

## LatAm IT

### Sonda: Strong Guidance, Execution by New Teams Is Crucial

**OUR TAKE:** We attended the first-ever Sonda Day in Santiago, where the company presented an expansion plan that, if executed correctly, could turn Sonda into the hottest growth story in the LatAm sector. Based on positive macro conditions in key geographies, as well as opportunities in transport, retail, financial services, and government, the company expects to double sales by 2023 and reach a 16% EBITDA margin by 2021 (from 11.3% in 2018E), implying a 500bp expansion versus 2018 levels. Sonda sees compounded annual revenue and EBITDA growth of 11% and 24% in the 2018-2021 period (or 12% and 26%, respectively, if excluding Apple stores in Chile) under a 16% margin by 2021 (19% if excluding Apple stores). Guidance for Chile, Brazil, Mexico, and Colombia was ahead of our estimates (see key graphs on page 2). Buy.

Data traffic in the region is exploding and large corporations are demanding more public/private cloud and high-value administered services (e.g., Microsoft is one of Sonda's largest customers in South America). Capex guidance for 2019 of US\$195M was ahead of our previous US\$60M estimate, but this is primarily due to the construction of two new Tier IV data centres in Chile and Colombia (unique in the region). We understand the company is also planning to ramp up its transportation division in Chile, which we believe could increase the odds of extending the Transantiago contract by several more years. A major platform project in Brazil will demand capex but should contribute to revenues as early as 2019. We are increasing our 2019 consolidated EBITDA estimate to CLP 119B from CLP 112B, but our price target is left unchanged at CLP 1,250 given short-term impact of capex on net debt (the CFO sees the net debt to EBITDA ratio below 1.0x by 2021). New management teams in Brazil, Colombia, and Mexico brought in considerable experience to the company and early results are encouraging.

**Brazil.** Sonda sees revenues growing at a CAGR of 12% in the next three years, while the margin at 18% by 2021 (from 5.9% in 2018E) would more than double from current levels. Sonda is already half the size of IBM in Brazil and the potential privatization of poorly run electricity utilities may create significant opportunities as Sonda is a leader in that segment. The new management team sees cost savings of R\$60M in 2019 thanks to initiatives implemented in 2018. Higher-margin projects now contribute 40% of sales but cost savings are rendering all contracts more profitable.

**Chile: the stars are aligning for the IT sector.** Sonda sees sales growing at a CAGR of 7% and the margin reaching 15% by 2021 (or an excellent 24% if excluding Apple stores, which we understand the company may be looking to divest). A stronger economy is reviving IT investments, while the government is expected to launch relevant digitalization projects in 2019 amid a push to switch capex for opex.

**Mexico.** Sales should expand at a strong CAGR of 17% in the guided period under a 15% margin by 2021 (from 7.7% in 2018E). Successful NAFTA renegotiation, new banking regulations on biometrics starting in 2019, and AMLO's plan to create the world's largest **free-trade zone** (potentially attracting IT companies exporting services to the U.S.) are behind management's optimism on the IT sector. According to management, AMLO's push to tackle corruption means a company like Sonda, with high governance standards, may have a better shot at government contracts, especially in the oil, gas, and electricity sectors.

