

Communications Analyst Report

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Company Ticker: VG

Sector: Communication Services

Industry: Wireless Telecommunication Services

Vonage P/B: 4.54

Sector P/B: 1.6

Market Price: \$13.52

Estimated Fair Price: \$9.60

Recommendation: SELL

Company Summary:

Vonage Holdings Corp. engages in the provision of communication services through cloud-connected devices such as UCaaS and CPaaS solutions. It operates through the Business and Consumer segments offering office phone systems, marketing automation, call centers, conferencing, mobility, and phone related accessories. Vonage's clients operate in almost every industry across the Americas, Europe, Asia-Pacific, and Middle East.

Industry Outlook:

Cloud based telecommunication services is a market that is expected to grow significantly through 2022 as companies become more reliant on the technology to scale up business operations. Although the Industry took a hit at the beginning of COVID-19, wireless telecommunication services are performing stronger than ever. The biggest threat to this industry is the highly intensive competition as many telecommunication companies are switching to cloud-based technologies.

Earnings Forecast:

(In US Millions)	Annual Projections							
	2017	2018	2019	2020	2021	2022	2023	2024
Net Sales or Revenue	1002.286	1048.782	1189.346	1245.072	1297.366	1429.697	1501.182	1576.241
Cost of Goods Sold incl. Depreciation	482.965	497.738	608.729	630.893	643.820	679.173	649.941	682.438
Depreciation, Depletion and Amortization	72.523	70.980	97.615	87.040	82.040	84.419	87.778	85.319
Gross Income	519.321	551.044	580.617	614.180	653.546	750.524	851.241	893.803
Selling, General and Administrative Expense	454.417	498.896	573.631	614.525	617.852	689.043	725.844	762.612
Other Operating Expenses	0.412	0.237	(0.030)					
Operating Income	64.492	51.911	7.016	(0.345)	35.693	61.481	125.397	131.191
Unusual Expense (Income) – Net	5.101		0.253					
Nonoperating Income (Net) - Total	1.270	(0.318)	(0.050)	1.841	1.841	1.841	1.841	1.841
Interest Expense	14.868	15.068	32.821	34.637	34.637	34.637	34.637	34.637
Pretax Income	45.793	36.525	(26.108)	(33.141)	2.898	28.686	92.602	98.396
Income Taxes	79.726	0.797	(6.626)	(7.393)	0.669	6.626	21.391	22.729
Deferred Income Taxes	74.577	(4.809)	(13.411)					
Consolidated Net Income	(33.933)	35.728	(19.482)	(25.748)	2.228	22.059	71.211	75.667
Net Income	(33.933)	35.728	(19.482)	(25.748)	2.228	22.059	71.211	75.667

Our earnings forecast for Vonage is based on three key drivers based on historic data and analyst reports. Sales growth for years 2021-22 are based on JP Morgan analyst reports and years 2023-24 were based on historical growth. Gross profit margins increase over time as the company finalizes the transition to a focus on its business segment. SG&A is expected to stay relatively consistent and is based on a historical average. These factors allow us to forecast a significant increase in earnings for Vonage through 2024.

Valuation:

Valuation (in US Millions)	2017	2018	2019	2020	2021	2022	2023	2024
Net Income	(33.933)	35.728	(19.482)	(25.748)	2.228	22.059	71.211	75.667
Depreciation & Ammortization	72.523	70.980	97.615	87.040	82.040	84.419	87.778	85.319
NWC	(55.791)	(88.080)	(92.662)	(78.844)	(86.529)	(86.012)	(83.795)	(85.445)
CapEx	33.289	26.746	49.079	36.371	37.399	40.950	38.240	38.863
Debt	232.655	519.228	555.357	435.747	503.444	498.183	479.124	493.584
FCFE	293.747	398.824	69.765	(108.507)	122.251	59.750	99.474	138.232
			PV FCFE	(100.469)	104.810	47.431	73.117	94.079
Growth Rate	3.50%							
Discount Rate	8.00%							
Terminal Value	\$ 2,163,809,333.69							
Sum of Cash Flows	\$ 2,382,777,140.54							
Shares outstanding	248,178,000.00							
Price	\$ 9.60							

A standard long-term growth rate of 3.5% was used, while a discount rate of about 8% was calculated from our sector P/E of 22.1. Net working capital for Vonage is consistently negative through recent years which we believe is due to a liquidity ratio significantly below the industry average. We have assumed this trend will continue through 2024. Capital expenditures and debt were calculated using historical averages.

