

Aussie Broadband Ltd

Investing to get on with business

The June quarter update re-iterated that ABB is on track to deliver FY22E EBITDA at the top end of the \$38m-\$39m guidance range, whilst missing very marginally, by <1%, on subscriber estimates. Our subscriber forecasts are largely unchanged into FY23e at +18%. Operating costs have grown incrementally into FY23e. This includes a rising wages bill on existing staff, increased call centre headcount to maintain competitive advantage in service levels and commitment to build out the business and enterprise sale channels. Operating cost assumptions within the business segment are 15% higher in FY23e, net of synergies captured. Including Over the Wire (OTW), business and enterprise has now become the key EBITDA contributor, which we argue improves the quality and visibility of group earnings. OTW's contribution during the June quarter, and \$5m-\$6m of captured synergies, sets the business up for a strong c\$38m+ EBITDA contribution in FY23e, with reducing execution risks. Medium term, our investment thesis of rising gross margins, increasing scale through on-net fibre migration and improving earnings mix holds firm. NBN Co's decision to reset and review the wholesale pricing structure creates potential upside risk for ABB forecasts and terminal value calculations. We have revised FY23e EBITDA by -3% to allow for higher opex. DCF based valuation rolls forward 1-year and falls to \$4.69 per share (from \$5.10). Maintain BUY.

Market share growth against a tight backdrop

- Estimated market share on the NBN network has risen to 6.46% on 30 June (from 6.1% at 31st March). Against a tight market for new activations, we expect ABB's FY23e market share growth to come from incumbent providers, leveraging brand and high customer ratings.

Business and enterprise growth

- OTW adds ~16,000 business, enterprise, government and wholesale customers to the group. With the fibre roll-out strategy c90% complete, we expect the group to capture ~\$10m net cost savings in FY23e.

Maintain BUY, valuation \$4.69 (from \$5.10)

- Our DCF reduces from a modest reduction in the earnings base and higher cost of capital. Next catalyst: FY22 results.

Year-end June (\$)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (\$m)	190.5	350.3	556.6	846.2	990.0
EBITDA (\$m)	3.5	19.2	38.6	90.6	120.5
EBIT (\$m)	(2.0)	11.6	22.5	61.1	84.6
Reported NPAT (\$m)	(12.3)	(4.5)	11.4	26.2	42.4
Reported EPS (c)	(6.5)	(2.4)	4.8	11.0	17.9
Normalised NPAT (\$m)	(2.2)	6.6	12.9	37.0	54.5
Normalised EPS (c)	(1.2)	3.5	5.9	15.6	22.9
EPS Growth (%)	-	-	68.8	164.6	47.1
Dividend (c)	-	-	-	-	-
Net Yield (%)	-	-	-	-	-
Franking (%)	-	-	-	-	-
EV/EBITDA (X)	-	27.3	22.3	9.2	6.6
Normalised P/E (x)	-	87.4	51.8	19.6	13.3
Normalised ROE (%)	15.4	34.2	9.1	15.6	20.1

Source: OML, Iress, Aussie Broadband Ltd

Last Price

A\$3.05

Target Price

A\$4.69 (Previously A\$5.10)

Recommendation

Buy

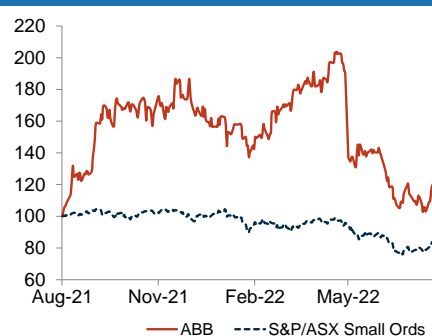
Risk

Higher

Telecommunication Services

ASX Code	ABB
52 Week Range (\$)	2.92 - 5.95
Market Cap (\$m)	724.8
Shares Outstanding (m)	237.6
Av Daily Turnover (\$m)	2.9
3 Month Total Return (%)	-45.1
12 Month Total Return (%)	7.0
Benchmark 12 Month Return (%)	-13.8
NTA FY22E (¢ per share)	-21.9
Net Debt FY22E (\$m)	135.4

Relative Price Performance



Source: FactSet

Consensus Earnings

	FY22E	FY23E
NPAT (C) (\$m)	15.3	38.3
NPAT (OM) (\$m)	12.9	37.0
EPS (C) (c)	6.8	15.8
EPS (OM) (c)	5.9	15.6

Source: OML, Iress, Aussie Broadband Ltd

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Forecast changes

Figure 1: FY23e EBITDA reduces to \$90.6m (from \$93.1m)

