



Roger Montgomery

Switzer Expert

The NBN's impact on Telstra, iiNet and TPG

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by Roger Montgomery

ADSL has for many years been the staple of what retail service providers (RSPs) utilise to offer internet services. This is largely based off of the existing Telstra copper network, one originally designed for telephony services and not the internet. Technology has since developed and more advanced ways of delivering internet capacity are now available, particularly in fibre-based networks, the backbone of the National Broadband Network (NBN).

An NBN had been debated by various private institutions such as Telstra since the early 2000's yet were never able to obtain approval by the ACCC. In April 2009, the Labor government announced plans for a new NBN project that would provide a wholesale open-access network to RSPs and deliver internet connectivity at 100Mbps to 90% of Australian households via fibre to the premise technology (FTTP). This project was estimated to cost \$43 billion and would be designed, built and operated by a newly created government business enterprise: NBN Co.

Part of the process would involve the decommissioning of telephone network assets owned by Telstra and Optus, allowing for NBN Co to hold a monopoly in the provision of wholesale internet capacity.

Soon after the Coalition's victory in 2013, an independent review of NBN Co was conducted with several key conclusions found:

1. Progress of NBN deployment (as measured by the metric; premises passed) was **55%** behind corporate plan as of September 2013.
2. Fibre to the node (FTTN) networks could be rolled out quicker and a lot more cheaply compared to FTTP (the Coalition forecast the cost at \$29.5B however it's difficult to say whether this will hold). This would be, however, at the expense of internet speed, with entry-level speeds falling from 100MB/s to 12MB/s (comparatively, our fastest ADSL connections on copper networks have a theoretical maximum speed of about 24MB/s, 16MB/s more practically).
3. FTTP will comprise 20-26% of the network, FTTN & fibre to the basement (FTTB) will comprise 44-50% of the network and hybrid fibre coaxial technology (HFC) will comprise 30% of the network.

Actual NBN deployments are worse if you consider that the metric — premises passed — does not mean that a particular premise is able to use the NBN. Each premise passed still needs to be activated by NBN Co. Asking whether or not the project will be completed in the next decade or the one after that isn't a bad question.

Of course the real billion-dollar question is: how will the NBN's rollout impact listed RSPs like Telstra Corporation Limited, iiNet Limited, Singapore Telecommunications Limited (Optus) and TPG Telecom Limited? Consider that each customer (as the NBN is activated for their premise) will be able to review the pricing and offers from the spectrum of

providers. Naturally, those such as TPG and Dodo, with lower cost plans, will look more appealing and hence possess a competitive advantage over their peers.

Another question we can ask is: "How profitable will each RSP be on the NBN?" We firstly note that the average revenue per user (ARPU) amongst the providers is about \$60-\$80 per month, and on the cost side? Well this is where it gets complicated...

Connecting a user to the NBN involves several different kinds of costs. Firstly, NBN Co charges a connection fee based on the speed of the connection the user requires. For example, a user wanting a 12/1 Mbps service will incur a connection fee of \$24 per month whereas a user wanting a 100/40 Mbps service will incur a connection fee of \$38 per month. Next are the connecting virtual circuit (CVC) charges, which are calculated via a complex algorithm but grant the user an allocation of bandwidth capacity in which data can be carried. The average CVC can be estimated but is not currently known (and we won't add to the speculation with our own estimate). Other charges include network-to-network costs and other backhaul charges, which when averaged, vary depending on the location and the number of users.

Estimates of total averaged costs vary widely from \$25 per user per month to north of \$40 per user per month (noting additional charges for providers such as iiNet whom have to rent their backhaul). At the lower end of the spectrum, the NBN is a boon for the industry. At the upper end, it's the opposite, especially when you consider the projected NBN Co price rises (whether by higher data demand or price increases) and the competitive market, which places downward pressure on RSP ARPU.

I'll finish up with a quick look at TPG and their progress in developing their own FTTB NBN, which is directly in competition with NBN Co. Other RSPs have signaled their intent to develop similar networks should the progress of the NBN's rollout continue to stagnate. On the surface, this does seem like the jolt that perhaps NBN Co needs to "get moving", however the move could be anti-competitive should a premise hooked on to one RSP's FTTB network only have access to said RSP's plan. In response, the Vertigan Review has recommended that TPG be allowed to develop their own NBN provided that they allow other providers to use it. Ultimately the decision will rest with the ACCC, whom we'll be watching very closely.

Montgomery Investment Management owns shares of iiNet Limited (ASX: IIN).

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