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Market Briefing

BigAir Group CEO on FY16 results and outlook

Interview with Jason Ashton (CEO and Co-founder)

In this Market Briefing interview, BigAir Group's CEO & Co-founder, Jason Ashton, discusses the company's full year 2016 (FY16) results and strategic outlook including:

- *Financial performance over FY16*
- *Progress update on the Fixed Wireless division and outlook for FY17*
- *Progress update on the Cloud and Managed Services division and outlook for FY17*
- *Progress update on the Community Broadband division and outlook for FY17*
- *Key balance sheet movements*
- *Background to the recent CyberHound acquisition.*

Market Briefing
BigAir Group's full year results showed solid revenue and EBITDA growth, yet underlying NPAT growth was not as impressive. What were the key drivers for these results?

Jason Ashton
Group revenue and other income was up 27% to $80.7 million, and underlying EBITDA was up 18% to $22.3 million, due largely to strong revenue and margin expansion in all three of our operating divisions.

There were three main reasons for lower underlying NPAT growth of 7%. Firstly, interest was over $600,000 higher due to the increased use of our debt facility in calendar year 2015. This trend is not expected to continue as we started to reduce net debt in the second half of FY16 with the repayment of $2.1 million of borrowings.

There was also an increase in the non-cash amortisation of subscriber acquisition costs of over $330,000 reflecting the acquisitions we have undertaken. Lastly, depreciation increased by over $890,000 due to the unusually high capital expenditure in calendar year 2015 when we established our Cloud offering and completed some other projects. This trend is not expected to continue as capex has declined considerably in the second half of FY16.

Excluding these three factors, underlying NPAT growth was 21% over FY16.

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Your Fixed Wireless division appears to have had a very solid result with underlying EBITDA increasing by 16% despite a fairly modest growth in Revenues of 6%. What were the main drivers here?

Jason Ashton

Corporate fixed wireless revenue was up 26% in FY16. A key driver for this increase was the recent expansion of our offerings into Cloud and Managed Services. Not only did revenue increase, but the ability to bundle new services greatly increased customer stickiness. Churn in our Corporate services reduced by a third in FY16 to just 3.7% of revenue for the year.

This solid growth in Corporate was partially offset by the ongoing planned decline in our legacy Wholesale business. Our legacy wholesale business has been facing headwinds for many years due to ongoing industry consolidation. Four years ago we shifted our strategic focus to Corporate and this has seen Corporate comprise 58% of FY16 revenue and Wholesale 42%, compared to Wholesale's historic 80% level. As this shift continues we expect the drag created by the wholesale decline to dissipate allowing us to lift our overall organic revenue growth rate for this division.

The main drivers for the strong growth in underlying EBITDA were a combination of increased operating leverage and the changing revenue mix. The fixed wireless network of POPs we have built has mostly fixed costs which means the incremental cost for adding a new customer, mainly installing a radio link, is very low. The changing revenue mix from Wholesale to Corporate means that our average revenue per service is higher which improves the return on our invested capital.

With our own infrastructure in place, we are able to completely bypass Telstra and the NBN and avoid paying line rental costs and other charges such as NBN's controversial CVC charge. As a result, we don't have any significant variable costs when adding new customers. Today we can deliver bandwidths of up to 1Gbps using high speed microwave radio links that only require clear line of sight from our POP to the customer building rooftop. And the future roadmap is bright for this Division as we are expecting to start offering 2Gbps services this financial year and we will soon have access to low cost radios that can deliver 10Gbps which is literally 100 times as fast as the highest speed service you can order from NBN today.

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What were the main drivers in the result for the Cloud and Managed Services division, and can you provide an update on the integration of the recent acquisitions and some outlook for FY17?

Jason Ashton

Our Cloud and Managed Services division has become a very important part of the engine driving our business growth. We experienced strong growth in this division over FY16, with revenue up 45% to $42 million, due in large part to the acquisitions of Oriel in 2014 and Applaud in 2015. In addition we achieved underlying EBITDA growth of 25% to $7.5 million which is now almost one third of our total Group underlying EBITDA of $22.3 million.

It is important to note that this result was achieved despite some secondary lines of business declining, including procurement [product sales], and our smaller SME service offerings. Product sales are declining in line with industry trends and our focus is very much on building recurring contracted revenue streams from our service offerings - WAN, Cloud, and Managed Services. As a result, we are not focused on preserving historical product revenue streams that tend to operate on very low margins. This saw second half product sales down 20% versus the first half, and only contributing 13% of EBITDA for this division in the second half compared to 28% in the first half. We see this trend continuing, bolstering EBITDA margins in this division going forward.

In addition some of the earlier acquisitions including Anittel Communications provided a combination of Mid-Market customers [BigAir's core customer segment] along with some smaller SME customers [non-core]. Our "solutions" bundle is not optimally designed for the smaller SME segment and as a result we have seen some attrition in this base, which was factored into our strategic plans.

The net result of this strategic focus was that second half revenue for this division was lower than the first half as we moved the business away from lower margin business. Our half on half growth would have been around 5% [2H16 vs 1H16] if you reversed the decline in product sales and lost SME revenues. As we pick up momentum in our mid-market customer growth we expect the impact from these changes to be greatly reduced and we are targeting revenue growth to exceed 10% in FY17 for this division.

