

Converge ICT Solutions (PSE:CNVRG)

Converge ICT Solutions is a telecommunication service provider in the Philippines. The firm operates in 3 divisions: fiber optic broadband networks, cable television, and cable internet. As of March 2021, the firm has 54% market share of residential fiber networks. CNVRG is a subsidiary of ComClark Network and Technology Corporation, which holds 63.74% of the company's stock. Note that ComClark is a holding company whose CEO, Dennis Uy also being the CEO of CNVRG.

DCF Valuation

Model used: 3-stage FCFE Model

I implemental a three-stage FCFE Model because CNVRG is experiencing significant growth driven by the work-from-home setup that resulted in a demand for Wi-Fi services. The three-stage model is suitable for firms that have a high-growth period before growth slowly decreases and enters stable growth.

Assumptions	High Growth	Transition	Stable Growth
Length of Growth Period (Years)	5	5 -> Infinity	Infinity
Growth Rate	77.60%	77.60 % -> 5.0%	5.00%
Riskfree Rate	3.78%	3.78 %	3.78%
Equity Risk Premium	6.56%	6.56%	6.56%
Equity Reinvestment Rate	475.71%	475.71% -> 32%	32%
Beta	0.41	0.41 -> 0.80	0.80
Cost of Equity	6.47%	6.47% -> 9.03%	9.03%

	1	2	3	4	5
Expected Growth Rate	77.86%	77.86%	63.04%	33.41%	3.78%
Net Income	₱5,980,880,145	₱10,637,593,426	₱17,343,957,825	₱23,138,921,014	₱24,013,572,228
Equity Reinvestment Rate	475.71%	475.71%	384.37%	201.68%	18.99%
FCFE	-₱22,470,850,925	-₱39,966,655,455	-₱49,320,691,498	-₱23,528,016,080	₱19,452,200,217
Cost of Equity	6.47%	6.47%	6.98%	8.00%	9.03%
Cumulative Cost of Equity	106.47%	113.36%	121.27%	130.98%	142.80%
Present Value	-₱21,105,414,996	-₱35,257,097,906	-₱40,669,620,722	-₱17,963,206,396	₱13,621,634,944

Present Value of Terminal Equity Value	P269,369,907,496
Value of equity in operating assets	P167,996,202,419
Value of Cash and Marketable Securities	P12,957,408,688
Value of equity in firm	P180,953,611,107
Value per share	P24.03

Based on these inputs the valuation is as follows:

Value of equity in the firm: P180,953,611,107.41

Value per share: P24.03

Current market price: P22.07 (June 30, 2021)

Therefore, CNVRG stock is undervalued by 8.88% based on the intrinsic valuation.

Sensitivity Analysis

Growth rate	60.00%	70.00%	77.60%	80.00%	90.00%
Value per share	P16.02	P20.21	P24.03	P25.16	P30.96

Relative Valuation

23 companies were used as comparables. The selection criteria were telecommunication and information technology companies with a market capitalization of less than \$30B. The multiple analyzed was the Price to Book Value ratio. I used PBV because of the economic instability brought by the Covid-19 pandemic on the stock market. As a result, the PSEi fell to an 8-year-historic low on March 19, a few months before CNVRG's IPO in October. I decided to use PBV ratio instead because the book value of equity is relatively stable and CNVRG's value lies in the firm's network infrastructure and existing users.

	ROE	Beta	2020 Growth	Payout Ratio	PBV
CNVRG	19.90%	0.36	71.26%	0%	5.76
Median (Industry)	9.73%	0.71	0.04%	17%	2.24

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	6.12	3.38	1.81	0.09
ROE	5.23	2.19	2.38	0.03
Beta	-1.47	3.37	-0.44	0.67
Payout Ratio	0.16	0.73	0.22	0.83
Emerging Market	-3.45	2.23	-1.55	0.14

The regression equation is seen below:

Regression Analysis: PBV versus ROE

$$PBV = 5.23(ROE) + 6.12$$

$$R \text{ Square: } 38.3\%$$

The regression leads to a PBV of 7.16, which gives a market price of P26.43

Market Valuation

I used Damodaran's market regression, where he performed a regression on all emerging market companies in South-East Asia. The dataset was last updated on Jan 2021. The market regression equation is seen below:

$$PBV = -0.32 + 5.00 gEPS + 0.90 Payout - 0.05 Beta + 17.20 ROE$$

(1.47)
(13.79)
(8.75)
(0.45)
(28.67)

$$R \text{ Square: } 48.3\%$$

Using $gEPS = 0.78$, I got a PBV of 7.29. This PBV is much higher than both the actual and regression with relative industries. This would imply the price of stock to be worth P26.90 per share.

Conclusion:

DCF Low	P16.02
DCF	P24.03
DCF High	P30.96
Relative Valuation	P26.43
Market Valuation	P26.90
Current Price	P22.07

I place more weight on DCF valuation than the regression since there is ambiguity associated in choosing comparable firms. I think DCF valuations are more robust, incorporating a fundamental

assessment of value and I would prefer to rely on my intrinsic valuation rather than the market's assessment.

That being said, each valuation shows the company is undervalued. I believe that the company will continue to invest in their infrastructure and continue to grow their market share as a network provider. The business may not reach the levels of brands such as PLDT, and Globe but that's fine. CNVRG is still relatively young compared to its competitors, the firm should consolidate their business and continue building infrastructure to expand its residential market to generate excess returns.

Recommendation: BUY. The current stock price of CNVRG at P22.07 is undervalued based on the DCF and relative valuation.