MFIF

Minutemen Fixed Income Fund

Frontier Communications (NYSE: FYBR)

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Investment Thesis: We recommend an underweight position on Frontier Communications' 5.00% 2028 notes. The company operates in the telecommunications industry as a provider of communication services within the United States serving retail, commercial, and wholesale customers. In 2Q20, the company went through a Chapter 11 restructuring support agreement, shedding $11B in debt and decreasing interest expenses by ~$1B annually. In May 2020, FYBR's management team sold the Northwest Operations segment of their business (encompassing ~7% of the company's annual revenues) for $1,131B. These strategic initiatives have resulted in the market's increasing confidence in the future of the company's operations as shown in the recent tightening of FYBR's 28 notes. Although the restructuring agreement has resulted in a decreased leverage of ~6 turns, FYBR still has a significant amount debt with a leverage ratio of ~4.31x. We believe the market is largely misinterpreting FYBR's upside potential as a result of their recent business turnaround initiatives, causing the spread of the 28s to tighten past competitors LUMN and CNSL. Revenues have continued to decline in the company's data and internet services, voice services, and video services segments by 7.4%, 16.6%, and 21.4% in FY19, and by 6.9%, 15.1% and 22.3% respectively from 1H20 to 1H21. These substantial losses in revenue are a direct result of the company's declining customer retention in combination with the strengthening competitive landscape of the telecommunications industry. We expect this trend of declining revenue to continue well into the future, along with diminishing operating margins pending price reductions. Given the severity of FYBR's future Capex targets, even if revenues begin to stabilize in FY23, we lack confidence in FYBR's ability to expand coverage after their project is complete. We also expect FCF deficits of greater than ~$1B annual through FY25, putting pressure on the company's ability to cover interest expenses. FYBR's core strategy moving forward resides on their fiber-buildout plan, with increased forecasts of ~$13B in spending from now until FY25. With only ~$2.5bn in liquidity, we expect FYBR to tap into additional leverage in the future to fund their strategic network expansion as cash flows will largely remain negative until approximately FY25. We believe there is significant downgrade risk on FYBR's debt profile. We believe that as Frontier continues operations, investors will notice the combination of headwinds FYBR is facing, causing the spread of the 28s to widen ~40 bps relative to LUMN and CNSL by 2H25.

Figure 1: Capitalization Table

Frontier Communications						
Debt Outstanding (USD in Millions)						
Type	**Amount O/S**	**Leverage**	**Maturity**	**Coupon**	**Price**	**YTW**
2027 Term Loan	1467.64		10/8/2027	4.500%	99.63	
Total First Lien Sec. Loans	1467.64	**0.59x**				
2027 First Lien Notes	1150		10/15/2027	5.875%	105.19	4.434%
2028 First Lien Notes	1550		5/1/2028	5.000%	104.78	4.419%
2031 First Lien Notes	100		11/15/2031	8.500%	115.12	6.433%
Total First Lien Sec. Notes	2800	**1.13x**				
2029 Second Lien Notes	1000		5/1/2029	6.750%	103.49	5.858%
2029 Second Lien Notes	750		11/1/2029	5.875%	99.62	5.935%
2030 Second Lien Notes	1000		1/15/2030	6.000%	100.55	5.863%
Total Second Lien Sec. Notes	2750	**1.11x**				
2027 Notes	200		5/15/2027	6.860%	106.65	5.349%
2028 Notes	200		2/15/2028	6.730%	107.08	5.388%
2028 Notes	300		2/1/2028	6.860%	107.06	5.509%
2029 Notes	50		10/15/2029	8.400%	104.38	7.654%
566822BH4 Municipal Bond	13.55		5/1/2030	6.200%	100.00	6.063%
Total Unsecured Debt	763.55	**0.31x**				
Total Long Term Debt	**14798.83**	**3.15x**				

Security Data

Bond Maturity: 5/1/2028

Rating: B+

Rank: Sr. Secured

Dirty Price: 104.78

YTW: 4.419%

Next Call: 05/01/2024

Coupon: 5.00%

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Market Misinterpretation of Frontier's Potential with Regards to Business Turnaround Efforts

