

Zayo Group Holdings (ZAYO)

\$34.75 (As of 01/31/20)

Price Target (6-12 Months): **\$37.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 02/11/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: D

Growth: C

Momentum: F

Summary

Zayo is well positioned to benefit from a diversified blue-chip customer base and improving trends like increased bookings and stable churn, which are likely to drive net installs and organic growth. It focuses on strategic investments like e-rate deals, mobile infrastructure and long-haul fiber while continuing to augment its fiber footprint and forging partnerships with local providers. Its extensive wavelength network provides bandwidth to major data centers, carrier hotels and enterprise locations across its long-haul and metro networks. However, owing to its significant presence in international markets, Zayo is exposed to foreign currency translation and exchange-rate fluctuation risks. Perpetual inorganic expansion adds to integration risks. Rising cost of goods sold and escalating expenses dent its profitability and margins.

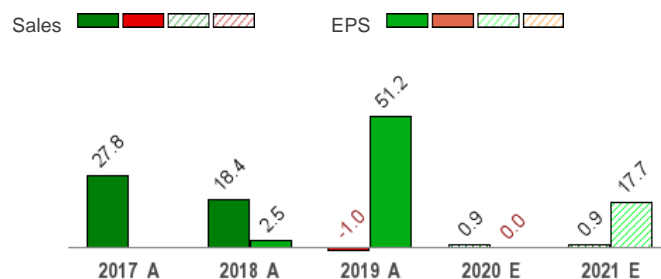
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$34.88 - \$24.20
20 Day Average Volume (sh)	2,751,345
Market Cap	\$8.2 B
YTD Price Change	0.3%
Beta	0.73
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Communication - Infrastructure
Zacks Industry Rank	Bottom 27% (186 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-55.6%
Last Sales Surprise	-1.3%
EPS F1 Est- 4 week change	6.3%
Expected Report Date	02/04/2020
Earnings ESP	0.0%
P/E TTM	56.1
P/E F1	56.1
PEG F1	11.2
P/S TTM	3.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					2,623 E
2020	639 A	648 E	652 E	655 E	2,600 E
2019	641 A	639 A	647 A	651 A	2,578 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.19 E	\$0.15 E	\$0.17 E	\$0.17 E	\$0.73 E
2020	\$0.08 A	\$0.18 E	\$0.20 E	\$0.19 E	\$0.62 E
2019	\$0.09 A	\$0.13 A	\$0.15 A	\$0.26 A	\$0.62 A

*Quarterly figures may not add up to annual.

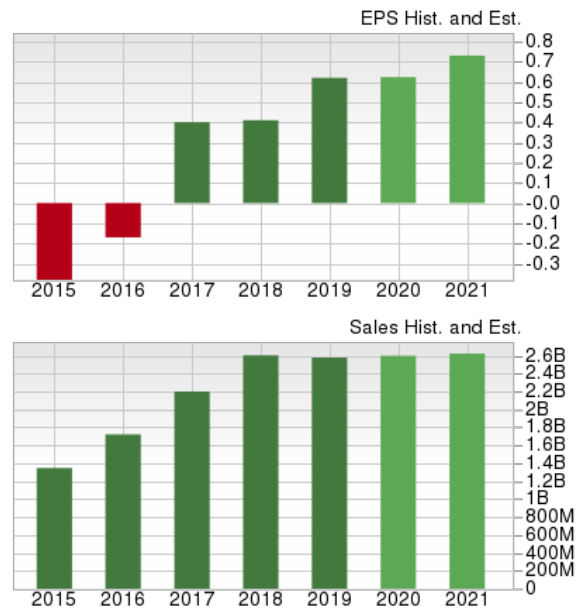
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/31/2020. The reports text is as of 02/03/2020.

Overview

Headquartered in Boulder, CO, Zayo Group Holdings, Inc. is a provider of bandwidth infrastructure solutions for the communications industry in the United States, Canada and Europe. It provides a wide range of communications infrastructure services, including fiber and bandwidth connectivity, colocation and cloud infrastructure to leading businesses throughout the world. The company's products include leased dark fiber, wavelength connections, Ethernet, Internet Protocol (IP) connectivity and cloud services. Its products and services support high-bandwidth applications like cloud-based computing, video, mobile and machine-to-machine connectivity.