	FY22e	FY22e	change	FY23e	FY23e	change	FY24e	FY24e	change
	old	new		old	new		old	new	
Sales by segment \$m									
residential	414.1	412.1	0%	513.5	507.8	-1%	592.4	587.9	-1%
business (incl OTW)	107.9	117.0	8%	253.3	265.7	5%	290.3	309.8	7%
white label & wholesale	26.6	27.4	0%	69.4	72.7	0%	89.8	92.4	0%
sales - total	548.6	556.6	1%	836.2	846.2	1%	972.4	990.0	2%
key P&L metrics \$m									
Gross profit	156.8	161.7	3%	246.0	248.5	1%	280.8	290.1	3%
GP margin	28.6%	29.0%	2%	29.4%	29.4%	0%	28.9%	29.3%	1%
EBITDA	36.3	38.6	6%	93.1	90.6	-3%	120.9	120.5	0%
EBITDA margin	6.6%	6.9%	5%	11.1%	10.7%	-4%	12.4%	12.2%	-2%
D&A	-16.2	-16.2	0%	-28.9	-29.5	2%	-34.2	-35.9	5%
EBIT	20.2	22.5	11%	64.2	61.1	-5%	86.7	84.6	-2%
Net interest	-3.1	-4.1	31%	-7.9	-8.2	4%	-6.5	-6.8	4%
Associate profit	0.0	0.0	0%	0.0	0.0	0%	0.0	0.0	0%
PBT	17.1	18.4	8%	56.3	52.9	-6%	80.2	77.8	-3%
NPATA	12.0	12.9	8%	39.4	37.0	-6%	56.2	54.5	-3%
NPAT (reported)	10.5	11.4	9%	28.5	26.2	-8%	44.1	42.4	-4%
EPS -A (cents)	5.5	5.9	8%	16.6	15.6	-6%	23.6	22.9	-3%
Key metrics \$m									
dividend (cents)	0.0	0.0	0%	0.0	0.0	0%	0.0	0.0	0%
net debt (cash)	136.7	135.4	-1%	104.5	111.4	7%	57.5	76.2	33%
net debt (cash)/EBITDA x	3.8x	3.5x	-7%	1.1x	1.2x	10%	0.5x	0.6x	33%
operating cash flow	26.9	28.2	5%	69.9	67.7	-3%	86.6	85.8	-1%
investing cash & leases	-338.4	-338.4	0%	-37.7	-43.7	16%	-39.6	-50.6	28%
free cash flow	-311.5	-310.2	0%	32.2	24.0	-26%	47.0	35.2	-25%
ROIC (pre-tax) %	8.1%	9.0%	11%	14.8%	14.1%	-5%	19.9%	19.5%	-2%
price/book value x	3.4x	3.2x	-5%	3.0x	2.9x	-4%	2.6x	2.5x	-4%
EV/EBITDA x	24.8x	22.3x	-10%	9.3x	9.3x	-1%	6.8x	6.7x	-2%
P/E ratio x	58.5x	51.8x	-11%	19.3x	19.6x	1%	13.5x	13.3x	-2%

Source Ord Minnett Limited Research

- **Subscriber numbers largely unchanged into FY23e:** We assume that ABB adds a net ~74K residential subscribers during FY23e. This is equivalent to 4x the level of residential subscriber growth during the June '22 quarter. We have also maintained white label subscriber growth numbers at a net 2K/month, which is a conservative starting position compared with the June quarter growth rate of 2.5-3.0K/month.
- **Increased operating costs to support growth:** We have increased forecast operating costs by ~\$4m during FY23e to account for increased investment in the business segment, including sales, technical and support staff. Overall operating costs in the business segment rise by 15% in FY23e, net of synergies captured from the OTW acquisition and network cost savings.
- **Capex forecasts rise to 5-5.5% of revenues:** Our capex forecasts rise by \$6m into FY23e to account for the delayed completion of the fibre project and a higher level of growth capex. Given the mix between residential and business networks, we expect capex/revenue to steady at 5-5.5% of group sales in FY24e.
- **Interest costs reflect higher swap rates:** Interest cost assumptions have risen to an estimated 4.2% weighted average for ABB. Our interest expense assumption rises to \$8.2m (from \$7.9m) in FY23e. Net debt/EBITDA is likely to reduce to 1.2x in FY23e on the revised forecasts.

