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Crown shareholders express patience amid activist pressure for fiber sale

26 August 2020 | 15:51 EDT

- Support changes to 'ossified' board
- Compromise may be for fiber stake sale

Elliott Management's push for **Crown Castle International** [NYSE:CCI] to explore the sale of its fiber assets may be premature as the roll-out of high-speed 5G wireless service could serve as a key catalyst for the company's strategy, three shareholders said.

Still, these shareholders as well as a fourth shareholder acknowledged that the activist's campaign did raise some legitimate governance concerns, among other issues, at the cellphone tower REIT, and said they welcomed Crown's plans to refresh the board.

The Texas-based communications infrastructure company said in July that five current directors will leave its board through 2022, and it has engaged a search firm to seek replacement candidates. The company told this news service that it believes it has "broad shareholder support for our overall strategy" of owning towers, small cells and fiber assets.

Crown Castle unveiled the board refresh after Elliott published a letter that highlighted Crown's long-tenured board and laid out other suggestions for operational improvements at the company. The activist raised questions about the efficacy of Crown Castle's close to 16bn investment in fiber and small cells. The activist said in July that it holds a USD 1bn economic interest in the company, which currently has a market cap of USD 67bn.

Elliott has heard from many top active investors in Crown Castle and only one supports the company's small cell strategy, said a source familiar with the matter.

Crown Castle's board membership has been "ossified," said Jason Benowitz, senior portfolio manager at **Roosevelt Investments**, which holds a small stake in Crown. The company needs new perspectives to replace those departing directors who have each been on board for at least 15 years, Benowitz said.

The board could benefit from candidates with additional fiber industry experience in line with the company's investments in the area, said Jonathan Reichek, portfolio manager at **Brasada Capital Management**, who holds small stakes in Crown as well as its pure-play macro tower competitors **American Tower** [NYSE:AMT] and **SBA Communications** [NASDAQ:SBAC].

While Crown has underperformed its pure-play peers, the growth in American Tower in particular comes with its own risks given the company's substantial investment in foreign developing markets, said a sector advisor and a third Crown shareholder who also holds a stake in American Tower.

Another sector advisors said the counterargument is that based on stock market performance, it has been "less risky" to be an investor in American Tower or SBA despite the geographic dispersion of some of their assets versus investing in Crown. "So, you can argue both sides," he said.

This advisor did acknowledge that Crown Castle management could create more value by being disciplined about how they operate the business. "They [Elliott] I don't think need Crown Castle to make complete wholesale changes to their business... they need them to make incremental adjustments," he said.

Reichek and Benowitz along with the third Crown shareholder agreed that Elliott's push for additional transparency into Crown's fiber business was welcome.

Although management had broken out small cell and fiber solutions rental revenues within the segment in its 2Q20 earnings, it would be useful to have more information on the profitability, capex as well as other key performance indicators of each of those businesses, Reichek said.

While management may be understandably reticent to disclose certain information for competitive reasons, if the company could further detail its long-term plans, particularly for the fiber business, this could strengthen the company's case in the face of activist pressure, the third shareholder said. Elliott had pushed Crown to articulate a five-year plan for its fiber business.

Still, Benowitz said he believed management has proven responsive to calls for transparency, adding that he was also pleased to see the company reviewing executive compensation – which Elliott said should be re-aligned by incorporating return on invested capital. The third investor agreed that ROIC was a key metric to keep in mind for capital allocators, as using it as a yardstick for performance can discourage long-term investments such as Crown's multi-year push into fiber.

In light of this long-term investment, all four investors questioned whether an asset sale would be the right path for the company. Sector sources have also expressed skepticism about the prospect of a sale, this news service previously reported.

While progress has been slower than what investors had hoped for in the company's small cell business, Benowitz said he is comfortable with Crown retaining its fiber assets, noting that the strategy is underpinned by the progress of 5G roll-out in the US and needs more time to bear fruit.

The activist believes that Crown could unlock more value in its fiber business by expanding its use cases, this news service previously reported. Elliott would likely want to see a joint venture partner or buyer that can bolster the enterprise side of the fiber business, Benowitz said.

The source familiar with the matter said that Elliott believes that an ideal compromise would be for Crown Castle to partner with an investor that would buy a stake in the fiber business and contribute management expertise and financing. There are precedent transactions in the space for such structures, the source added.

Still, divesting the company's fiber portfolio would also raise questions about its small cell strategy, said Jay Butler, director of research at **BTR Capital Management**, which holds a small stake in Crown Castle.

Some 5G deployment strategies, like those pursued by **Verizon** [NYSE:VZ], require dense fiber build-outs to connect a large web of small cell sites.

Elliott has cast doubt on the viability of this strategy, pointing out in presentation materials that telecom companies like Verizon and **AT&T** [NYSE:T] have accumulated their own fiber assets and may be motivated to build their own small cells.

While Benowitz, Reichek and the third shareholder acknowledged that this is a legitimate concern, they said they believed that demand for bandwidth would be high enough to allow for both self perform and rental players like Crown Castle with the ramp of 5G.

Though it may sometimes make sense for US telecom companies to own or further develop their own infrastructure assets, Crown has already amassed some of the best assets in the top 25 metro markets in the US, and it is not aiming to get 100% of major carriers' business, Reichek said.

Ultimately, the third shareholder as well as Benowitz did not completely rule out the prospect of a sale of the fiber assets, with Benowitz noting he would settle for a fair price. Butler added that a partial sale of assets that would minimize impact on small cell backhaul could potentially make sense, and could provide a welcome boost in dividends.

Indeed, Benowitz and the third shareholder agreed that telecom players as well as financial sponsors could be logical suitors for these assets in the event of a sale. Elliott has said that interested industry executives and financial buyers have approached the fund.

Reuters reported on Wednesday that Digital Colony Partners has spoken to Crown Castle about buying a minority stake in the fiber business.

The second sector advisor noted that the company could also weigh a more prudent fiber investment strategy in order to free up capital for dividends.

However, Benowitz said the company should prioritize strengthening its balance sheet over increasing dividends per share beyond the company's targeted growth of 7% to 8% per year. He pointed out that the company is already on track to improve its leverage profile near-term by increasing EBITDA – a move that could decrease cost of capital and financing of future growth.

The company reported net debt to last quarter annualized adjusted EBITDA of 5.6x. This year, Crown expects to generate up to USD 5.4bn in revenues and up to USD 3.5bn in adjusted EBITDA.

Crown Castle is advised by **Morgan Stanley** and **Cravath, Swaine & Moore**.

Elliott did not respond to requests for comment.

by Hanqing Chen, Bhavna Kaul and Ed Mullane

Grade: Strong evidence

TARGETS

Crown Castle Fiber business

VENDORS

Crown Castle International Corporation

OTHERS

Elliott Management Corporation

Roosevelt Investment Group

Brasada Capital Management, LP

USA

Telecommunications: Carriers

Topics: Major Asset Disposals, Shareholder Activism

Intelligence ID: intelcms-s6gphm