Estimates, valuation, and risks

Estimates revision

We have updated our model to reflect 3Q results, revised guidance, and our updated outlook. Our 2016 normalized FFO/sh estimate moves to $2.60 from $2.56, FAD/sh moves to $2.22 from $2.44, and adjusted EBITDA moves to $274.9MM from $275.3MM. For 2017, normalized FFO/sh moves to $2.96 from $2.95, FAD/sh moves to $2.80 from $2.90, and adjusted EBITDA moves to $339.2MM from $337.7MM. Our FFO estimates increase to reflect updated run-rates and one-time items, while FAD falls on higher straight line rent.

Valuation

We are lowering our target price to $57 from $59, with the decline largely tied to our lowered FAD estimates partially offset by the roll forward of our model. Our target price is based on a 50:50 blend of our FAD multiple-based target and our EBITDA multiple-based target. Our FAD based target is found by applying a 19.1x multiple on our 2-year forward FAD estimate, while our EBITDA based target is found by applying a 17.4x multiple on our 2-year forward EBITDA estimate. Our assumed multiples are based on modest discounts to our blended peer average.

Risks

The key risks for CONE are tied to the success of the company's development efforts, which in addition to driving earnings upside, would also improve tenant and geographic concentration, which are currently above-average. While development risk remains elevated, we think CONE's lower construction cost/KW and faster construction delivery times should allow management to better manage these risks. However, CONE's current construction cost advantage versus competitors appears to be driven by design choices and as such could be replicated, which could cause overall returns to fall. Finally, we see heightened operational risk versus its peers in light of higher tenant and geographic concentration, and its higher SG&A business model.