Quarterly highlights

- FY22 EBITDA is likely to be at the upper end of the \$38m-\$39m guidance range based on unaudited accounts. FY22 result is due to be released to the market on Monday 29th August 2022.
- 30 June subscriber numbers of 578,864 (Ords 582,064), excluding the OTW small business customers, missed our expectations by <1%. Including the OTW small business customer segment, total subscribers were 584,793, in line with the prior guidance range of 580,000 to 585,000 by 30 June 2022.
- The white label agreement with Origin is tracking ahead of expectations, adding a net 2.5-3.0K new subscribers per month and finishing 30 June at 60,326 (Ords 56,748).
- The company owned fibre program is 90% complete. Roll outs in VIC, QLD and NSW have been delayed partly due to weather events. The program is likely to be complete during the September quarter FY23e.
- The Fibre program is set to deliver \$13.5m in annual opex savings once all of the enterprise agreements have been transitioned from the former supplier. Accounting for operating costs and potential faults, we expect an actual operating cost saving of ~\$10m during FY23e.
- The June quarter market share of NBN services is expected to rise to 6.46% (from 4.74% June '21 and 6.19% in March '22). ABB continues to grow share leveraging the leading brand and high customer ratings.
- Over the Wire (OTW) integration is progressing to plan with run-rate cost synergies of \$5.2m achieved to date (Ords \$4.5m). ABB has re-stated the \$8m to \$12m medium term synergy target, consistent with prior guidance.
- OTW and ABB are collaborating on new enterprise customer wins, resulting in 3 large incremental enterprise customer wins.
- During 4Q22 the company focussed on hiring additional call centre staff to maintain service levels at historical levels and was awarded the “Most Trusted Telco brand in Australia” by Roy Morgan research.
- Aussie Broadband supports the Federal Government’s decision to reset the NBN Co’s proposed special access undertaking into wholesale prices.

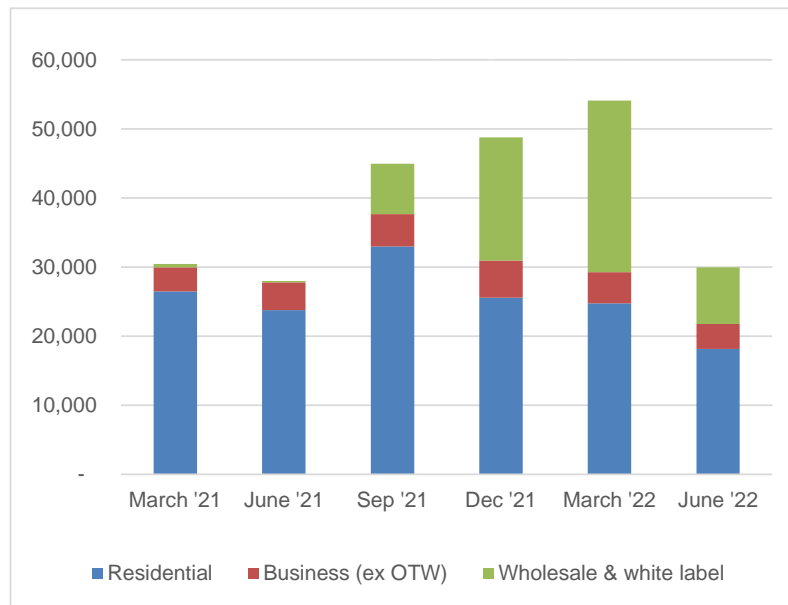
Figure 2: Broadband services by segment (closing)

Quarterly - Broadband Services	Dec '20*	March '21	June '21	Sep '21	Dec '21	March '22	June '22
Residential	313,193	339,668	363,455	396,452	422,034	446,814	464,979
Business	27,941	31,446	35,466	40,135	45,483	49,972	53,559
Wholesale & white label	1,500	1,959	2,144	9,460	27,286	52,125	60,326

Source: Ord Minnett Research, Company reports

- Total subscriber growth of +46% versus the pcp:** Total broadband services excluding the Over the Wire acquisition were slightly below the previous guidance range (<1% below versus Ords assumptions) largely as a result of less aggressive marketing following the Federal election. We assume 2H22 marketing expenses of \$19.6m vs. the 1H of \$16.4m. Cost of customer acquisition likely increased marginally from the 1H and churn rates were within expectations.

