

Quarterly Investment Insight - March 2021

As Easy as Pie

Aussie Broadband hungry to grow its slice of the Australian NBN pie

A green graphic with a diagonal split from the bottom right corner. The top-left portion is a lighter shade of green, and the bottom-right portion is a darker shade. The text "Join the telco that gives a ****" is written in white, bold, sans-serif font across the graphic.

**Join the telco
that gives a ******

While 2020 was a character building experience, 2021 emanates a more optimistic tone. Vaccination rates are rising, infection rates appear to have peaked and borders are cautiously opening. In recent times we have seen an almost-overwhelming range of factors play out across markets: a global pandemic, bond volatility, polarised expectations of inflation, rising commodity prices, and an unprecedented level of populism intermixed with investment behaviour [*read: Gamestop*]. These themes have shown us that now more than ever it is vital to consider investment fundamentals, with a robust analytical process key to long-term alpha generation.

At Celeste, we apply an investment process built on three crucial pillars. We analyse the entity's business model, its board & management, and the quality of its financial accounts. These pillars assist us to derive a valuation and a floor price, and ultimately gauge the upside and downside to a potential investment. We recently applied our investment process to founder-led business, Aussie Broadband (ABB). ABB is a Victorian based telco focussed on providing premium, high-speed NBN connections to residential and commercial users across Australia. ABB also provides ancillary products like mobile plans, entertainment services and VOIP.

In a year that rained IPOs, ABB came to market in October 2020. However, unlike many of its newly-listed peers, ABB has a long-established operating history and a board & management team with grassroots expertise. Since June 2017, ABB has grown its share of the Australian broadband market from 1.1% to 4.0%. Market share gain remains a key ingredient in their recipe for long-term profit growth. It has been a vital catalyst in boosting ABB's IPO share price from \$1/share to the current price of \$2.80/share - a move of nearly 200%.

The Australian retail broadband market is dominated by four major telecommunication carriers - Telstra, TPG, Optus and Vocus. These incumbent players collectively hold a market share of 92%. In Australia, there are 11.7m premises ready to connect to the NBN network, of which 7.4m have been completed as at June 20. As the rollout progresses, the remaining 4.3m premises will be forced to migrate from their historic providers and join the NBN network. With 4.3m new additions, this is a significant land-grab opportunity. While some may consider ancillary services, we largely expect customers to base their decision on price, speed and service quality. Given its product suite and high calibre customer service, we think ABB is well placed to fight it out with incumbents, with potential to capture 7.5% of the market by 2025.

So what does this all mean for shareholders? ABB is essentially a fixed cost business that adds variable costs for each NBN customer added. Variable costs are influenced by the number of customers serviced and their data usage. However, the existing fibre in place allows ABB to do more with less – they can achieve high incremental margins on new customers, serving a higher volume for little cost addition. This boost has the potential to add around \$3/share to the current price.

Once the NBN rollout is complete, we think ABB will look a lot like a premium utility business, providing a staple resource to residential and commercial premises. So why are we confident ABB can differentiate themselves in a tough market? In addition to reliable, high-speed connections, ABB's branding is centred on its best-in-class service offering. It markets itself



on providing high touch, no-nonsense service to customers. ABB's ability to deliver in this space is evidenced by the 5-star ratings across multiple review platforms and very low customer churn of <1% per month. At the 1H21 result, 70% of sales were from customers switching NBN providers and this highlights the strength of ABB's model.

In preparation for its long-term target of 1 million subscribers, ABB has undertaken a \$50m+ capex project focused on expanding the company's fibre network across Australia. This means more reliable connections, and better margins for ABB as it will no longer need to lease fibre from other telco providers. An upgraded network is future-proofing for long-term trends around data usage and speed requirements, and positions ABB to continue to gain market share. Data demands are unlikely to slow - not only are households increasing their number of connected devices, these devices have more

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onerous data demands than ever before. We are connecting to smart houses, demanding better quality streaming across video, audio and gaming, and downloading more content from online news sources and social media. These trends were further bolstered by the habits we saw during Covid-induced lockdowns. Offices migrated to remote work, while others discovered the world of streaming to join those of us already hooked on the data drip.

ABB's growth story is in-part a reflection of its capable board, aligned management, and history of successful execution. Managing Director Phillip Britt holds over 20 years of telco experience, and has led ABB's growth story since its origins. Britt founded Wideband Networks, which went on to merge with Westvic Broadband in 2008 to form Aussie Broadband. In addition to Britt, ABB's Board and Management is rich in telecommunications experience whilst still maintaining a healthy spread of industry experience in executive and non-executive roles across a wide array of sectors. Board members hold a +20% shareholding in the company - we think this aligns interests to shareholders and ultimately shows they are willing to put their money where their mouth is.



Annual reports are a key piece of communication between the company and its shareholders. A key step of our investment process is to assess the quality of accounts. This requires an assessment of the financial statements, line by line, and also what can be read between the lines - are the accounting policies aggressive or conservative? Do they paint an accurate picture of the business's financial position? Do the accounts fit the narrative told by the business? Can we reconcile profit to cash?



We found ABB to have high quality accounting policies that give an accurate representation of their business performance. The subscription structure provides easy, predictable revenue recognition, with the majority of contracts paid monthly in advance. Network connection costs move largely in line with the number of connections, allowing us to easily match them against revenue and enable us to get an understanding of true underlying profitability. As Aussie Broadband's operations are capital-light, there is little risk around inventory valuation and working capital management. Additionally, the entity holds minimal debt, with the bulk of its net cash position to be invested into ABB's fibre project. Overall, we believe these are a clean set of accounts.

Supported by the fundamentals, we believe the market will continue to recognise the ABB story. With strongly aligned Board and management, the company will likely enhance margins through focused capex spending and well-targeted advertising. Equipped with great products, speed and service, we see Aussie Broadband serving up growth for years to come.

Bon appétit.

Sheryl Chand
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