Frontier's management team has taken significant strides to keep the business alive following their restructuring agreement in April 2020. The agreement alone helped FYBR's leverage decrease by ~6 full turns and interest expense was deducted by about $1B annually, giving the company an interest coverage ratio of ~5.46x from ~1.56x previously. In addition, the company was able to sell a significant amount of assets from their Northwest Operations for an additional $1,131B of cash. As a result of the gradual tightening since the restructuring agreement in April 2020, we can conclude that the market is optimistic of FYBR's management strategy moving forward. Although FYBR has made impressive strides to remain afloat, we do not believe the company can sustain the amount of cash flow necessary to survive long-term given the severity of our CapEx forecasts. Although Frontier has higher operating margins than some of its competitors, we expect that with increasing competition (expected 6.2% CAGR to FY25 in telecom), FYBR will have to decrease pricing to win more customers in their footprint, resulting in margin deterioration. We are confident that price decreases are a possibility given the fact that Frontier will have very low capital to fund coverage expansion to win more customers outside of their existing footprint. In addition, as a result of FYBR's recent divestiture of their Northwest operations, we can conclude that management is not focused on coverage expansion as much as fiber-integration. We believe by 2H25, investors will notice the lack of Frontier's upside potential, driving the spread of FYBR's 2028 notes back in line with competitors.

Issues Corresponding to the Funding of FYBR's Fiber Expansion Plan

Frontier has announced a fiber-expansion plan to replace their existing copper wire infrastructure with expectations to increase network speed and support customer retention. Moody's has forecasted Capex spending of ~$13B, up previously from ~$6.5B from 2H21 until FY25, as management is now targeting 10 million fiber passings, significantly more than the initial 5.9 million estimated. Currently, FYBR has a cash balance of ~$993m, a 2025 revolver with ~$500m of borrowing capacity, and a recently issued 2030 note worth $1B. In addition to the company's expansion efforts, management has spent ~$325m on average from over the past 2 fiscal years to maintain current infrastructure. We believe the company will be forced to issue additional leverage to meet future Capex goals pertaining to their fiber expansion initiatives, given the fact that this project is about ~5x the amount of liquidity the company currently has. We are estimating that Frontier's cash flows will equate to deficits that could reach ~1B until 2H25. Fitch has stated a downgrade is possible if margins begin to deteriorate, revenues do not begin to stabilize, or leverage increases without an adequate deleveraging plan. <u>Fitch's recent rating's commentary does factor in the additional passings management has targeted to replace, an additional ~4.1 million by 2H25</u>. Overall, we expect FYBR's liquidity position to deteriorate, leverage to increase and free cash flow to remain negative through FY25, leading to significant issues regarding the funding of Frontier's fiber-optic expansion.

Risks to Thesis:

- FYBR issues additional common stock or receives outside funding to finance expansion
- FYBR is taken private before our bond matures
- FYBR diverts money from their fiber rollout into expanding coverage

Figure 2: Operating Margin Comparisons (LTM)

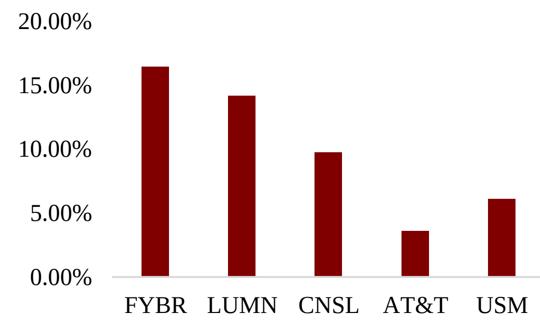


Figure 3: Fiber-Expansion Capex Forecasts (2H21-FY25)

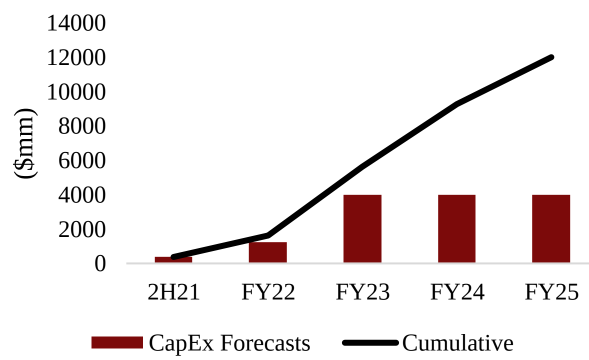
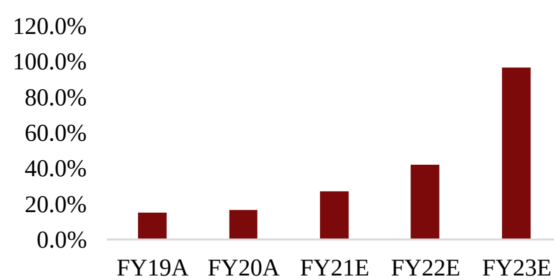