Figure 3: Broadband additions by segment (per quarter)



Source: Ord Minnett Research, Company reports

Valuation

We value Aussie Broadband on a DCF basis utilising a WACC of 10.4% (from 9.4%), a cost of equity of 11.8% (from 10.4%) and a terminal growth rate of 3% (from 3.0%) based on forecasts for FY23e-FY31e. Our DCF valuation yields a 12-month price target of \$4.69 (from \$5.10). We maintain a BUY recommendation.

Next catalysts include: FY22 audited results, new white label agreements, news on revisions to the NBN pricing model, update on the OTW growth rate, residential churn rates. Medium-term catalysts include earnings momentum in the business market, cut-through of the multi-product and enterprise offering, NBN wholesale pricing and margin growth from operating leverage across the segments.

Peer Analysis

Aussie Broadband currently trades on a substantial -42% EV/EBITDA discount to peers in FY23e, including a full year contribution from OTW. Versus ASX listed peers Symbio & TPG, ABB trades on a -69% P/E discount and -65% EV/EBIT discount on FY23e forecasts.

We see FY23e-FY24e as a period with which ABB can attain a level of scale and operating leverage across the substantial overhead and infrastructure costs. The integration of OTW fast tracks this transition and places the company on strong footing to generate ROE of 15%-20% during this period.

Figure 4: Relative valuation vs peers

Company	Mkt cap	EV	Price / Earnings			EV/EBIT			EV/ EBITDA			EV/ Sales		
	US\$m	US\$m	FY21	FY22	FY23	FY21	FY22*	FY23	FY21	FY22*	FY23	FY21	FY22	FY23
Uniti	2394	2523	65.7	43.4	38.1	48.2	27.9	25.4	41.9	25.6	22.5	20.0	15.2	13.5
Macquarie Telco	1,011	1,198	136.4	239	42.9	74.5	90.9	33.7	23.1	19.4	15.7	5.6	5.6	4.8
TPG	8,247	12,256	45.7	41.5	29.0	38.1	38.1	29.4	9.9	9.4	8.7	3.2	3.3	3.1
Cogent Communications	3,062	4,033	72.7	83.2	53.3	35.6	32.6	28.1	17.0	16.4	15.0	6.8	6.6	6.3
Vonage Holdings	5,386	5,886	119.9	139.9	149.9	178.9	78.7	65.3	29.8	27.3	22.0	4.2	3.8	3.3
Switch Inc	8,280	10,346	197.7	153.0	162.5	111.3	91.7	79.3	33.1	29.4	26.3	17.4	15.4	13.9
Symbio Holdings	243	217	20.9	25.6	22.2	10.9	17.3	15.3	7.5	8.8	7.9	1.2	1.5	1.4
Ciena Corporation	7,725	7,308	17.6	25.5	16.0	n.a.	n.a.	n.a.	10.4	13.6	9.8	n.a.	n.a.	n.a.
		Average	84.6	93.9	64.2	71.1	53.9	39.5	21.6	18.7	16.0	8.4	7.3	6.6
		Median	69.2	63.3	40.5	48.2	38.1	29.4	20.1	17.9	15.4	5.6	5.6	4.8
Aussie Broadband (USD)	487	578	87.4	51.8	19.6	45.2	38.4	13.7	27.4	22.3	9.3	1.5	1.6	1.0

FY22e includes only a partial contribution from the OTW acquisition settled on 15th March 2022.

Source: Ord Minnett Research, Bloomberg

Investment thesis

We are attracted to the growth profile of Aussie Broadband, leveraging the company's core advantages including a highly rated customer support team, tech-savvy positioning in the residential market, and highly efficient sales and marketing engine. The company is 90% progressed with a ~\$67m fibre roll-out strategy to replace 3rd party fibre backhaul, saving operating costs across all customer segments and improving network quality. Aussie Broadband holds ~6.5% of the domestic broadband market and has scope to grow this materially, underpinned by market share gains in the residential and small business market. We also see opportunity in the enterprise market, assisted by cloud, security and management services acquired through OTW and via the roll-out of the company's own order management system *Carbon*. Post the acquisition of OTW, business has become the primary EBITDA contributor which we believe improves the quality and predictability of earnings for the group.

