CREDO WEALTH

Change on the horizon

Making money is a balance of four things. Identifying a group of people with money, finding a problem that needs solving, being able to solve that problem, and being paid for it because the people with money choose you. That problem solving exists within the barriers of supply and demand. What constraints are there that stop others from doing the same thing?

Verizon is an American telecommunication company that grew out of the seven regional “Baby Bells” after the American Justice Department ordered the break-up of the nationwide “Bell” telecom monopoly, also colloquially known as “Ma Bell”.

Verizon launched its new 5G “fixed wireless” service last month. 5G is the fifth generation of cellular mobile communications. Amongst other benefits, the next generation is expected to increase connectivity through reduced costs, greater capacity, and increased speed. 5G mobile is only expected to be launched circa 2020. 5G fixed wireless is a high-speed home broadband offering which will compete against fibre (currently the premium offering of cable and telecoms), using the 5G mobile infrastructure.

What distinguishes 5G fixed wireless, is that the “last mile” (from the fibre backbone network to the home) is delivered wirelessly. By installing an antenna at the home, Verizon avoid needing to dig up the pavements to deliver broadband (via fibre cables) which is prohibitively expensive. Although Ma Bell was broken up, there aren’t seven companies that possess what we believe is the necessary architecture to compete nationally at scale in the 5G fixed wireless space. Instead there are only two – AT&T and Verizon. To be able to offer fixed wireless within major cities, you need (1) a dense fibre backbone network, (2) high frequency “MM wave” spectrum rights to connect the last mile, (3) the financial strength for further investment in the infrastructure and (4) a large customer base to leverage those high capital costs.

History doesn’t repeat itself but it often does rhyme. In the 1990s, satellite TV took market share from cable TV because it was cheaper to deploy into new markets. Since the network infrastructure Verizon needs to offer 5G mobile and fixed wireless (high speed broadband) is the same, Verizon should be able to contest the broadband market at no incremental capital costs.

There is still scepticism about the technology and Verizon is the first to offer this. Over the next few years, Verizon is targeting an addressable market of just over a quarter of US households. Within those, it is aiming to achieve a quarter market share, which seems reasonable considering its leading market share in mobile communications in the US and their ability to cross-sell this new product to its existing customer base. To attract new customers, Verizon is offering competitive bundles combining broadband, pay TV and mobile.

Although this change shouldn’t drive significantly different revenue growth, the incremental profit margins will be extremely high and it should also increase customer retention. Verizon is priced as a low single digit grower of revenue, but we believe that this underestimates the impact this technology will have on “bottom line” profitability over the next few years.

This could lead to attractive returns for backing this Baby Bell, as it ventures towards the horizon.

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