Figure 4: Capex / Revenue



Unpredictability of the Effectiveness of Fiber-Optic Expansion

Frontier's fiber-optic build will enhance network speeds for data transfer, network connectivity, voice, and video. However, we believe the company's expectation that this strategy will help gain more customers and bolster revenues is somewhat unrealistic. Currently in the regions in which Frontier operates, they have ~40% fiber penetration in those areas already. Management has stated that they are targeting expanding fiber to an additional 10 million consumer locations by 2H25, resulting in ~50% of the company's network being fiber-optic. Additionally, a majority of Frontier's coverage areas are composed of a limited number of competitors, which we believe decreases the likelihood of attracting new customers given their prominence in those areas. For a project that would likely cost ~$13 billion, we feel as if a ~10% increase in fiber is not going to help the company drive revenues much further in their already established network. For consumers that are not subscribed to Frontier's business within their footprint, switching costs are a significant factor to consider for customers transitioning from one provider to the other. For Frontier's video segment, satellite cable is vastly shrinking in popularity as retail consumers have begun transitioning towards OTT services that offer comparatively better prices and viewing options. In 1H21, consumer video customers fell ~13%. Even if FYBR's implementation of fiber-optic solutions helps improve speeds in this segment, we believe video revenue will continue to decline simply based on the general momentum of consumer preference. We believe that significant improvements in customer additions is unlikely given the fact that Frontier is well established in the footprint they serve. As mentioned previously, FYBR's future revenues will be heavily reliant on winning customers within their existing footprint as expansion is unlikely post-modernization. As FYBR's fiber expansion continues, we expect the project's effect on customer retention and revenues to be less significant than management has predicted, resulting in the spread of FYBR's 28s widening further relative to competitors.

Figure 6: Frontier's Coverage

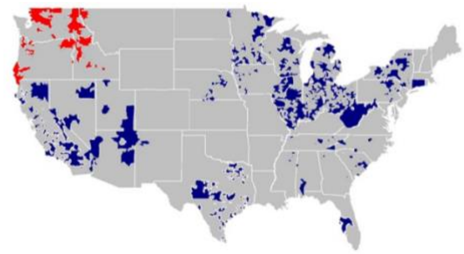


Figure 7: Share of Adults Receiving TV via Cable in the U.S.

