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SBA Communications Corporation (SBAC)
Earnings Quality Review

6- Exceptionally Strong
5- Strong
4- Acceptable
3- Minor Concern
2- Weak
1- Strong Concern
+ quality improving
- quality deteriorating

We are initiating our earnings quality coverage of SBAC at 3- (Minor Concern).

For an explanation of the EQ Review Rating scale, please refer to the end of this report.

Summary

In completing the series of cell phone tower REITs, we are adding SBAC to the mix. In some key areas, SBAC's accounting is more conservative than CCI or AMT. However, SBAC also carries a much higher debt load at 7.3x annualized last quarter's EBITDA, which is a key reason we made it a 3- rating vs. 4- for AMT and CCI. We urge readers to review SBAC in conjunction with our recent reports on AMT and CCI.

SBAC's FFO (Funds From Operations – defined as Net income + Real Estate depreciation + Impairments) has been missing or beating by wide margins quarter-to-quarter of late. This is largely due to the remeasurement of intercompany loans in emerging market currencies, which is included in other income/expense:

SBAC FFO Beat/Miss	Loan FX chg.	Per Share
2Q21 Beat 59-cents	$111.3	$1.00
1Q21 Miss 44-cents	-$86.3	-$0.79
4Q20 Beat 51-cents	$79.5	$0.71
3Q20 Miss 21-cents	-$38.6	-$0.34

There are other issues we will address below, but here is a basic EQ comparison for the three major domestic tower companies:

Industry Comparison	SBAC	AMT	CCI
Net Debt/(Last Q EBITDA *4)	7.3	5.7	5.1
ROI for 2020 and 2019	10.3%/10.1%	10.4%/10.6%	10.5%/10.1%
Straight-Line rent out of EBITDA	yes	no	no
Straight-Line rent out of AFFO	yes	yes	yes
Depreciation life for PP&E	3-15 years	up to 20 years	up to 20 years
Amortization for Intangibles	15 years	3-20 years	up to 20 years
Goodwill % Total Assets	0.0%	18.0%	26.0%
Goodwill % Total Intangibles	0.0%	36.0%	70.0%
Maint. Cap-Ex to Gross PP&E '20/19	52/53bp	77/88bp	33/48bp

Straight-line rent normally is non-cash and SBAC is the only company that doesn't include it in EBITDA. SBAC does not ascribe acquisition value to goodwill and it amortizes and depreciates intangibles and PP&E at a faster rate too. We think all three companies have a maintenance capital spending figure that is too low – but some are worse than others.

What is strong?

- **No goodwill at SBAC. It is amortizing or depreciating all acquired/fixed assets, it is tough to beat that for earnings quality. SBAC even uses shorter lives on these assets than its competitors.** This penalizes SBAC's earnings even more. As a REIT, few look at actual income because depreciation and amortization are such large reductions to income and instead focus on FFO and AFFO which add back these non-cash items. But look at how much income at AMT and CCI is due solely to non-amortization of goodwill and having amortization of intangibles be 30% higher to deal with the shorter lives at SBAC:

	2020	2019	2018
SBAC EPS	$0.21	$1.28	$0.41
AMT EPS	$3.79	$4.24	$2.77
Goodwill / 15 years	$1.09	$0.92	$0.83
30% higher Intang Amort.	$0.58	$0.53	$0.77
Adj. AMT EPS	$2.12	$2.79	$1.17
CCI EPS	$2.35	$1.79	$1.23
Goodwill / 15 years	$1.58	$1.61	$1.62
40% higher Intang Amort	$0.31	$0.31	$0.31
Adj. CCI EPS	$0.46	-$0.13	-$0.70

- **For REITs that are working to be growth vehicles (adding more towers, adding new capacity to existing towers, making acquisitions), we are amazed they all do not use SBAC's assumptions.** Investors do not focus on income, but as REITs these companies have to pay out 90% of income as dividends. They are all carrying heavy debt loads. Wouldn't an accounting policy that allows the company to retain more of its cash flow and pay out less as dividends be a nice source of funds? AMT's dividend yield is 2.0%, CCI's is 3.1%, and SBAC's only 0.7%. Also, all these companies have NOL's that expire. CCI has $1.5 billion in federal NOL's and $0.6 billion in state NOLs that start to expire in 2025 and 2021 respectively. AMT has $1.0 billion combined with half expiring between 2021-30. SBAC has $771 million that starts to expire between 2025-37. These companies operate Taxable REIT subsidiaries too. Faster amortization may allow SBAC to utilize more of its NOLs than the others. SBAC's depreciation and amortization is already declining:

	1H21	1H20	2020	2019	2018
SBAC Lease Rev.	$1,029	$975	$1,955	$1,861	$1,740
SBAC Depr/Amort	$359	$361	$720	$697	$672
% of Rent	34.9%	37.1%	36.8%	37.5%	38.6%

- **EBITDA and AFFO adjust out Straight-Line rent and Straight-Line rent expense at SBAC.** We have discussed this with AMT and CCI. Straight-Line accounting simply takes the full amount of cash flows to be received over the life of a contract and divides by the number of years/quarters for the life of the deal and recognizes the revenue or expense equally over the life of the contracts. In reality, the revenue or expense rises on a contracted rent escalator – so that cash may start at $100 and end at $110, but Straight-Line accounting will record that as 10-years of $105. Early on, the cash received/paid is lower than at the end.

