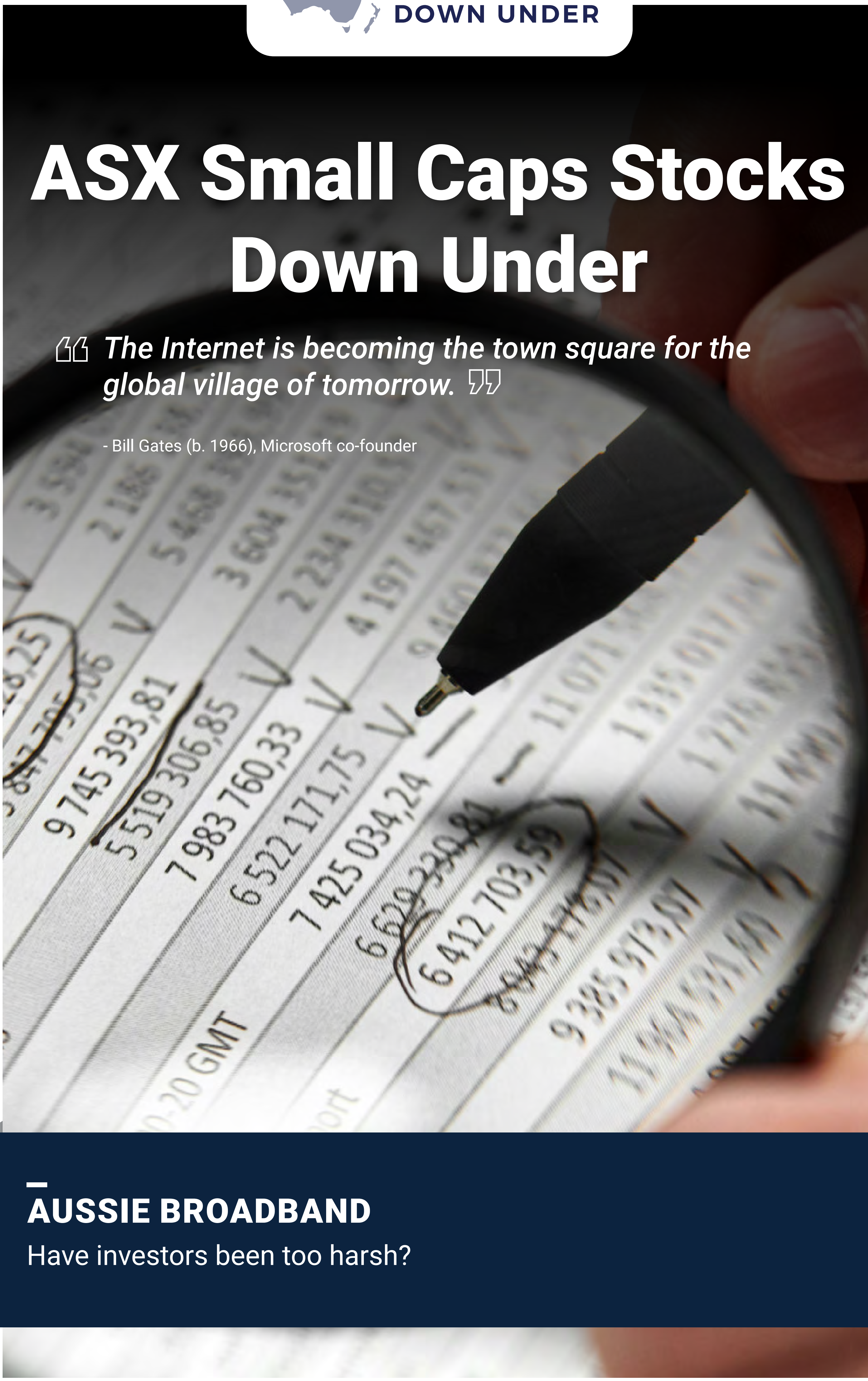
STOCKS DOWN UNDER

22 JULY 2022

ASX Small Caps Stocks Down Under

The Internet is becoming the town square for the global village of tomorrow.

- Bill Gates (b. 1966), Microsoft co-founder



AUSSIE BROADBAND

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Stocks Down Under rating: ★★★★

ASX: ABB
Market cap: A$826.9M

52-week range: A$2.60 / A$6.03
Share price: A$3.48

Telcos are not the most liked businesses, but Aussie Broadband is proving an exception, to customers and investors. Aussie Broadband is one of several NBN providers in Australia and prides itself in its high internet speeds and customer service experience. Since listing on the ASX in 2020 at $1 per share it has substantially grown its customer base, revenues and, consequently, its share price. It went as high as $5.95 in late April 2022 before dipping after informing shareholders it would only meet the lower end of its guidance. Has the subsequent dip presented an opportunity to buy in?

