STOCKS DOWN UNDER

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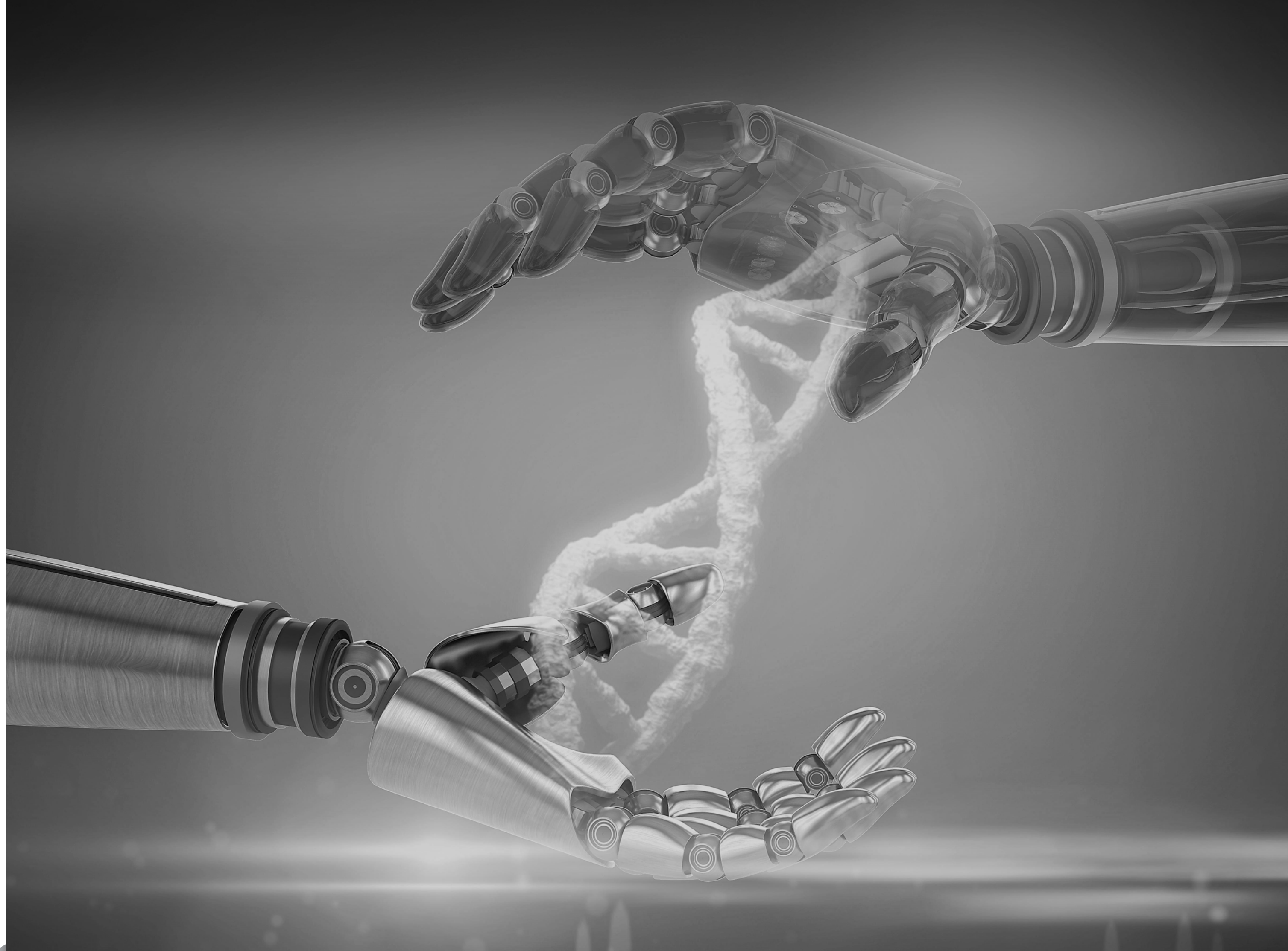
Emerging Stocks Down Under

"A fool learns from his own mistakes. The wise learn from the mistakes of others."

- Otto von Bismarck (1815-1898), Former German Chancellor



PENTANET

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Stocks Down Under rating: ★ ★

ASX: 5GG
Market cap: A$55.9M

52-week range: A$0.24 / A$0.76
Share price: A$0.26

When an industry is dominated by a handful of big providers that have little incentive to innovate or deliver for customers, small companies become motivated to take them head on. Pentanet (ASX: 5GG) is one of a handful of such companies in the telco space and IPOs in 2020-21. As one of the later listings, it rose post-listing, but arguably was driven by FOMO (Fear of Missing Out) by investors who hadn't bought into previous IPO's or missed out. But with the 'bull run' over, is there anything going for Pentanet other than FOMO?