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#### COVERAGE SUMMARY

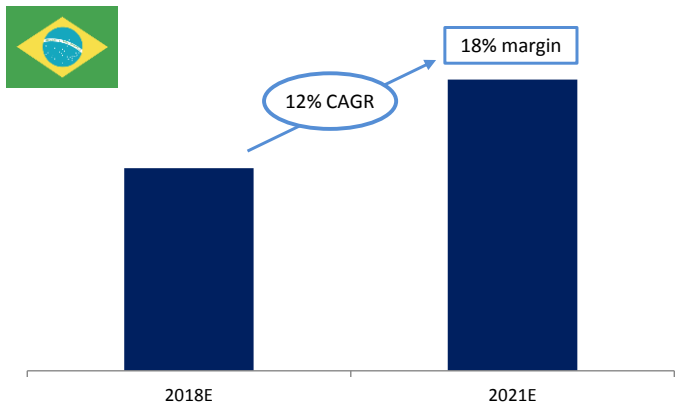
	Rating	1-Yr. Target	Return
AMX-N	SO	US\$19.00	40.3%
AXTEL CPO-MX	SO	MXN 6.00	99.3%
ENTEL-SN	SP	CLP 5,900	8.0%
MEGA CPO-MX	SP	MXN 88.00	-5.2%
SONDA-SN*	SO	CLP 1,250	19.9%
TOTS3-SA	SP	BRL 26.00	-5.9%

\*Companies with pertinent revisions

**Colombia.** 20 days after taking office, President Duque held a meeting with the leaders of the IT sector to discuss the country's modernization agenda. These meetings will take place every quarter, denoting a real interest to push digitalization efforts. It appears the ministries of education and transport are preparing relevant IT projects for 2019. OPLA is expected to grow sales at a CAGR of 15% in the next three years under an 18% margin by 2021 (from 13.2% in 2018E).

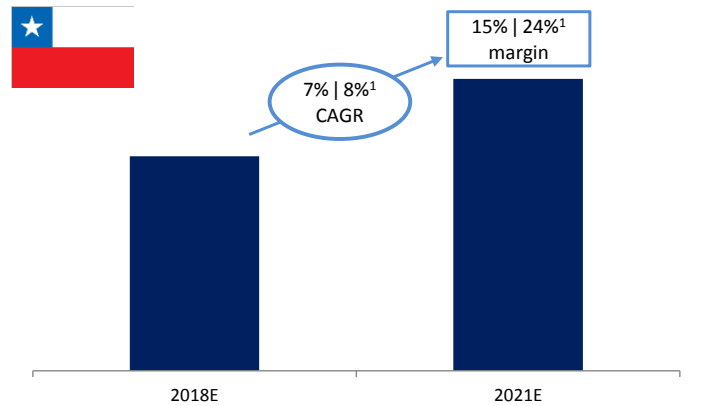
## Sonda: Strong Revenue and Margin Guidance for the 2018-2021 Period

**Exhibit 1: Revenue CAGR and EBITDA Margin Guided for 2018-2021 in Brazil (in US\$)**



Source: Company reports; Scotiabank GBM.

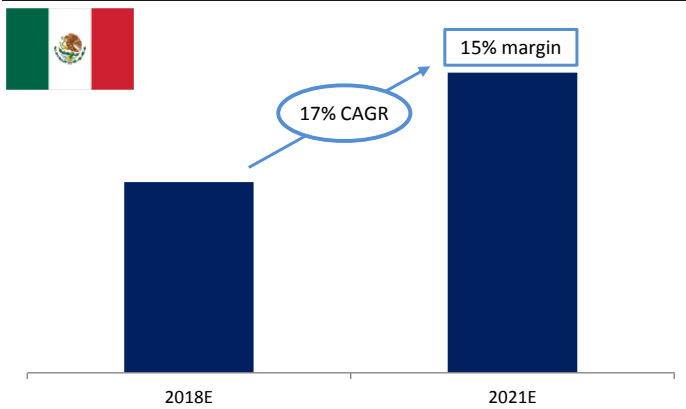
**Exhibit 2: Revenue CAGR and EBITDA Margin Guided for 2018-2021 in Chile (in US\$)**



<sup>1</sup>Excluding Apple retail business in Chile.

