

The move towards FTTP gathers momentum

Whitepaper

Foreword

In this whitepaper I argue that, with fibre to the premise (FTTP) rollouts now reaching critical mass due to network providers such as BT and CityFibre, B2B channel partners should, if they have not already done so, start thinking about capitalising on the opportunity to boost the value of their businesses through reselling fibre connectivity products.

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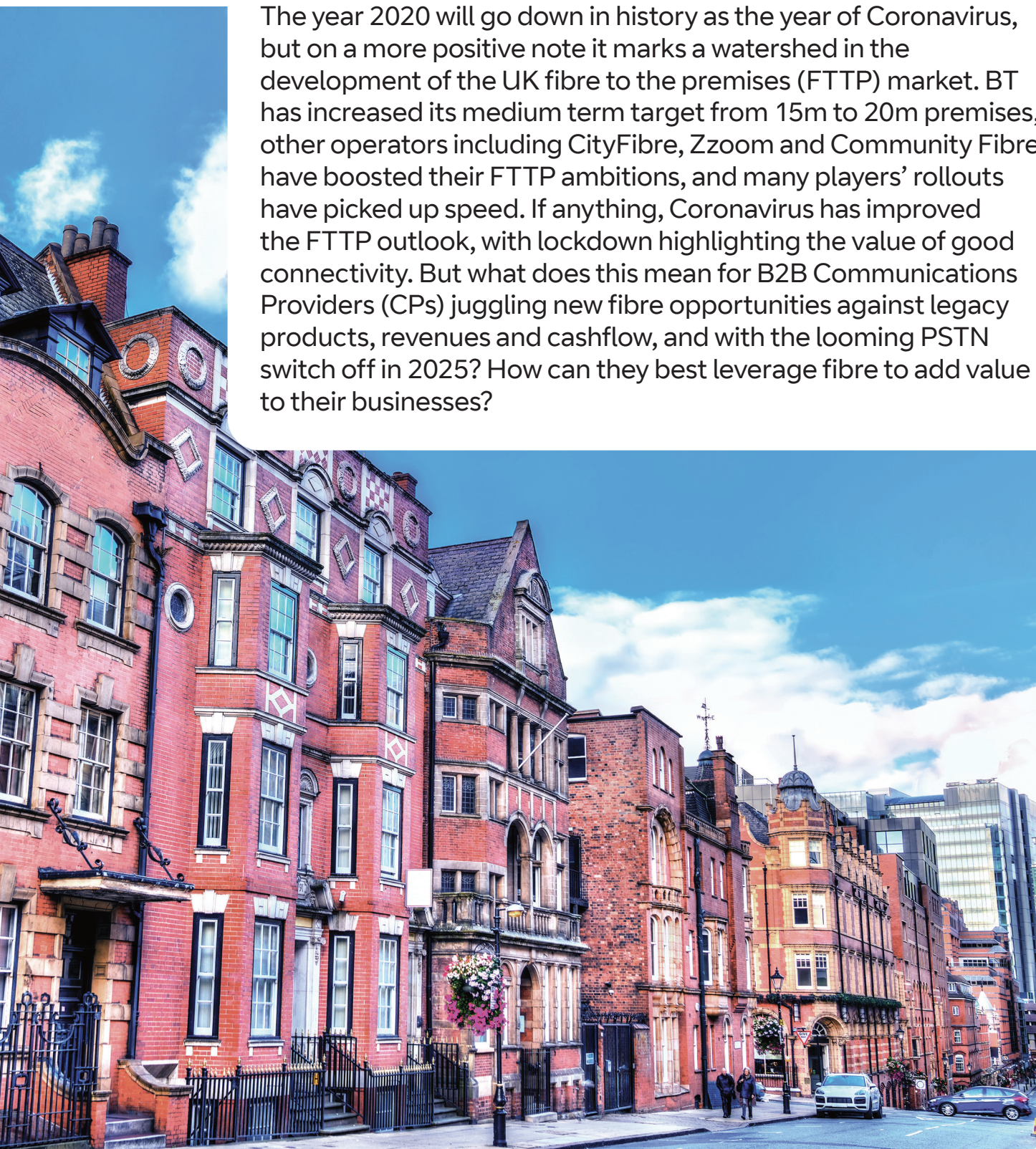
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Megabuyte is the leading source of independent intelligence on UK technology and digital businesses, providing proprietary data, insights and consultancy to the sector's leading CxOs, investors and advisers.