Share price chart

Source: Tradingview

Investors were attracted by FOMO

Pentanet was founded by West Australian brothers Timothy and Stephen Cornish in 2017, frustrated with Perth's slow internet and the lack of local support in the market. Pentanet was one of the first companies to list in 2021, doing so at 25c a share and raising $22.5m. Shares have mostly been above the listing price ever since, but are off the all-time highs of $1.10 (reached in 2021). We think the post-listing rise was simply because of FOMO (Fear of Missing Out) by investors who missed out on the listings of Uniti (ASX: UWL) and Aussie Broadband (ASX: ABB), which delivered spectacular returns for investors.

Pentanet was small compared to these companies, but it boasted over 8,000 subscribers and intended to use the IPO proceeds to expand onto the East Coast. It promised to roll out a next generation gigabit fixed-wireless technology developed by Facebook, which will enable higher speeds and would be another alternative to the NBN.

Do people really need better Internet, you might ask? Yes, they do. By 2028, the average household data demand will reach 767 gigabytes per month, nearly four times higher than a decade earlier as a direct result of people spending more time online and using more data – both because of spending more time online and using more data-rich applications. NBN alternative technologies are proving technologically superior and have higher margins, thereby providing opportunities for Pentanet and its competitors.

Esports ambitions

Faster internet was attractive in and of itself, but there was another end game for Pentanet. The company has ambitions in the Esports space and it was eyeing off the right space at the right time. You see, lockdowns led to a big boom in Esports, which was a significant opportunity for companies to capitalise on, both from a consumer market and share price perspective.

Although ambitions are all well and good, Pentanet had a couple of assets that could make it possible. First, a fast enough network to make it possible. And second, an alliance with NASDAQ-listed NVIDA to roll out the gaming service GeForce NOW to enable cloud Esports on any computer or mobile device. Pentanet also has its own esports team (Pentanet.GG), which showcases its dedication to the sector, hoping it can indirectly bring in new business.

A strong top line, but bad bottom line

Nearly two years since listing, just how have things panned out? Investors who bought in at all-time highs are underwater, but those who bought at IPO and held would still be sitting on paper gains. In FY22 (the 12 months to 30 June 2022), Pentanet generated revenues of $16.8m (up 54%), a gross profit of $7.4m (up 55% and representing a 44% margin), an underlying EBITDA loss of $4.4m (an increase of 83%) and made an NPAT loss of $7.9m (down from $13.7m in FY21, although FY21 included $8.4m in IPO costs). Telco subscribers grew 34% to 16,674.

The company lauded the revenue results, but acknowledged the negative bottom line noting it had put significant expenditure into hiring, marketing and network coverage. It hopes these will pay off in the years to come, increasing available coverage and network performance. It told shareholders it would increase margins attract off-net customers to higher margin on-net services.

Good growth, but the price is too high

The company has not provided forward guidance, but there are consensus estimates available for Pentanet. For FY23, these suggest $25.2m in revenue and -$3.1m in EBITDA, improvements of 50% and 30% respectively. In FY24, consensus estimates predict $36.2m in revenue (up 44%) and $900k in positive EBITDA, but still a negative EPS. You might be tempted to buy in purely on the expected growth. However, the EV/EBITDA multiple for FY24 is discouragingly high, at 79.4x.

We also briefly turn our attention to Aussie Broadband (ASX: ABB), which trades at 6.1x EV/EBITDA for FY24, but is expecting $939.8m in revenue and $111.9m in EBITDA, up 32% from FY23 consensus estimates and up 184% from FY22 results. We also observe that ABB has over 700,000 total services across its customer base (which is retail consumer as well as business, enterprise and government). We have not considered Uniti given it has been taken over and consequently delisted from the ASX.

West Australian investors might be tempted to buy into Pentanet purely on the angle of sticking it up to the East Coast. But we think even if it does achieve its consensus estimates, growth in Pentanet's share price is far more likely to be driven by some kind of FOMO as was the post-IPO listing splurge, whether in Esports, retail telcos or the Cloud. Ultimately, we think there are better businesses with exposure to those thematics at a more reasonable price. As a result, Pentanet gets two stars from us.

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