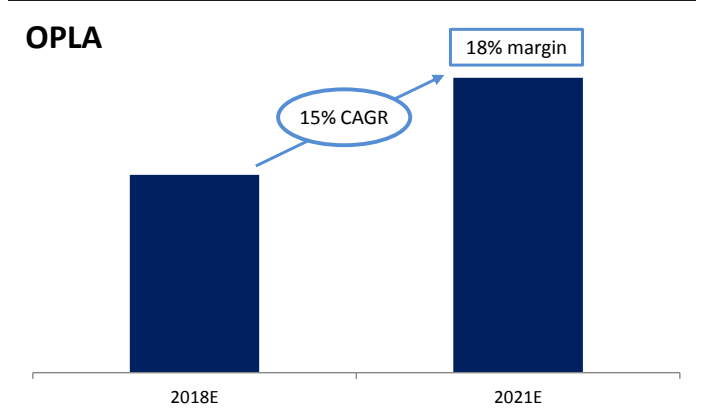
Source: Company reports; Scotiabank GBM.

**Exhibit 3: Revenue CAGR and EBITDA Margin Guided for 2018-2021 in Mexico (in US\$)**



Source: Company reports; Scotiabank GBM.

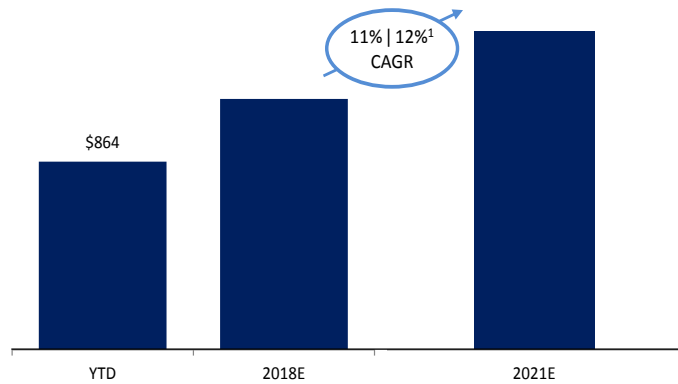
**Exhibit 4: Revenue CAGR and EBITDA Margin Guided for 2018-2021 in OPLA (in US\$)**



Source: Company reports; Scotiabank GBM.

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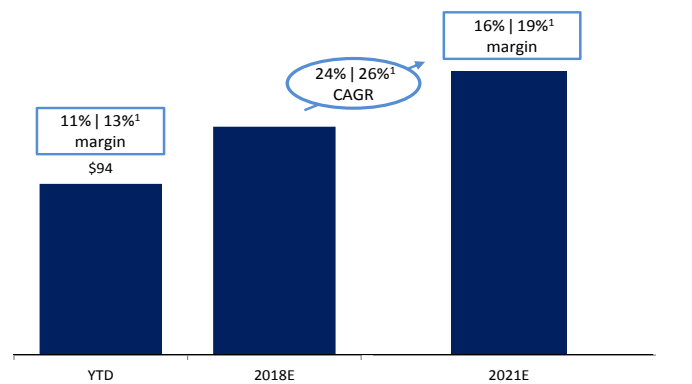
**Exhibit 5: Consolidated Revenue CAGR Guided for 2018-2021 (in US\$ Millions)**



<sup>1</sup>Excluding Apple retail business in Chile.

Source: Company reports; Scotiabank GBM.