Zayo has announced plans to separate into two publicly traded companies to better focus on its businesses. One of the two entities will focus on providing core communications infrastructure while the other will leverage infrastructure to provide solutions for a broad set of enterprise customers. The company expects the process to be complete in late 2019, with each Zayo shareholder owning shares of both the entities.

Dubbed InfraCo, the infrastructure-based firm will have a broad geographic reach throughout North America and Western Europe and will include the current Fiber Solutions and zColo business segments along with the Wavelength and IP Transit businesses of Zayo's current Transport segment. The other division named EnterpriseCo will be centered on higher bandwidth connectivity to enterprise locations, including to public cloud and SaaS providers, and will comprise the current Enterprise Networks and Allstream segments, along with the SONET and Ethernet businesses of Zayo's current Transport segment.



Reasons To Buy:

- ▲ Zayo is poised to benefit from a diversified blue-chip customer base that comprises the largest and most sophisticated users of bandwidth. It aims to grow the network business beyond 5% while controlling expenses to boost OpEx efficiency. The company emphasizes on less than 12-month payback deals while leaning into strategic investments like e-rate deals, mobile infrastructure and long-haul fiber. Such deals leverage its existing assets in conjunction with new builds. These are likely to deliver strong free cash flow yields and attractive returns on invested capital.
- ▲ The company announced plans to split into two public companies — Zayo Infrastructure or InfraCo and EnterpriseCo — to focus better on its operations. One of the businesses will focus on providing core communications infrastructure while the other will leverage infrastructure to provide solutions for a broad set of enterprise customers. Also, it has been assessing multiple options to achieve its long-term objectives while enhancing shareholder value. Zayo is very enthusiastic about the prospects of its largest business segment, Fiber Solutions, as it is witnessing a very strong momentum.
- ▲ The company continues enhancing global reach by expanding its fiber footprint and forging partnerships with local providers. It leverages its dense fiber assets in almost all North American and Western European metro markets to deliver a premier metro wavelength offering. Zayo's extensive wavelength network provides bandwidth to major data centers, carrier hotels, cable landing stations and enterprise locations across its long-haul and metro networks. Moreover, it has been experiencing broad-based demand across all the customer verticals, which should drive its top line.

Zayo is well positioned to benefit from a diversified blue-chip customer base and improving trends like increased bookings and stable churn, which are likely to drive net installs and organic growth.

Reasons To Sell:

- ▼ The Zacks Consensus Estimate for Zayo's current fiscal earnings has been revised 8.8% downward over the past 90 days. The company also looks relatively more leveraged than the industry with debt/capital ratio currently pegged at 0.8, much higher than 0.03 recorded by the latter.
- ▼ Rising cost of goods sold has been a major concern for the company over the past few years. Escalating expenses may continue to hurt its margins. Moreover, efforts to build resilient infrastructure facilities to withstand natural catastrophes further increase operating costs. Further, simmering tensions between the United States and China related to trade restrictions imposed on the sale of communication equipment to the Chinese firms have dented the credibility of the industry and led to loss of businesses.
- ▼ Zayo's business is exposed to exchange-rate fluctuations and foreign currency translation risks, given its significant presence in international markets. Notably, the company's top line remains highly volatile due to continued strength of the dollar compared with other foreign currencies. In addition, the company's policy of inorganic expansion adds to the integration risks. Moreover, the success of 5G technology hinges on substantial investments to upgrade infrastructure in the core fiber backhaul network to support anticipated growth in data services. Although these investments will eventually help minimize service delivery costs to adequately support broadband competition, rural coverage and wireless densification, short-term profitability is likely to fall, leading to earnings dilution.

The fiber optic bandwidth infrastructure company's profitability remains vulnerable to rise in cost of goods sold, thereby hurting its gross margin.

Last Earnings Report

Zayo Q1 Earnings & Revenues Miss Estimates, Fall Y/Y

Zayo reported lackluster first-quarter fiscal 2020 results, wherein both the bottom line and the top line missed the respective Zacks Consensus Estimate. Revenues and income declined year over year despite robust infrastructure capacity demand for webscale, content and cloud providers.

Net Income

Net income for the September quarter was \$17.9 million or 8 cents per share compared with \$22.1 million or 9 cents per share a year ago. The year-over-year decline was primarily due to higher operating costs and lower revenues. The bottom line missed the Zacks Consensus Estimate by 10 cents.