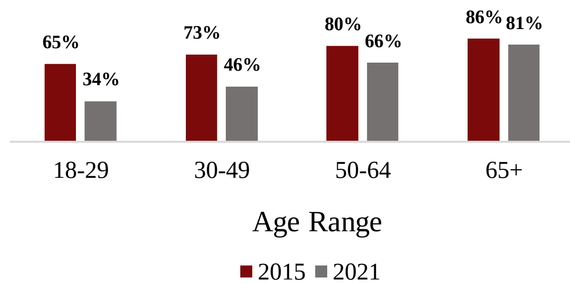


Figure 8: Comparable OAS

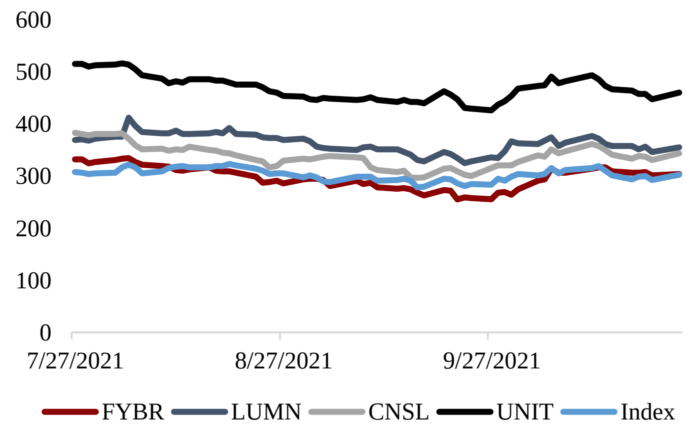


Figure 9: Peer Financials and Securities' Data

Comps (USD in Millions)	LUMN	CNSL	FYBR	UNIT
Market Cap	14,300.0	910.5	**6,936.2**	2,980.0
Debt	35,084.0	2,388.7	**9,398.0**	5,021.0
Net Debt	34,149.0	2,189.4	**8,405.0**	4,912.5
Enterprise Value	48,449.0	3,099.9	**15,341.2**	7,892.5
EBITDA (LTM)	5,811.0	378.5	**2,474.0**	760.1
Debt / EBITDA (LTM)	6.04x	6.31x	**3.80x**	6.61x
Net Debt / EBITDA (LTM)	5.88x	5.78x	**3.40x**	6.46x
Interest Expense	1,578.0	173.9	**399.0**	458.5
EBITDA / Interest (LTM)	3.68x	2.18x	**6.20x**	1.66x
FCF (LTM)	3,532.0	52.6	**(674.0)**	(111.6)
Individual Security Comps				
Ratings (Fitch)	B+	B	**B+**	CCC+
Coupon	4.500%	6.50%	**5.000%**	6.50%
Maturity	1/15/29	10/1/28	**5/1/28**	2/15/29
Price (Dirty)	97.86	107.94	**104.78**	103.58
YTW	5.066%	4.767%	**4.419%**	5.883%
OAS	358.4	343.16	**304.8**	444.9
Next Call Date	1/15/24	10/1/23	**5/1/24**	4/15/24
Spread / Turn of Leverage	59.36	54.38	**80.24**	67.35

Relative Value Analysis

Currently, FYBR's 28s trade ~39 bps tight of CNSL's 28s and ~50 bps tight of LUMN's 29s. Based on FYBR's OAS, we believe the market has misinterpreted the company's financial position moving forward. In comparison to LUMN, Frontier has ~2.2x less leverage on an adjusted basis, however FYBR has a stronger interest coverage ratio by ~2.5 turns. In comparison to CNSL, Frontier's leverage is currently stronger by ~2.5x. We believe FYBR's spread relative to competitors accurately reflects the strength of Frontier's current credit position. However, due to the significance of our estimates regarding future capital expenditures, our expectation for margin erosion, and the likeliness of additional leveraging, we expect the spread of FYBR's 28s to widen ~40 bps relative to LUMN and CNSL by 2H25.