**Exhibit 6: Consolidated EBITDA CAGR and EBITDA Margin Guided for 2018-2021 (in US\$ Millions)**

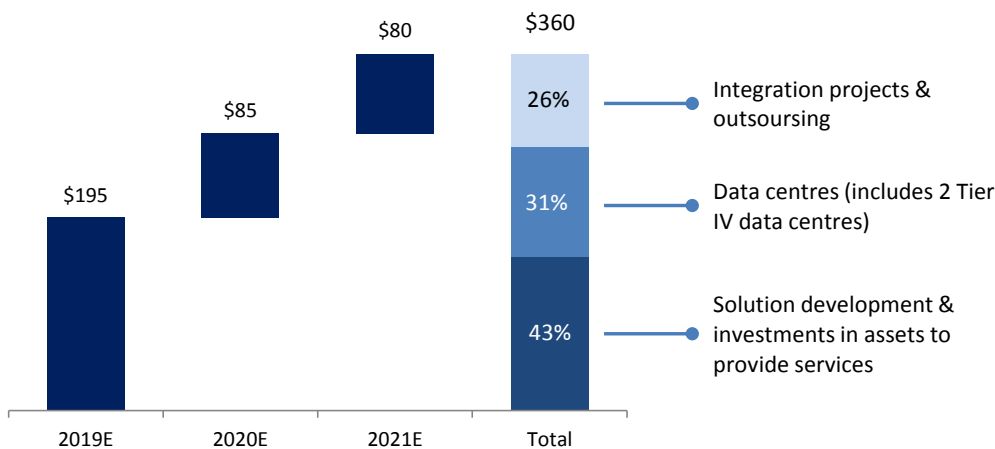


<sup>1</sup>Excluding Apple retail business in Chile.

Source: Company reports; Scotiabank GBM.

## Sonda: Higher Guided Capex Related to Data Centres and Expansion Projects

**Exhibit 7: Sonda's Capex and Its Expected Uses for the 2019 - 2021 Period (in US\$ Millions)**



Source: Company reports; Scotiabank GBM.

## Valuation Model for Sonda

**Exhibit 8: Sonda – Valuation Model (in CLP Millions Unless Otherwise Stated)**

	<b>2019E</b>
EBITDA	118,719
<b>EV/EBITDA</b>	<b>10.5x</b>
Enterprise value	1,252,369
Minus: net debt Q3/18	120,018
Minus: provision for negative cash flow 2019E (higher capex)	37,702
Minus: minority interest	5,825
Equity value	1,088,824
Shares outstanding (M)	871
<b>Value per share (CLP)</b>	<b>1,250</b>

Source: Company reports; Scotiabank GBM estimates.

## Our Old vs. New Estimates for Sonda

**Exhibit 9: Sonda – Old vs. New Estimates (in CLP Millions Unless Otherwise Stated)**

	New		Old		Change %	
	2018E	2019E	2018E	2019E	2018E	2019E
Chile revenues	365,592	398,332	363,807	389,267	0.5%	2.3%
Brazil revenues	222,941	257,319	218,247	251,180	2.2%	2.4%
In BRL millions	1,286	1,422	1,248	1,344	3.1%	5.8%
Mexico revenues	66,589	64,023	65,665	63,276	1.4%	1.2%
In MXN millions	1,972	1,896	1,935	1,799	1.9%	5.4%
OPLA revenues	141,738	156,353	139,977	150,627	1.3%	3.8%
<b>Total revenues</b>	<b>796,860</b>	<b>876,027</b>	<b>787,696</b>	<b>854,349</b>	<b>1.2%</b>	<b>2.5%</b>
Cost of sales	657,313	704,165	650,532	688,007	1.0%	2.3%
Administrative expenses	85,946	89,242	85,186	89,008	0.9%	0.3%
<b>EBIT</b>	<b>53,601</b>	<b>82,619</b>	<b>51,977</b>	<b>77,334</b>	<b>3.1%</b>	<b>6.8%</b>
Depreciation and amortization	36,368	36,100	36,292	35,081	0.2%	2.9%
<b>EBITDA</b>	<b>89,969</b>	<b>118,719</b>	<b>88,269</b>	<b>112,414</b>	<b>1.9%</b>	<b>5.6%</b>
EBITDA margin	11.3%	13.6%	11.2%	13.2%	8 bp	39 bp
<b>Net income</b>	<b>19,515</b>	<b>50,577</b>	<b>18,125</b>	<b>48,045</b>	<b>7.7%</b>	<b>5.3%</b>
EPS (CLP)	22.40	58.06	20.81	55.16	7.7%	5.3%
EBITDA minus capex	62,684	-14,696	54,648	69,801	14.7%	-121.1%
<b>EBITDA by geography</b>	<b>2018E</b>	<b>2019E</b>	<b>2018E</b>	<b>2019E</b>	<b>2018E</b>	<b>2019E</b>
EBITDA Chile	53,004	56,715	52,522	55,206	0.9%	2.7%
EBITDA Brazil	13,069	32,412	12,398	29,867	5.4%	8.5%
EBITDA Mexico	5,202	8,056	5,008	7,603	3.9%	6.0%
EBITDA OPLA	18,695	21,536	18,341	19,738	1.9%	9.1%
<b>EBITDA margin by geography</b>	<b>2018E</b>	<b>2019E</b>	<b>2018E</b>	<b>2019E</b>	<b>2018E</b>	<b>2019E</b>
EBITDA margin Chile	14.5%	14.2%	14.4%	14.2%	6 bp	6 bp
EBITDA margin Brazil	5.9%	12.6%	5.7%	11.9%	18 bp	71 bp
EBITDA margin Mexico	7.8%	12.6%	7.6%	12.0%	19 bp	57 bp
EBITDA margin OPLA	13.2%	13.8%	13.1%	13.1%	9 bp	67 bp
Capex	27,285	133,415	33,621	42,613	-18.8%	213.1%