Overview

Aussie broadband was formed in 2008 and provides broadband and related telecommunications services to residential homes, small business, not for profits, enterprise, and managed service providers. The company is headquartered in Morwell, Victoria, with an office in Lynbrook, Melbourne and plans to open a new office in Perth. The range of services include broadband, partnerships in mobile and entertainment products, including Optus and Fetch TV. In 2020, Carbon was launched, creating a fully owned portal for larger enterprises and managed service providers to order equipment and services. Aussie Broadband operates both as a national multiprotocol label switching (MPLS) network and as a licensed telecommunications carrier balancing between owned infrastructure and wholesale partners. The company employs over 700 team members. Over the Wire Limited is a telecommunications company built around a range of technology platforms. The company employs 300 staff and is headquartered in Brisbane, with offices in Sydney, Melbourne and Adelaide. Key areas of service include data and voice networks, cloud hosting and security, plus managed services.

Key risks

- **Competition:** The company is exposed to highly competitive pricing within the retail broadband network. ~90% of existing market share is held by the four major telecommunication carriers. Competitive pressure from 5G plans has intensified during 2022 at the same time as the level of growth in ready to connect customers has slowed.
- **NBN Co pricing:** The NBN Co sets wholesale charges for access to carriers such as Aussie Broadband, including AVC and CVC pricing. Gross profit margins are negatively impacted by CVC charging in future periods as households consume more data. Failure of the residential service provider (RSP) segment to alter the CVC pricing regime and/or inability of ABB to continue managing CVC obligations effectively, may negatively impact our profit forecasts.
- **Cost growth:** The company has increased operating expenses to cover rising staff wages and to build out the business and enterprise platform for future growth. Cost inflation and operational investment above forecasts remain a risk to short term estimates in FY23e, noting the upside from expansion of the business segment into future periods.

Aussie Broadband Ltd

PROFIT & LOSS (A\$m)	2020A	2021A	2022E	2023E	2024E
Revenue	190.5	350.3	556.6	846.2	990.0
Operating costs	(187.0)	(331.1)	(518.0)	(755.6)	(869.6)
Operating EBITDA	3.5	19.2	38.6	90.6	120.5
D&A	(5.5)	(7.6)	(16.2)	(29.5)	(35.9)
EBIT	(2.0)	11.6	22.5	61.1	84.6
Net interest	(1.2)	(2.2)	(4.1)	(8.2)	(6.8)
Pre-tax profit	(3.2)	9.5	18.4	52.9	77.8
Net tax (expense) / benefit	1.0	(2.8)	(5.5)	(15.9)	(23.3)
Significant items/Adj.	(10.0)	(11.1)	(1.5)	-	-
Normalised NPAT	(2.2)	6.6	12.9	37.0	54.5
Reported NPAT	(12.3)	(4.5)	11.4	26.2	42.4
Normalised dil. EPS (cps)	(1.2)	3.5	5.9	15.6	22.9
Reported EPS (cps)	(6.5)	(2.4)	4.8	11.0	17.9
Effective tax rate (%)	30.0	30.0	30.0	30.0	30.0
DPS (cps)	-	-	-	-	-
Dividend yield (%)	-	-	-	-	-
Payout ratio (%)	-	-	-	-	-
Franking (%)	-	-	-	-	-
Diluted # of shares (m)	190.5	191.2	238.5	238.5	238.5

CASH FLOW (A\$m)	2020A	2021A	2022E	2023E	2024E
EBITDA incl. adjustments	3.5	19.1	30.1	77.3	114.1
Change in working capital	3.8	4.9	7.7	14.5	1.8
Net Interest (paid)/received	(1.2)	(2.2)	(4.1)	(8.2)	(6.8)
Income tax paid	-	-	(5.5)	(15.9)	(23.3)
Other operating items	0.8	3.4	-	-	-
Operating Cash Flow	6.9	25.3	28.2	67.7	85.8
Capex	(5.4)	(17.1)	(52.4)	(31.6)	(37.3)
Acquisitions	-	-	(275.1)	-	-
Other investing items	-	-	-	-	-
Investing Cash Flow	(5.4)	(17.1)	(327.4)	(31.6)	(37.3)
Inc/(Dec) in equity	-	37.4	117.8	-	-
Inc/(Dec) in borrowings	23.3	(5.5)	175.0	(30.0)	(40.0)
Dividends paid	-	-	-	-	-
Other financing items	(3.9)	(4.5)	(11.0)	(12.1)	(13.3)
Financing Cash Flow	19.4	27.4	281.8	(42.1)	(53.3)
Net Inc/(Dec) in Cash	20.8	35.6	(17.4)	(6.0)	(4.8)