Figure 10: Summary Model

Frontier Communications (NYSE: FYBR)														
Fiscal Year	**FY19A**	**FY20A**	**1Q21A**	**2Q21A**	**3Q21P**	**4Q21P**	**1Q22P**	**2Q22P**	**3Q22P**	**4Q22P**	**1Q23P**	**2Q23P**	**3Q23P**	**4Q23P**
EOP Date	*12/31/19*	*12/31/20*	*3/31/21*	*6/30/21*	*9/30/21*	*12/31/21*	*3/31/22*	*6/30/22*	*9/30/22*	*12/31/22*	*3/31/23*	*6/30/23*	*9/30/23*	*12/31/23*
Income Statement (Millions)														
Revenue Breakdown														
Data and internet services	3,756.0	3,478.0	842.0	839.0	827.8	816.8	805.9	795.1	784.5	774.1	763.8	763.8	763.8	763.8
Voice services	2,500.0	2,085.0	487.0	443.0	429.7	416.8	404.3	392.2	380.4	369.0	357.9	354.4	350.8	347.3
Video services	1,005.0	789.0	169.0	159.0	148.4	138.5	129.3	120.7	114.0	107.7	101.8	98.8	95.8	92.9
Other	477.0	429.0	95.0	92.0	88.4	84.9	81.6	78.4	75.3	73.5	71.6	69.8	68.1	66.4
Subsidy Revenue	369.0	374.0	83.0	83.0	80.2	77.4	74.8	72.2	69.7	67.3	65.0	62.8	60.6	58.6
Revenue	8,107.0	7,155.0	1,676.0	1,616.0	1,574.5	1,534.4	1,495.8	1,458.6	1,424.0	1,391.6	1,360.1	1,349.5	1,339.1	1,328.9
Operating Expenses:														
Network access expenses	1,247.0	975.0	198.0	193.0	283.4	276.2	269.2	262.5	256.3	250.5	244.8	242.9	241.0	239.2
Network related expenses	1,810.0	1,726.0	422.0	413.0	425.1	414.3	403.9	393.8	384.5	375.7	367.2	364.4	361.6	358.8
Selling, general and administrative expenses	1,804.0	1,648.0	408.0	398.0	472.3	460.3	448.7	437.6	427.2	417.5	408.0	404.8	401.7	398.7
Restructuring costs and other charges	168.0	87.0	2.0	16.0	-	-	-	-	-	-	-	-	-	-
Depreciation and amortization	1,780.0	1,598.0	387.0	298.0	468.3	467.9	468.5	470.0	471.8	473.8	480.5	494.8	509.1	523.3
Goodwill Impairment	5,725.0	-			-	-	-	-	-	-	-	-	-	-
Loss on disposal of Northwest Operations	446.0	162.0			-	-	-	-	-	-	-	-	-	-
Operating Income	(4,873.0)	959.0	259.0	298.0	(74.7)	(84.3)	(94.5)	(105.3)	(115.8)	(125.9)	(140.5)	(157.4)	(174.3)	(191.1)
Investment and other loss, net	(37.0)	(43.0)	2.0	(3.0)	-	-	-	-	-	-	-	-	-	-
Gain (loss) on extinguishment of debt	(20.0)	(72.0)			-	-	-	-	-	-	-	-	-	-
Pension settlement costs	57.0	159.0			-	-	-	-	-	-	-	-	-	-
Reorganization items, net	-	(409.0)	(25.0)	4,196.0	-	-	-	-	-	-	-	-	-	-
Interest expense	1,535.0	762.0	89.0	91.0	47.0	176.6	47.0	174.9	47.0	173.3	47.0	171.6	47.0	170.0
Income (Loss) before income taxes	(6,522.0)	(486.0)	147.0	4,400.0	(121.7)	(260.9)	(141.6)	(280.3)	(162.8)	(299.2)	(187.5)	(329.0)	(221.3)	(361.1)
Income tax (benefit) expense	(611.0)	(84.0)	87.0	(180.0)	(29.2)	(62.6)	(34.0)	(67.3)	(39.1)	(71.8)	(45.0)	(79.0)	(53.1)	(86.7)
Net Income (Loss)	(5,911.0)	(402.0)	60.0	4,580.0	(92.5)	(198.3)	(107.6)	(213.0)	(123.7)	(227.4)	(142.5)	(250.1)	(168.2)	(274.4)
EBITDA Reconciliation														
Depreciation and amortization	1,780.0	1,598.0	387.0	298.0	468.3	467.9	468.5	470.0	471.8	473.8	480.5	494.8	509.1	523.3
EBITDA	(3,207.0)	1,874.0	623.0	4,789.0	393.6	383.6	374.0	364.6	356.0	347.9	340.0	337.4	334.8	332.2
Stock based compensation	15.0	3.0	(1.0)	-	-	-	-	-	-	-	-	-	-	-
Less: Reorganization Items	-	(409.0)	(25.0)	4,196.0	-	-	-	-	-	-	-	-	-	-
Adj. EBITDA	(3,192.0)	2,286.0	647.0	593.0	393.6	383.6	374.0	364.6	356.0	347.9	340.0	337.4	334.8	332.2
FCF RECONCILIATION														
EBIT	(4,987.0)	276.0	236.0	4,491.0	(74.7)	(84.3)	(94.5)	(105.3)	(115.8)	(125.9)	(140.5)	(157.4)	(174.3)	(191.1)
Depriciation & Amortization	1,780.0	1,598.0	387.0	298.0	468.3	467.9	468.5	470.0	471.8	473.8	480.5	494.8	509.1	523.3
Changes in working capital	1,133.0	(4,719.0)	182.0	4,538.0	617.7	(154.7)	(280.8)	(377.4)	(279.0)	(374.0)	(963.7)	(1,049.5)	(951.3)	(1,041.2)
Less: Capital Expenditures	1,226.0	1,181.0	384.0	385.0	484.6	477.0	594.8	587.7	581.2	575.1	1,256.7	1,254.6	1,252.7	1,250.8
Free cash flow to firm	(3,300.0)	(4,026.0)	421.0	8,942.0	526.7	(248.2)	(501.6)	(600.4)	(504.3)	(601.2)	(1,880.3)	(1,966.7)	(1,869.2)	(1,959.8)