

Best Ideas 2020 Preview: Megacable

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Megacable (Mega) is the second-largest high-speed cable company in Mexico with roughly 3.6 million unique subscribers. While operational performance has continued to be strong, Mega shares have sold-off along with other Mexican assets following the election of Andrés Manuel López Obrador (AMLO) in 2018. The selloff has occurred despite a neutral to positive telecom regulation environment for Mega.

Historically, Mega has traded for anywhere from 8-10x EBITDA, but Mega now trades at 6.3 2020E EBITDA. At the highest level, we think Mega shares look attractive relative to the company's pristine balance sheet (net debt is 0.4x 2019E EBITDA and the company has often carried positive net cash balances historically), consistent execution and our double-digit projected EBITDA growth from 2018-2020.

Mega should benefit from increases in broadband penetration rates, continued growth of its fiber network and a robust commercial offering. Broadband penetration rates are roughly 65 percent within Mega's footprint, with the Megacable estimating penetration rates expanding to 74 percent over the next five years. Mega has generally been expanding the numbers of homes passed by 4-5% over the past 3-4 years using the existing city fiber rings within its footprint as well as additional passings less than ten kilometers from existing towns.

Mega has also benefited from increased bundling of its services and the company targets a 2.5x RGU/Customer ratio over the medium term. This bundling combined with price increases and value-added product up-sales have allowed the recent 3-4% average revenue per user (ARPU) increases. As noted, Megacable also benefits from a robust commercial offering, which currently accounts for 18 percent of revenue, with the largest sub-segment roughly tripling revenue over the past three years. It is highly likely that commercial revenue could expand at a 15+ percent CAGR over the next 3-5 years.

Finally, there is a strong possibility of a Megacable takeout within the next several years. Rumors of a Televisa/Megacable merger have existed for some time, and the companies could argue a combined company would be better positioned to compete against incumbent América Móvil. Mega could also attract interest from other companies who would like to enter Mexico's attractive cable market and use a deal to expand scale against a wider Latin America offering. Considering the growth profile, balance sheet strength/inefficiency, strategic importance of its asset base and low relative/absolute valuation level, the risk/reward in Mega shares appears highly favorable at current levels.