Sensitivity Analysis:

The following tables show the effects of the discount rate shifting +/- 1.5%:

Valuation (in US Millions)	2017	2018	2019	2020	2021	2022	2023	2024
Net Income	(33.933)	35.728	(19.482)	(25.748)	2.228	22.059	71.211	75.667
Depreciation & Ammortization	72.523	70.980	97.615	87.040	82.040	84.419	87.778	85.319
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FCFE	293.747	398.824	69.765	(108.507)	122.251	59.750	99.474	138.232
			PV FCFE	(99.093)	101.959	45.509	69.192	87.809
Growth Rate	3.50%							
Discount Rate	9.50%							
Terminal Value	\$ 1,514,706,310.50							
Sum of Cash Flows	\$ 1,720,081,480.04							
Shares outstanding	248,178,000.00							
Price	\$ 6.93							

Valuation (in US Millions)	2017	2018	2019	2020	2021	2022	2023	2024
Net Income	(33.933)	35.728	(19.482)	(25.748)	2.228	22.059	71.211	75.667
Depreciation & Ammortization	72.523	70.980	97.615	87.040	82.040	84.419	87.778	85.319
NWC	(55.791)	(88.080)	(92.662)	(78.844)	(86.529)	(86.012)	(83.795)	(85.445)
CapEx	33.289	26.746	49.079	36.371	37.399	40.950	38.240	38.863
Debt	232.655	519.228	555.357	435.747	503.444	498.183	479.124	493.584
FCFE	293.747	398.824	69.765	(108.507)	122.251	59.750	99.474	138.232
			PV FCFE	(101.884)	107.784	49.464	77.324	100.893
Growth Rate	3.50%							
Discount Rate	6.50%							
Terminal Value	\$ 3,480,815,365.63							
Sum of Cash Flows	\$ 3,714,395,439.72							
Shares outstanding	248,178,000.00							
Price	\$ 14.97							

The following tables show the effects of the growth rate shifting +/- 1.5%:

Valuation (in US Millions)	2017	2018	2019	2020	2021	2022	2023	2024
Net Income	(33.933)	35.728	(19.482)	(25.748)	2.228	22.059	71.211	75.667
Depreciation & Ammortization	72.523	70.980	97.615	87.040	82.040	84.419	87.778	85.319
NWC	(55.791)	(88.080)	(92.662)	(78.844)	(86.529)	(86.012)	(83.795)	(85.445)
CapEx	33.289	26.746	49.079	36.371	37.399	40.950	38.240	38.863
Debt	232.655	519.228	555.357	435.747	503.444	498.183	479.124	493.584
FCFE	293.747	398.824	69.765	(108.507)	122.251	59.750	99.474	138.232
			PV FCFE	(100.469)	104.810	47.431	73.117	94.079
Growth Rate	5.00%							
Discount Rate	8.00%							
Terminal Value	\$ 3,292,753,333.88							
Sum of Cash Flows	\$ 3,511,721,140.73							
Shares outstanding	248,178,000.00							
Price	\$ 14.15							

Valuation (in US Millions)	2017	2018	2019	2020	2021	2022	2023	2024
Net Income	(33.933)	35.728	(19.482)	(25.748)	2.228	22.059	71.211	75.667
Depreciation & Ammortization	72.523	70.980	97.615	87.040	82.040	84.419	87.778	85.319
NWC	(55.791)	(88.080)	(92.662)	(78.844)	(86.529)	(86.012)	(83.795)	(85.445)
CapEx	33.289	26.746	49.079	36.371	37.399	40.950	38.240	38.863
Debt	232.655	519.228	555.357	435.747	503.444	498.183	479.124	493.584
FCFE	293.747	398.824	69.765	(108.507)	122.251	59.750	99.474	138.232
			PV FCFE	(100.469)	104.810	47.431	73.117	94.079
Growth Rate	2.00%							
Discount Rate	8.00%							
Terminal Value	\$ 1,599,337,333.60							
Sum of Cash Flows	\$ 1,818,305,140.44							
Shares outstanding	248,178,000.00							
Price	\$ 7.33							

Change in the discount rates and growth rates have similar impacts on our target price. Sales growth rate is the key factor of focus here as Vonage is expected to and has historically had higher growth rates than the standard 3.5%.

Conclusion:

Even though our model shows Vonage to be overvalued, we are recommending holding Vonage. This is due to the assumption that expected sales growth will be higher than the 3.5%. This assumption aligns with J.P. Morgan Research where they have a target price of about \$13.50.