Source: Company reports; Scotiabank GBM estimates.

**Pertinent Data and Revisions**

	Price	Rating	1-Yr. Target	1-Yr. Return
AMX-N	US\$13.78	SO	US\$19.00	40.3%
AXTEL CPO-MX*	MXN 3.01	SO	MXN 6.00	99.3%
ENDEL-SN	CLP 5,511	SP	CLP 5,900	8.0%
MEGA CPO-MX	MXN 94.85	SP	MXN 88.00	-5.2%
SONDA-SN	CLP 1,068	SO	CLP 1,250	19.9%
TOTS3-SA	BRL 28.20	SP	BRL 26.00	-5.9%

\*Speculative risk ranking.

**Sonda (SONDA-SN;CLP 1,068)**

Valuation: 10.5x 2019E EV/EBITDA multiple

Key Risks: Technology obsolescence; increased competition; M&A risk; Brazil's economic and political situation

Key Data	New	Old
	EBITDA (M)18E: CLP 89,969	EBITDA (M)18E: CLP 88,269
	EBITDA (M)19E: CLP 118,719	EBITDA (M)19E: CLP 112,414

## Appendix A: Important Disclosures

Company	Disclosures (see legend below)*
America Movil	M16, M4
Axtel	M16, M4
Entel Chile	M16, M4
Megacable Holdings	M16, M4, O1
Sonda	M16, M4
Totvs	M16, M4

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### Sonda (SONDA-SN) as of December 10, 2018 (in CLP)

09-20-2016 Price: 1,265.50 Rating: SP Target: 1,400.00	07-11-2017 Price: 1,111.20 Rating: SO Target: 1,500.00	01-04-2018 Price: 1,285.50 Rating: SO Target: 1,400.00	08-15-2018 Price: 923.79 Rating: SO Target: 1,250.00
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\*Represents the value(s) that changed.

Ratings Legend: FS=Focus Stock; SO=Sector Outperform; SP=Sector Perform; SU=Sector Underperform; T=Tender; UR=Under Review; CS=Coverage Suspended; DC=Discontinued Coverage

Source: Scotiabank GBM estimates/Scotia Howard Weil estimates; FactSet.

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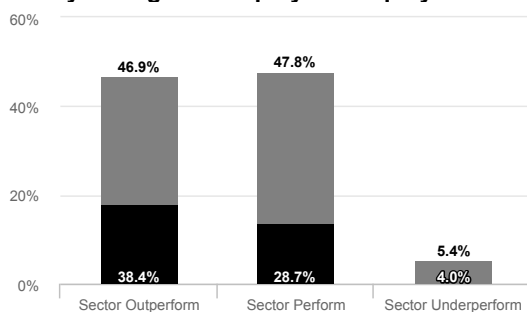
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