The move towards FTTP gathers momentum

The year 2020 will go down in history as the year of Coronavirus, but on a more positive note it marks a watershed in the development of the UK fibre to the premises (FTTP) market. BT has increased its medium term target from 15m to 20m premises, other operators including CityFibre, Zzoom and Community Fibre have boosted their FTTP ambitions, and many players' rollouts have picked up speed. If anything, Coronavirus has improved the FTTP outlook, with lockdown highlighting the value of good connectivity. But what does this mean for B2B Communications Providers (CPs) juggling new fibre opportunities against legacy products, revenues and cashflow, and with the looming PSTN switch off in 2025? How can they best leverage fibre to add value to their businesses?



State of FTTP rollout plans

So where do we stand today in terms of FTTP (or wireless-based alternatives) plans? At Megabuyte, we categorise three types of builder: the three majors (BT, Virgin Media (plus O2)/Liberty Global, and CityFibre); the established second order (KCOM, Gigaclear, Hyperoptic and CommunityFibre); and a third tier of new entrants/established small ISPs that have secured reasonably significant funding (e.g. toob, Truespeed, Zzoom).

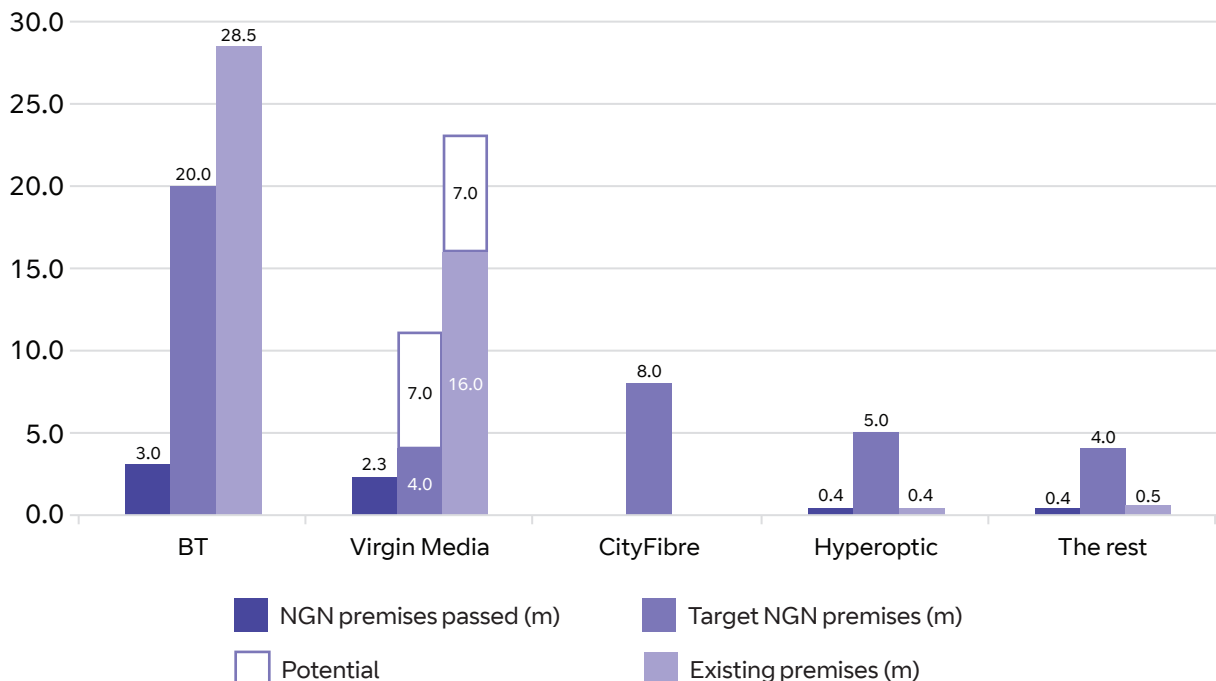
On current plans, the majors, in total, plan to cover at least 32m and potentially up to 40m properties (with Virgin Media owner Liberty Global mulling a separate build), with the second group adding 6-7m and the final group at least 1m. This compares with a UK total of circa 32m premises, implying some overbuild but also likely gaps which are to be addressed through rural funding. In other words, the UK is well on track to be almost fully fibred by the mid-late 2020s.