Revenues

Quarterly revenues were \$638.6 million, down 0.4% from \$641.1 million year over year. The top line lagged the consensus estimate of \$647 million. While revenues from Zayo Networks segment totaled \$483.2 million, the same from Allstream totaled \$86.6 million. Revenues from zColo were \$63.7 million.

Other Quarterly Details

Operating income improved to \$128.9 million from \$122.8 million in the prior-year quarter, primarily due to lower operating expenses. Adjusted EBITDA was \$314.8 million compared with \$319.4 million in the year-ago quarter with respective margins of 49% and 50%. Adjusted EBITDA from Zayo Networks was \$277.5 million, \$26.6 million from zColo and \$9.3 million from Allstream. Capital expenditures were \$217.1 million.

On a monthly recurring revenue and monthly amortized revenue basis, consolidated net installs were \$0.9 million (excluding Allstream segment), which includes \$1.1 million of net installs from the Zayo Networks segment and (\$0.2) million from the zColo segment.

Update on Merger

With respect to its previously announced pending merger with affiliates of Digital Colony Partners and EQT Infrastructure IV fund, the company continues to make progress on all necessary approvals, and the transaction is expected to close in the first half of 2020. The closing is subject to customary conditions, including certain regulatory approvals.

Cash Flow & Liquidity

During the first fiscal quarter, Zayo generated \$311.8 million of net cash from operating activities compared with \$241.8 million in the year-ago quarter. Adjusted unlevered free cash flow was \$138.8 million, up from \$130.4 million.

As of Sep 30, 2019, the fiber optic bandwidth infrastructure company had \$254.6 million in cash and equivalents compared with \$353.9 million a year ago, and \$5,696.1 million of long-term debt.

Quarter Ending **09/2019**

Report Date	Nov 06, 2019
Sales Surprise	-1.31%
EPS Surprise	-55.56%
Quarterly EPS	0.08
Annual EPS (TTM)	0.62

Recent News

On Jan 13, 2020, Zayo announced that it has augmented Internet connectivity of Denver Public Schools ("DPS") by developing an extensive network of high-capacity fiber across the district. Spanning more than 600 route miles, the dark fiber network will connect 132 schools in the region with a highly reliable and cost-effective bandwidth solution. The network is expected to improve the bandwidth of each school location by approximately 500%, equipping the educational institutions with digital resources such as electronic textbooks, online standardized testing, streaming media and cloud-based applications.

On Dec 30, 2019, Zayo announced that it has augmented the network connectivity between Montreal, Quebec and Albany, New York with the expansion of its fiber network infrastructure in the region. The network expansion will add about 100G capable new wavelength route miles to connect the largest city in Quebec, Canada with one of the busiest cities in the United States. The shorter and more direct route between the cities of two neighboring countries is likely to be operational by January 2020. The move will enable the company to provide high-quality connectivity to support the seamless transition of enterprise and mobile carrier customers to 5G technology.

On Nov 19, 2019, Zayo announced that it has been chosen by Mid-Atlantic Crossroads (MAX) to provide data center colocation in zColo's Ashburn facility. MAX is a center at the University of Maryland that manages a multi-state advanced cyberinfrastructure platform. The company will offer fiber connectivity to support MAX's network services to its academic, government and business communities. Financial terms of the deal remained undisclosed.

Valuation

Zayo shares are up 27.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer and Technology sector are up 0.4% and 23.9% over the past year, respectively.

The S&P 500 index is up 17.4% in the past year.

The stock is currently trading at 13.82X trailing 12-month EV/EBITDA, which compares to 11.18X for the Zacks sub-industry, 12.68X for the Zacks sector and 12.25X for the S&P 500 index.

Over the past three years, the stock has traded as high as 18.3X and as low as 9.7X, with a 3-year median of 13.8X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$37 price target reflects 6.17X trailing 12-month book value.

The table below shows summary valuation data for ZAYO

Valuation Multiples - ZAYO					
		Stock	Sub-Industry	Sector	S&P 500
EV/EBITDA TTM	Current	13.82	11.18	12.68	12.25
	3-Year High	18.33	12.32	12.68	12.86
	3-Year Low	9.74	8.21	9.1	9.32
	3-Year Median	13.8	11.46	11.25	11.16
P/B TTM	Current	6	3.96	5.44	4.41
	3-Year High	6.52	5.38	5.63	4.55
	3-Year Low	3.24	2.39	3.56	3.36
	3-Year Median	5.89	4.15	4.52	3.9
P/S F12M	Current	3.15	0.95	3.59	3.43
	3-Year High	3.86	2.07	3.59	3.43
	3-Year Low	1.85	0.86	2.62	2.76
	3-Year Median	3.11	1.8	3.17	3.15