On a positive note, underlying EBITDA in the second half of FY16 was up by 5% to $3.8 million, compared to the first half results of $3.6 million due to the changing revenue mix towards higher margin business and the integration work completed during the year. We made very good progress during the second half on completing the integration of Oriel and Applaud that has delivered improved operating margins. Our underlying recurring EBITDA margin increased from 18% in the first half of FY16 to 24% in the second half. We expect further gains in FY17 as we remove some remaining duplication and are targeting recurring EBITDA margins to reach 27% in FY17.

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Why the focus on the Mid-Market segment? Have you considered expanding your Fixed Wireless or Cloud and Managed Service offerings into the residential or small business markets, and what about the large enterprise segment?

Jason Ashton

We are aware of a few smaller wireless operators that are targeting the small business and consumer segments. We have contemplated it before, and in fact we rolled out a limited service to apartment buildings in Sydney back in the early 2000s. However, our experience at that time was that the return on invested capital could not match what we were achieving in the corporate market. We don't believe this has changed in the 10 plus years since. If anything the consumer market is even more competitive than ever with the recent consolidation of the large ISPs and the NBN coming online over the next few years.

Large enterprise customers typically have a well resourced IT capability and are less likely to value the overall solutions sale approach that BigAir offers. This makes it harder to differentiate BigAir's services, and this market is typically dominated by the two or three largest players in both the Telco and IT segments, since they can afford to discount heavily to win the business.

BigAir's offerings remain very much focused on the mid-market [medium enterprise] sector. To further build our presence in this market sector, we are enhancing our existing offerings and adding additional capabilities either in-house or through strong industry partnerships. We believe that this will help us grow and retain these mid-market customer relationships long-term.

Mid-Market customers have limited IT capabilities but complex needs, and they need a trusted partner to help design and deliver complex ICT solutions cost effectively. For example, we may need to work out a plan for migrating some legacy business applications to our Private or Public Cloud environment and then implement this plan. If you look at all the services we offer such as connectivity, voice, cloud, security, managed services and IT solutions - they are often co-dependent. BigAir has the subject matter experts that can help customers tackle these complex problems and work out a technology roadmap for their overall network and IT needs, or more broadly their overall technology needs.

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You have experienced solid organic growth in your Community Broadband division over the last few years. What is driving that?

Jason Ashton

The primary driver continues to be relentless growth in new student accommodation facilities. BigAir is the number 1 provider of managed WiFi and Internet services to student campuses across Australia, delivering fast and reliable connectivity that enhances the learning experience of tens of thousands of tertiary students. The student housing market has seen significant investment growth in the last few years due to pent up demand for quality accommodation close to University campuses. The market is also being fueled by the growth in foreign students choosing Australia as the destination for their tertiary education.

In addition we have also expanded BigAir's managed WiFi offering into new verticals including retail shopping centres and retirement living.

We also offer a solution for mining camps and the recent downturn in this sector has created an opportunity for BigAir to undercut the traditional service providers in this sector with our lower cost solution. BigAir is able to leverage its fixed wireless division in order to deliver high speed lower cost connectivity to remote sites and then provide a WiFi network as a fully managed solution.

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BigAir's balance sheet is in strong shape at 30 June versus 31 December. What are the drivers for that?

Jason Ashton

There are several factors. Firstly our second half FY16 operating cashflow, before Interest and Tax, was up 61% to $9.2 million. This is a 60% increase on the first half which was impacted by some working capital movements resulting from recent acquisitions. It was pleasing to see our cash generation return to historic levels.

Another significant factor was the steady decline in capital expenditure over the second half. As previously forecast, the higher than normal PP&E investments made in calendar year 2015 for the establishment of our Cloud and Managed Services division and for other special projects was not repeated in 2016. Capital expenditure [payments for PP&E] as a percentage of revenue declined to just 9% in the fourth quarter of FY16 and we expect this to normalise at between 8-10% of revenue in FY17.

Another driver for the improving balance sheet is the significant reduction of our Earn Out provisions relating to recent acquisitions. These provisions declined by $6.9 million in the second half. This includes a reduction in contingent consideration for Oriel of $4.3 million due in no small part to the

CMS product sale decline we discussed earlier, and a reduction in contingent consideration for Everywhere Internet of $2.6 million. As a result our remaining earn out provisions as at 30 June 2016 were just $2.5 million.

The other driver impacting the balance sheet was the $2.1 million repayment of borrowings in the second half which reduced our net debt to $27.1 million. Our gearing levels remain comfortable with Net Debt to underlying EBITDA less than 1.2x, and we retain significant headroom under our existing $45 million facility.

Market Briefing
What were the drivers for the acquisition of CyberHound last month and how do you expect this to strategically fit your growth plans?

Jason Ashton
Our acquisition strategy remains focused on identifying complementary services and customers with a strong fit to our target customer segment.

CyberHound is a fantastic recent addition to the Group as it provides BigAir with deep CyberSecurity and CyberSafety solutions along with a behavioural analytics platform. It also deepens our understanding of customers in the education sector with over 340 schools already on board and more than 10 years of industry knowledge in online risk management and prevention. As with other acquisitions, this broadens our customer base to cross-sell complementary BigAir Services.

At its core this is a high margin software as a service (SaaS) business which means we now have the potential to expand our geographic reach outside Australia for the first time with relatively minimal investment. CyberHound has also recently secured its first Government customer in June 2016. This is a multi-million dollar deal which is expected to be operational before the end of 2016 and represents a significant anchor customer and case study we can use for future growth in this segment.

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Thank you, Jason.

For further information, please contact BigAir on +61-2 9993 1300, or visit www.bigair.com.au