Looking at the majors, and **BT** is aiming to pass 2m premises this year, with just under 3m premises passed at June 2020, a near-term target of 4.5m premises by March 2021, and a mid-late 2020s target of 20m (versus its 28.5m current premises) at a cost of £6-8bn, increased in May from 15m subject to the right regulatory incentives being in place.

Virgin Media's £3bn Project Lightning network extension project (based on a mix of FTTP and DOCSIS technology) is expanding at a rate of 0.4m premises a year, with 2.3m of its 4m target met (out of 16m cable homes). Meanwhile, owner Liberty Global is also evaluating options to build another 5-8m premises, tapping third party funding. Note that much of BT's and Virgin's existing footprint can receive superfast broadband (30Mbps+) or ultrafast broadband (100Mbps+) through existing FTTC and cable broadband technologies. Finally, **CityFibre** is targeting 8m premises.

The second order (KCOM, Gigaclear, Hyperoptic and Community Fibre) have proven their FTTP capabilities, albeit that collectively they have passed around 1m premises to date (of which 0.4m are Hyperoptic's apartments). Hyperoptic is targeting 5m premises and the rest collectively around 2m, with Community Fibre recently doubling its target to 1m. The third order are collectively targeting around 1m premises. CityFibre and the second and third order are mainly supported by private equity/infrastructure funds, highlighting the attractiveness of fibre infrastructure.

Notes: BT Next Generation Network (NGN) build is FTTP. Virgin Media NGN reflects Project Lightning network expansion, a mix of FTTP and DOCSIS; owner Liberty Global is considering an additional 7m premises FTTP build.



And take up?

Although FTTP is now gaining traction, with 12% of UK premises passed at January 2020, most consumers and businesses (75% at November 2019 according to Ofcom) are still on superfast connections (30Mbps+) via Fibre to the Cabinet (FTTC) or cable, with just 2% on ultrafast/FTTP (300Mbps+). The availability and take-up of faster broadband means that average download and upload speeds increased in 2019 by 18% to 64Mbps and 90% to 14Mbps, and have no doubt continued to increase since. Demand drivers for consumers include faster internet access and support for video streaming and online gaming. Meanwhile, Coronavirus will have highlighted the need for decent broadband to support these plus working and education from home, often simultaneously.

The drivers for B2B take-up (the focus of this article) are different but still very strong. We call this the generational shift. This is the increasing adoption of digital technologies by businesses and public sector organisations to improve one or more of products and services, user experience, staff welfare and overall operational efficiency. These new applications reside in the Cloud, are accessible from any device over high speed networks, and are highly accessible through the use of APIs. The likely permanent increase in remote working as well as the need for operational efficiencies in the new Coronavirus world will also, we believe, accelerate these trends.



What's in it for me?

If you're a CP sitting there with a nicely cash-generative base of legacy broadband and other connectivity services, why risk churn by proactively selling FTTP-based services? Even though you're aware that your hand will ultimately be forced on some very legacy services (e.g. ISDN, WLR) by the 2025 PSTN switch-off, why not wait a couple of years to start selling fibre, especially given the considerable economic uncertainty?

We believe there are several reasons, at the very least, to start thinking about a proper fibre strategy. Rollouts are reaching a critical mass; wholesale provision of FTTP is becoming more prevalent; more fleet-of-foot competitors may steal your legacy customers; and the cost to serve FTTP products is lower. The evidence suggests that customers are prepared to pay more for faster connectivity, and FTTP supports a wider range of services.

FTTP reaching critical mass

The first point to note is that the accelerating FTTP rollouts are being accompanied by an ever-increasing range of B2B products, helping to meet existing customer requirements (and providing an easier starting point for future upgrades). For example, whilst FTTP is often and rightly associated with much faster speeds and capacity, services are also available at much lower speeds to support applications such as voice and Internet of Things connectivity.

