CyrusOne (CONE)

Updated July 30th, 2020 by Nikos Sismanis

Key Metrics

Current Price:	$81	**5 Year CAGR Estimate:**	7.4%	**Market Cap:**	$9.33B
Fair Value Price:	$65	**5 Year Growth Estimate:**	10.0%	**Ex-Dividend Date:**	09/24/20
% Fair Value:	125%	**5 Year Valuation Multiple Estimate:**	-4.3%	**Dividend Payment Date:**	10/09/20
Dividend Yield:	2.5%	**5 Year Price Target**	$105	**Years Of Dividend Growth:**	7
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	2%

Overview & Current Events

CyrusOne provides mission-critical data center facilities that protect and ensure the continued operation of firms and their IT departments. The company's strategy is focused on attracting customers that have not historically outsourced their data center needs. CyrusOne has approximately 1000 customers, including 200 of the Fortune 1000 companies. CyrusOne operates in the United States, Europe, and Asia. Its data centers provide customers the flexibility and scale to match their specific growth needs ideally. It has a market cap of $9.33 billion and generates annual revenues of nearly $1 billion. Boosted by the high demand for data and server storage, CyrusOne is currently the fastest-growing data center REIT in the U.S.

On July 29th, 2020, the company announced Q2 2020 earnings for the period ending June 30th, 2020. For the quarter, revenues and normalized FFO grew to $256.4 million, and $118.9 million, an increase of 2%, and 16%, respectively. FFO/share rose to $1.03, 14% higher than the year before. The mismatch in growth with the normalized FFO is due to additional share issuance. Overall, growth is set to continue, as the company reported a record quarter-end backlog of $97 Million in annualized GAAP. The lower sales growth rate of 2% was the result of less equipment sales, as well as the churn percentage rising from 0.6% to 1.1% YoY. However, it is only a temporary headwind as management reaffirmed its robust guidance for 2020, of FFO/share at $3.75-3.90, and total revenues at $1.010B-1.045B.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
FFO/share	---	---	---	$1.22	$1.73	$2.17	$2.66	$3.12	$3.31	$3.63	**$3.82**	**$6.15**
DPS	---	---	---	$0.64	$0.84	$1.26	$1.52	$1.68	$1.84	$1.92	**$2.00**	**$2.55**
Shares[1]	---	---	---	20.9	29.2	54.3	78.3	88.9	99.8	112.1	**115.7**	**200.0**

For REITs like CyrusOne, FFO is a better measurement of profitability and cash flow than the traditional earnings-per-share metric used to value most stocks. REITs often have high rates of depreciation, and therefore EPS is not an adequate measurement of performance. Since its IPO in 2013, the company has been able to expand its FFO consistently every single year rapidly. Over the past five years, FFO/share has seen a CAGR of 12%.

DPS has also been increasing annually at a swift CAGR of 20.1%, since the REIT's IPO. The company just announced another DPS increase of only 2%, sending next year's DPS to $2.04. Considering the company's impressive FFO/share growth and reiterating guidance, we believe this is a one-off DPS deceleration to reserve liquidity. However, we have lowered our medium-term DPS CAGR estimate from 7% to 5% to reflect a more prudent dividend policy.

Since REITs are required by law to distribute the majority of their underlying earnings, they tend to finance future growth through debt and equity. As a result, shares outstanding are currently five times those of the IPO. While this would signify dilution, it is a common practice for REITs, as the cost of equity is usually lower than the future ROE. Finally, considering the company's cheap cost of debt of just 2.7%, CyrusOne can utilize this pathway instead, should shares are ever undervalued. Therefore, it has significant flexibility.

[1] Share count is in millions.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/FFO	---	---	---	18.23	15.86	14.02	16.91	18.58	17.58	17.9	**21.2**	**17.0**
Avg. Yld.	---	---	---	3.1%	3.9%	4.0%	3.4%	3.2%	3.3%	2.9%	**2.4%**	**2.4%**

Like with the rest of high-growth data center REITs, CyrusOne trades at a premium compared to traditional REITs. The stock is currently trading at an all-time high valuation of 21.2 times its FFO. The reason is the stability of cash flows generated by data centers. Data centers cannot simply shut down. Unlike, say a mall tenant, firms that rent the company's facilities cannot suspend their usage of data centers, especially now, since online traffic is hitting all-time highs. As investors are rushing to capture such secure distributable funds, the dividend yield is currently at an all-time low of 2.47%. We are slightly increasing our medium-term valuation multiple to 17X FFOs, as data centers become increasingly attractive. However, considering the current premium on its valuation, investors who choose to buy into CyrusOne are probably destined to enjoy a lower average annual return than its past performance.