BALANCE SHEET (A\$m)	2020A	2021A	2022E	2023E	2024E
Cash	21.4	57.0	39.6	33.6	28.8
Receivables	11.4	17.0	30.5	41.7	48.8
Inventory	1.7	5.5	8.7	13.3	15.5
Other current assets	2.5	2.0	2.0	2.0	2.0
PP & E	5.4	17.4	94.1	122.2	143.7
Investments	-	-	-	-	-
Intangibles	2.5	4.0	276.1	264.7	252.8
Other non-current assets	12.9	14.0	61.9	61.9	61.2
Total Assets	57.8	116.9	513.0	539.4	553.0
Short term debt	27.2	-	-	-	-
Payables	16.1	26.8	42.7	64.9	75.9
Other current liabilities	27.1	25.2	33.8	41.8	41.9
Long term debt	-	-	175.0	145.0	105.0
Other non-current liabilities	7.8	5.4	37.4	37.4	37.4
Total Liabilities	78.3	57.4	288.9	289.2	260.3
Total Equity	(20.7)	59.5	224.1	250.3	292.7
Net debt (cash)	5.8	(57.0)	135.4	111.4	76.2

Buy

DIVISIONS	2020A	2021A	2022E	2023E	2024E
KEY METRICS (%)	2020A	2021A	2022E	2023E	2024E
Revenue growth	91.2	83.9	58.9	52.0	17.0
EBITDA growth	-	452.6	101.1	134.7	32.9
EBIT growth	-	-	92.8	172.1	38.4
Normalised EPS growth	-	-	68.8	164.6	47.1
EBITDA margin	1.8	5.5	6.9	10.7	12.2
EBIT margin	-	3.3	4.0	7.2	8.5
Return on equity	15.4	34.2	9.1	15.6	20.1

VALUATION RATIOS (x)	2020A	2021A	2022E	2023E	2024E
Reported P/E	-	-	63.7	27.7	17.1
Normalised P/E	-	87.4	51.8	19.6	13.3
Price To Free Cash Flow	-	269.0	-	30.2	20.6
Price To NTA	-	10.4	-	-	18.2
EV / EBITDA	-	27.3	22.3	9.2	6.6
EV / EBIT	-	44.9	38.3	13.7	9.5

LEVERAGE	2020A	2021A	2022E	2023E	2024E
ND / (ND + Equity) (%)	(38.9)	(2,247.1)	37.7	30.8	20.7
Net Debt / EBITDA (%)	167.0	(296.9)	350.6	122.9	63.3
EBIT Interest Cover (x)	-	5.4	5.5	7.4	12.5
EBITDA Interest Cover (x)	3.0	8.9	9.5	11.0	17.8

VALUATION

Cost of Equity (%)	11.8
Cost of debt (after tax) (%)	4.5
D / EV (%)	15.7
WACC (%)	10.4
Forecast cash flow (\$m)	487.6
Terminal value (\$m)	761.0
Franking credit value (\$m)	-
Enterprise Value (\$m)	1,248.6
Equity NPV Per Share (\$)	4.69

Target Price Method	DCF
Target Price (\$)	4.69
Valuation disc. / (prem.) to share price (%)	53.8

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SPECULATIVE BUY	We expect the stock's total return (nominal yield plus capital appreciation) to exceed 20% over 12 months. The investment may have a strong capital appreciation but also has high degree of risk and there is a significant risk of capital loss.
BUY	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over the next 12 months.
ACCUMULATE	We expect a total return of between 5% and 15%. Investors should consider adding to holdings or taking a position in the stock on share price weakness.
HOLD	We expect the stock to return between 0% and 5%, and believe the stock is fairly priced.
LIGHTEN	We expect the stock's return to be between 0% and negative 15%. Investors should consider decreasing their holdings.
SELL	We expect the total return to lose 15% or more.
RISK ASSESSMENT	Classified as Lower, Medium or Higher, the risk assessment denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, historical volatility of its share price, nature of its operations and other relevant quantitative and qualitative criteria. Risk is assessed by comparison with other Australian stocks, not across other asset classes such as Cash or Fixed Interest.

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