Achieving critical mass in terms of premises passed also means increasing wholesale availability of services, in turn supported by commitments from larger CPs. Having passed the most FTTP premises, BT has unsurprisingly led the way in wholesale FTTP provision. We understand it reached 75,000 business premises at launch. CPs can buy either individual components from BT Openreach or, more suitable for the bulk of CPs, a full end-to-end service with Quality of Service commitments from BT Wholesale (BTW). To support its B2B fibre offering, BTW has invested in additional backhaul capacity. It has also established an FTTP presence in 1,900 exchanges, and developed FTTP (and easier to order) versions of existing copper-based products, for example SoGEA (Single Order Generic Ethernet Access).

Other B2B wholesale providers include CityFibre, following the acquisition of TalkTalk's FibreNation earlier this year and with non-exclusive wholesale agreements with Vodafone and TalkTalk among others. Even a smaller FTTP player such as Gigaclear is developing a B2B wholesale proposition now that it has passed over 100k premises. Overall, therefore, CPs will have an ever-increasing choice of wholesale B2B FTTP services, initially on a relatively localised basis.

FTTP: a service game changer

FTTP is also not just about being bigger and faster, it's also a major leap in technology that represents what we consider to be a service 'game changer'. Perhaps the most tangible impact is a fault rate barely half of FTTC according to BT, with knock-on benefits in terms of end customer satisfaction and CP costs. In fact, the clear operational and cost benefits of FTTP to BT means that it will stop making available copper products in an area where 75% of premises have ultrafast broadband available. This provides another reason for CPs to embrace FTTP. FTTP is also software-defined, adding an aspect of future proofing and an easier (and again lower cost-to-serve) upgrade path.



Driving customer value

While there is no hard data on pre- and post-FTTP B2B spend, available evidence suggests that, unsurprisingly, end users place value on better broadband, with spending to match. For example, Ofcom statistics show that average household monthly broadband spend between 2008 and 2018 rose 20% to £34. This compares with a 14x rise in average speeds to 54Mbps and a 22x rise in average data consumption to 240GB. Although there was a 31% rise in the Retail Price Index over the same period, it compares well with most telecoms products, where prices have fallen significantly in real terms.

We anticipate a different and more positive dynamic in an FTTP world, with spend potentially rising in real terms. Not only is the speed differential from moving to FTTP more significant but the aforementioned generational shift means that B2B capacity needs will continue to grow. Good connectivity is as important in this new digital, Cloud-based world, as is the Cloud infrastructure and applications, with end users prepared to pay for decent connectivity if it supports digital transformation. Connectivity can be an entrée for a CP to then upsell and cross-sell to meet the end user's broader unified comms, IT, Cloud and cyber security needs.



Driving CP value

There are many examples of UK CPs tracked by Megabyte building considerable value in their businesses, achieving revenue and profit growth in the face of perennially falling telecoms prices. They achieved this by expanding their product offerings, providing good customer service, and having very effective sales departments. M&A has also been a key feature for many. The growth in value is not linear with profits, as larger (£2m + EBITDA*) businesses attract higher multiples than smaller businesses (for example 10x versus 5x), and below 5x for those with a mobile focus or substantial legacy on-premise fixed line bases. Interestingly, valuations have held up through Coronavirus, which has highlighted the mission-critical, high recurring revenue nature of CPs. We hear anecdotally of private equity investors who have never invested in the sector now looking at UK CPs given their resilience.

In this context, we believe that CPs that fully embrace FTTP opportunities should over time add value to their businesses. An FTTP customer is likely to have a higher lifetime value through lower churn, lower cost-to-serve, and higher revenues as they exploit digital opportunities.

The challenge for CPs that go down this route is to learn how to sell, provision and support new FTTP services alongside existing legacy services, and how to be more proactive with legacy customers where FTTP is newly available. Although this risks churn, a do-nothing approach risks losing those legacy customers anyway to the 1k+ other UK CPs looking for revenues and business value.

* EBITDA = Earnings Before Interest, Tax, Depreciation and Amortisation



This paper is authored by Philip Carse, Chief Analyst at Megabyte, the leading source of independent intelligence on UK technology and digital businesses, providing proprietary data, insights and consultancy to the sector's leading CxOs, investors and advisers.

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