Safety, Quality, Competitive Advantage, & Recession Resiliency

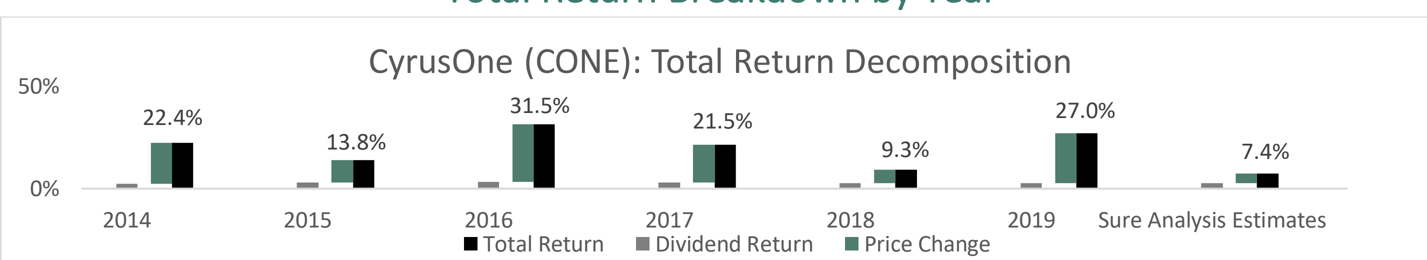
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	---	---	62.5%	73.2%	56.7%	64.7%	55.4%	46.6%	**52.3%**	***41%***

Being a data center REIT, CyrusOne is currently at an advantageous position, benefiting from the secured cash flows generated by its mission-critical tenants. The company is unlikely to experience any rent deferrals, as was the case with the more traditional REITs over the past few months. Moreover, the company is prudent with its distributions, proven by its thoughtful DPS increase despite keep on delivering incredible FFO/share growth during such uncertain times. While the company's balance sheet is strong, with approximately $6.5 billion worth of real estate assets vs. $3.1 billion of long-term debt, its interest coverage ratio should be watched by investors. Currently, interest payments are 1.0x covered by operating profits. While this may seem worrying, coverage should significantly increase as soon as the centers acquired by the latest debt issuance, start producing cash flows themselves. Slim interest coverage is typical for REITs into their investment cycle.

Final Thoughts & Recommendation

CyrusOne offers a compelling investment case. The company operates in probably the most exciting, and coincidentally secure sub-sector of REITs, so its premium valuation is understandable. With attractive characteristics like rapid FFO growth, a low payout ratio, and a quality pool of mission-critical tenants, the stock should continue to perform positively. However, considering management's DPS deceleration and a potential medium-term valuation contraction, we estimate that shares are currently overvalued by approximately 25%. However, investors could still achieve annual returns of around 7.4% over the next few years, fueled by the consistent demand for data centers, durable pricing power, and an all-time high backlog in development, soon to be contributing additional cash flows.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	----	----	----	----	$331	$399	$529	$672	$821	$981
Gross Profit	----	----	----	----	$206	$251	$342	$437	$529	$598
Gross Margin	----	----	----	----	62.4%	62.8%	64.6%	65.0%	64.4%	60.9%
SG&A Exp.	----	----	----	----	$47	$59	$78	$84	$100	$104
D&A Exp.	----	----	----	----	$118	$142	$184	$259	$334	$418
Operating Profit	----	----	----	----	$41	$50	$80	$94	$95	$77
Operating Margin	----	----	----	----	12.4%	12.6%	15.1%	14.0%	11.5%	7.8%
Net Profit	----	----	----	----	-$8	-$15	$20	-$84	$1	$41
Net Margin	----	----	----	----	-2.4%	-3.9%	3.8%	-12.4%	0.1%	4.2%
Free Cash Flow	----	----	----	----	-$173	-$94	$181	$290	$309	$366
Income Tax	----	----	----	----	$1.4	$1.8	$1.8	$3.0	$0.6	-$3.7

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	----	----	----	----	$1,571	$2,196	$2,852	$4,312	$5,593	$6,142
Cash & Equivalents	----	----	----	----	$37	$14	$15	$152	$64	$76
Accounts Receivable	----	----	----	----	$61	$76	$83	$87	$235	$292
Goodwill & Int. Ass.	----	----	----	----	$345	$624	$605	$658	$691	$651
Total Liabilities	----	----	----	----	$854	$1,374	$1,690	$2,598	$3,367	$3,707
Accounts Payable	----	----	----	----	$70	$137	$227	$98	$121	$123
Long-Term Debt	----	----	----	----	$644	$997	$1,240	$2,089	$2,625	$2,887
Shareholder's Equity	----	----	----	----	$461	$822	$1,162	$1,714	$2,226	$2,435
D/E Ratio	----	----	----	----	1.40	1.21	1.07	1.22	1.18	1.19

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	----	----	----	----	-0.6%	-0.8%	0.8%	-2.3%	0.0%	0.7%
Return on Equity	----	----	----	----	-2.0%	-2.4%	2.0%	-5.8%	0.1%	1.8%
ROIC	----	----	----	----	-0.7%	-1.0%	0.9%	-2.7%	0.0%	0.8%
Shares Out.	----	----	----	----	29.2	54.3	79.0	88.9	100.4	112.5
Revenue/Share	----	----	----	----	$11.33	$7.35	$6.70	$7.56	$8.18	$8.72
FCF/Share	----	----	----	----	-$5.93	-$1.74	$2.29	$3.26	$3.08	$3.25

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.