As of 01/31/2020

Industry Analysis Zacks Industry Rank: Bottom 27% (186 out of 255)



Top Peers

Acacia Communications, Inc. (ACIA)	Neutral
ADTRAN, Inc. (ADTN)	Neutral
Arista Networks, Inc. (ANET)	Neutral
Ciena Corporation (CIEN)	Neutral
EXFO Inc (EXFO)	Neutral
Harmonic Inc. (HLIT)	Neutral
Juniper Networks, Inc. (JNPR)	Neutral
CommScope Holding Company, Inc. (COMM)	Underperform

Industry Comparison Industry: Communication - Infrastructure				Industry Peers		
	ZAYO Neutral	X Industry	S&P 500	ADTN Neutral	COMM Underperform	JNPR Neutral
VGM Score	D	-	-	D	A	D
Market Cap	8.23 B	470.55 M	23.55 B	432.83 M	2.37 B	7.68 B
# of Analysts	3	2	13	2	6	9
Dividend Yield	0.00%	0.00%	1.81%	3.98%	0.00%	3.31%
Value Score	D	-	-	C	A	B
Cash/Price	0.03	0.10	0.04	0.26	0.22	0.27
EV/EBITDA	14.30	7.50	13.97	-18.10	15.40	9.58
PEG Ratio	11.24	9.14	1.97	10.65	0.46	1.94
Price/Book (P/B)	5.99	1.95	3.21	1.10	1.95	1.67
Price/Cash Flow (P/CF)	12.97	9.21	13.36	NA	3.04	12.14
P/E (F1)	56.18	49.52	18.42	53.24	5.55	13.09
Price/Sales (P/S)	3.20	0.75	2.60	0.78	0.33	1.73
Earnings Yield	1.78%	1.88%	5.43%	1.88%	17.97%	7.63%
Debt/Equity	4.56	0.03	0.72	0.00	8.34	0.37
Cash Flow (\$/share)	2.68	-0.14	6.92	-0.14	4.00	1.89
Growth Score	C	-	-	D	C	F
Hist. EPS Growth (3-5 yrs)	60.85%	0.99%	10.68%	-10.22%	0.99%	2.86%
Proj. EPS Growth (F1/F0)	0.54%	27.49%	7.59%	183.33%	7.92%	1.87%
Curr. Cash Flow Growth	-16.96%	-8.98%	10.81%	-111.13%	-0.93%	-8.77%
Hist. Cash Flow Growth (3-5 yrs)	44.27%	4.38%	8.78%	NA	8.68%	1.14%
Current Ratio	0.61	1.86	1.22	2.73	1.86	2.08
Debt/Capital	82.03%	3.18%	42.99%	0.00%	90.16%	26.75%
Net Margin	5.66%	-4.34%	11.69%	-8.79%	-7.26%	7.76%
Return on Equity	11.34%	-3.15%	17.33%	-0.57%	27.25%	9.16%
Sales/Assets	0.27	0.86	0.55	0.89	0.59	0.50
Proj. Sales Growth (F1/F0)	0.84%	4.00%	4.12%	-6.79%	11.54%	1.21%
Momentum Score	F	-	-	B	A	F
Daily Price Chg	-0.03%	-0.76%	-1.98%	-3.83%	0.04%	0.09%
1 Week Price Chg	0.03%	0.03%	-1.09%	-3.98%	-4.19%	-0.49%
4 Week Price Chg	0.17%	0.17%	-2.11%	-9.59%	-13.34%	-7.16%
12 Week Price Chg	1.40%	7.14%	2.15%	-4.03%	-18.44%	-10.91%
52 Week Price Chg	26.59%	-23.84%	14.15%	-37.93%	-41.73%	-11.56%
20 Day Average Volume	2,751,345	183,123	1,808,632	183,123	3,008,562	3,280,808
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-2.82%
(F1) EPS Est 4 week change	6.28%	0.00%	0.00%	0.00%	-0.40%	-2.82%
(F1) EPS Est 12 week change	-10.95%	-12.94%	-0.09%	-21.74%	-14.92%	-4.64%
(Q1) EPS Est Mthly Chg	0.85%	0.00%	0.00%	0.00%	0.00%	-19.41%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	C
Momentum Score	F
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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