioning. Thus, there is an appreciable risk that the leaseback economics will fall short of management's stated expectations.

- The transaction appears to be another de facto lending transaction, making AMT management's pronouncements about growth potential misleading because additional tenants will not move the needle much. It appears that the monthly leaseback rate, net of pass through expenses, will be approximately $1,900 per month.[4] The market rents in Mexico and Brazil are roughly $1,000 per month. Thus:
    - The aforementioned counterparty risks are heightened because AMT appears to be paying above the market and standalone economic values of the towers. The market values of these roughly single tenant towers would likely be under $150,000 per tower – particularly with the need to spend approximately $11,000 per tower on capex (infra). We reiterate our call for AMT management to offer more details on how it structures these de facto lending transactions.
    - Additional tenants, which will be paying approximately $1,000 per tower per month, will not cause the towers to generate growth rates that meet investors' expectations. Therefore, management's statement that this transaction will "drive meaningful revenue and cash flow growth for many years to come" is misleading.
    - There could be rent abatement provisions that would further damage growth prospects. Despite dedicating much of the recent Q2 2013 earnings call to its international business, management entirely evaded the issue of rent abatements. Management should disclose information on its existing rent abatement provisions with tenants, and whether there are

[4] This assumes that the tenancy ratio is 1.1 tenants / tower, and pass through expenses represent 25% of the $149 million of expected revenue. If the tenancy ratio were lower, then NIHD's monthly rent per tower would be higher.

similar provisions in the NIHD transaction – either with NIHD or with existing third party tenants. Note that the previous transactions with NIHD had rent abatement provisions that gave NIHD rent discounts when AMT co-located other tenants on the towers.

  - We believe that under GAAP, AMT should book an intangible asset for above market lease on each de facto lending transaction. AMT should then amortize the intangible asset against most of the above market rent payments, and report revenue net of that amortization. A portion of the above market rent payments should be recorded as interest income, and thus not netted out.
  - The leaseback term is 12 years, after which rents will likely reset to market. Market rents will likely continue to be far lower than contract rents, which means that tower revenues will fall significantly in Year 13. Management's statement about "meaningful growth" is again misleading for this reason. (We explained in our initial report why the argument that lease extensions would be at the original rent rates does not hold water.[5]) Management should explain whether its IRR model has factored in the rent reset.

- This purchase from NIHD at a very rich multiple further highlights the absurdity of AMT's accounting for, and disclosures about, its Site Sharing purchase. Management has still failed to provide any substantive rebuttal to our conclusion that its accounting for the transaction is misstated by approximately $250 million. AMT is paying NIHD $148,000 per tower in Brazil, compared to the $879,000 per tower AMT purports to have paid for Site Sharing.

- We reiterate that the historical transactions between AMT and NIHD also have consideration reporting and accounting discrepancies. AMT discloses having paid at least $6 million more for towers than NIHD discloses having received. While $6 million is pocket change compared to $250 million, this much older discrepancy could have signaled the onset of a major internal control problem in AMT's international operations.

- AMT's disclosure on capex requirements is likely misleading. AMT disclosed that the transaction requires approximately $50 million in capex; however, AMT has labeled this as "start-up" capex. Start-up capex benefits management because it is not deducted from AMT's already juiced AFFO calculation. An industry source had previously expressed belief that these towers were generally too small to allow for co-location, and would therefore require redevelopment capex. If this capex is really intended to increase the towers' capacities, then as we argued in our initial report, it should be subtracted from AFFO, and is yet another instance of management misleading investors.

[5] July 17, 2013 report, pp. 26.

We are further concerned that the $50 million might only be a partial number. What assurances will management give investors that it will disclose when and if capex related to this purchase exceeds $50 million? Such a disclosure would of course help investors evaluate the accuracy of management's modeling.