We noted that AMT added about 6% to its reported EBITDA by leaving this non-cash source of revenue and expense in the mix. SBAC is the only one pulling it out of both AFFO and EBITDA. It should be noted that while this is a more conservative way of accounting as it removes non-cash revenue and expense – SBAC has had a higher non-cash rent expense component for its ground leases than the non-cash rent income it was booking. This changed in the 2Q21, and it did penalize EBITDA. Overall, it has had a fairly minor impact on reported EBITDA results:

	2Q21	1Q21	4Q20	3Q20
Straight-Line Rev	-$9.5	-$0.6	-$0.2	-$0.6
Straight-Line Exp.	$2.0	$2.6	$3.1	$3.4
Net Impact	-$7.5	$2.1	$2.9	$2.7
Adj. EBITDA	$400.2	$390.1	$380.6	$373.3
% of EBITDA	-1.9%	0.5%	0.8%	0.7%

What is weak?

- AFFO was $2.64 vs. the dividend of $0.58 for 2Q21. That does not concern us. However, **we will make the same complaint we have for the AMT and CCI – the maintenance spending figure deducted from AFFO looks too low.** The hypothetical argument is that if SBAC didn't grow (with new building, expanding existing towers, making acquisitions) it would have almost zero capital spending and would produce a high amount of free cash flow. The flip-side for us is the minute SBAC announces it will not grow, it no longer trades at 30x EBITDA. Thus at a minimum, we believe SBAC at least needs to continue its growth via rent escalators and from expanding existing towers to carry more equipment. They simply cannot tout all the potential growth from 5G and not have the space to lease on existing towers to take advantage of that.

  SBAC has already cut back on spending in this area. It is spending only about 60% for 2019's spending levels to augment existing towers. This is not a game-changer for AFFO at SBAC but something to watch:

	2Q21	1Q21	4Q20	3Q20
AFFO per share	$2.64	$2.58	$2.49	$2.38
Cap Ex to expand towers	$6.9	$7.6	$8.6	$8.3
AFFO impact per share	$0.06	$0.07	$0.08	$0.08

- **FX Issues and Impairments are troubling for SBAC. SBAC had 13.7% of its revenue from foreign markets in 2020 and 17.5% of expenses. Its debt is in US Dollars and there are intercompany loans between the foreign subsidiaries and SBAC.** Among the countries it operates are Argentina, Columbia, Peru, Brazil, and South Africa. There has been hyperinflation in Argentina and history has seen big swings in some of those other currencies too. Under ASC 830 – SBAC has to value these intercompany loans at the end of each period. We showed this table in the summary above – but this is what has been happening:

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What to keep in mind:

- The amount of these intercompany loans was only $900 million until SBAC paid it down to $794 million at the end of 2Q21. So these are very material charges relative to a fairly small loan balance.

- These FX changes are reported in other income/expense on the income statement. FFO does not add it back. However, it is added back to AFFO and EBITDA.

- SBAC is also seeing annual impairment charges being taken when it determines that the future cash flows to be received do not support the carrying value of assets. This is running about $3-$10 million per quarter or 3-9 cents of FFO per share. Both AFFO and EBITDA add these impairments back too.

- **The high debt load should be a concern too. SBAC is in compliance with debt covenants, but at 7.3x annualized EBITDA, SBAC does not have as much wiggle room as say AMT. SBAC is already spending the cash it saves from limiting its dividend yield by repurchasing shares too.** Also, with some growth coming from the foreign markets, that may not translate into the same amount of dollars that SBAC forecast when those assets were added. Things to keep in mind:

- About 24% of SBAC's debt is floating rate. Rising interest rates may cut AFFO.

- There is little in the way of maturities this year – SBAC has still sought to refinance some coming debt at lower rates. It will see about 15% of its debt roll-over per year in 2022-24. That may come at higher rates.

- SBAC's FFO and AFFO have benefited from falling rates to drive growth. We calculate that SBAC's effective interest rates fell 30bp in 2020 vs. 2019 and another 30bp in 1H21 vs 1H20. That added about 28-cents to FFO and AFFO in 2020 and another 16-cents so far in 1H21. That is also helping SBAC beat forecasts in some quarters and may not last.

- Non-cash interest has become a larger part of the total too. This happened as SBAC closed out an interest swap related to its banking loans to new contracts. This had the effect of moving the fair value changes for the swap out of accumulated comprehensive loss into non-cash interest expense in "other income/expense" as the term expires. Without this item, the 30bp drop in interest rates in 1H21 vs. 1H20 – would increase to 60bp and the drop in interest expense would be 32-cents of AFFO.

Explanation of EQ Rating Scale

6- (Exceptionally Strong)- Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises

5 (Strong)- Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.

4 (Acceptable)- Indicates the company may have exhibited a minor “red flag”, but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement

3 (Minor Concern)- Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.

2 (Weak) Indicates the company’s recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.

1 (Strong Concern)- Indicates that the company’s recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely

In addition to the numerical rating, the EQ Review Rating also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into upcoming quarters. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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