Share price chart

Source: Tradingview

Substantial growth since listing

Aussie Broadband was formed in 2008 through the merger of two regional telcos – Wideband Networks and Westvic Broadband. Retail telco is a notoriously low margin business, especially if it's the NBN – even the major telcos hate it. It is also a thankless industry to be in with customers expecting perfect service, given how much we rely on the Internet. Aussie Broadband is able to make money through automation systems that lower the cost, but also provide a smooth customer experience, enabling sign-ups that can be done without any on-site work. As for customer service, it is highly rated by customers for its sign-up experience, its products, internet speed and for having a local call centre with low wait times.

As of 31 March 2022, the company had 446,814 residential customers (up 32% year-on-year), 49,972 business customers (up 59%) and 51,125 wholesale customers (up 2,561% from just 1,959 a year ago) representing 548,911 customers in total (up 47%). Aussie Broadband has undoubtedly been in the right place at the right time. Not just because people were confined to their homes during lockdowns, more people are using more broadband and are looking for maximum utility from what they are paying for. But also listing amidst an IPO boom, outperforming much of its peers as a growth stock and a profitable one at that. Arguably, investors who missed out on telco Uniti (ASX: UWL), which grew from 20c to over $1.40 in mid-2020 and nearly $5 now, did not want to miss out on such a growth opportunity again.

Since listing, Aussie Broadband has rolled out new products, including mobile plans and white label, rolled out its fibre optic network and acquired telco solutions provider Over the Wire. For FY22, Aussie Broadband is expecting $27-$28m in EBITDA, up 41-45% from FY21 ($19.6m) and up over 7 times from FY20 ($3.6m). You'd think shareholders would like that, but they didn't.

Shareholders can be tough to please

On 2 May, Aussie Broadband put out a quarterly trading update in which it gave the aforementioned EBITDA guidance, plus updated connections guidance of 580,000 to 585,000. The trouble was that although the EBITDA was within the previous guidance range, it was towards the lower end – Aussie Broadband provided $27-$30m for the full year back in February. Furthermore, broadband connections were not growing faster than the previous quarter – at 11% in both 2Q22 and 3Q22. This was in spite of the Over The Wire acquisition. Now, to be fair, it was only completed with two weeks to go in Q3 (15 March) so there was not going to be an impact this year. The company clarified this the next day and stated it expected an ~$11m EBITDA benefit above and beyond the $27-$28m estimate even though its ownership only extended 3.5 months in the financial year. The directors put their money where their mouths were, making big on-market buys of over $100,000 later that week.

Still, the company has continued to sell off and is barely above $3. We think shareholders are beginning to realise some negative aspects about the company. Most particularly, that it targets the low-margin retail telco segment. In contrast, Uniti has traditionally been wholesale only, as well as an alternative network to the NBN rather than just another provider. You see, Aussie Broadband's average revenue per user was $78.19 per month for residential and $129.67 p/m for business customers. Admittedly, some of this might be explained by a lower user base for business, but its EBITDA in FY21 for residential was $12.5m from $305m in revenue and business was $6.7m from $45.2m in revenue – representing a higher EBITDA margin in the latter case.

And while the company is in the green on an EBITDA level, it is negative on a NPAT level with -$4.2m in FY21, albeit only a third of FY20's loss. The company has not yet given NPAT guidance for FY22. Admittedly, it would have been positive but for a -$12.3m change in the fair value of its derivatives. Nevertheless, as a company that had gone up so much, with such a high valuation and without blemish in its 18 months of listed life, it was an easy target for investors to sell off.

Is it a buy? It all depends on whether it can continue its growth

Looking to its multiples, Aussie Broadband appears reasonably valued at 6.5x EV/EBITDA and 19.3x P/E for FY23. However, consensus estimates for FY23 forecast significant growth compared to FY22 - $825.7m in revenue and $92m in EBITDA, up 54% and 144%. Both figures would be several times higher than FY23, revenue and EBITDA would up 381% and 135% respectively.

In FY24, growth is forecast to moderate, with $962.4m in revenue and $123.1m in EBITDA, up 16% and 33% respectively from FY23. But remember, this is up from FY23 figures which assume significant growth.

Clearly, whether or not you invest in this company all comes down to whether or not you believe it can achieve these targets. We think on the balance of probabilities it can, given the acquisition of Over The Wire and its reputation in the industry. Ultimately, we've chosen to give this company four stars, but we probably wouldn't buy in until we see its final FY22 results due in August- preferably with some guidance for FY23.

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