COVID-19: operators are likely to prioritise FTTP capex post-pandemic

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The COVID-19 pandemic is a stress test for investment priorities. In this comment, we explain why investment in fibre has become particularly popular during the pandemic, especially fibre to the premises.

The crisis has shown how important digital inclusion is. Households and, indirectly, businesses have become ever more dependent on broadband connectivity during the pandemic, and in general, networks have stood up to the challenge. Data traffic has risen quickly (some operators have reported average usage of close to 0.5TB per month) and network traffic profiles have become less asymmetrical and less peaky. We assume that many of these changes will fade away as lockdown restrictions ease, but not all. Some businesses, such as Twitter, will have taken note that employees can work effectively remotely, and they will adjust (though not without pushback from employees) to a world with lower property overheads. However, it is not simply social utility that is leading to intensified investment in new fixed networks.

Many operators are now announcing accelerated investment in FTTP

All major operators acknowledged in their 1Q 2020 investor calls that they will face pressure on revenue and cashflow from 2Q 2020 onwards. A few common FTTP trends were also discernible during these calls.

- **Some aspects of fibre construction have been curtailed during the lockdown period.** Operators have not always had permission to work during lockdown nor have they had easy access to labour, but even where they have been able to work, engineers have not usually been able to enter properties. This has resulted in some crews being reallocated to work in the street rather than in (or to) properties. The slowdown in paper-based bureaucracy (for example, getting permissions for build) has become a roll-out bottleneck for Orange Polska.

- **COVID-19 provides an opportunity for some operators to accelerate or increase investment.** BT, KPN and Proximus are examples of this. Streets are emptier thereby facilitating faster roll-outs. KPN has said that network deployment costs may fall in an economic downturn: “there might be an opportunity to strike more longer-term deals with construction companies […] to have a larger joint commitment, where you trade off volumes, price, payment terms, etc. and commitments on both sides.”

- **Delays in 5G auctions could provide an opportunity to rethink the purpose and slow down the pace of 5G roll-outs.** This was suggested by the Orange CEO in the operator’s 1Q 2020 investor call. The bulk of the call was based on how important the home/fixed-centric strategy is, particularly in the light of the pandemic, and how quickly roll-out would pick up again after enforced delays. The pandemic is not an excuse to slow down FTTP. By way of contrast, Deutsche Telekom quantified its accelerated plans for 5G roll-out in Germany, but remained unspecific about its intention to ramp up FTTP.

- **Even though they are faced with a potential reduction in cashflow, many European operators appear to be treating FTTP as ringfenced investment.** However, none are actually indicating that reduced investment in fibre could be a way of managing this reduced cashflow (in fact, several have cut or suspended dividends). ROCE on FTTP looks strong and a first-mover advantage is critical; existing operators cannot afford to delay.

All of the above are based on the investment calls of European incumbent operators. We see no signs of a slowdown among altnets, although they may face other non-pandemic-related challenges. The USA is the worst-affected country outside Europe. There has been no obvious change in capex priorities among the cable-dominated broadband plays in the USA so far. Bell in Canada has maintained its plans for FTTP and has accelerated its 4G fixed-wireless access (FWA) roll-out.

The role of infrastructure funds and other non-telecoms investment is increasing

One of the most significant developments in the fibre sector in the last 3 years has been the greatly increased role of infrastructure funds, hedge funds and sovereign wealth funds in FTTP, which had previously been seen as high-risk. The COVID-19 crisis is likely to intensify this role, and not simply because the crisis has shone a light on its usefulness.

- COVID-19 will lead to a reduction in the range of attractive infrastructure projects; this is not the time to be investing in airports or shopping malls for example.
- Towercos' growth narratives are predicated on a need for the densification of sites due to 5G. This now appears to be receding further into the future, except where there are spectrum constraints. There appears to be more consensus in the infrastructure investor community around fibre than around 5G.
- Weakening cashflows among operators may encourage them to seek more co-investment/carve-out deals.
- Data centres remain attractive to funds, but existing non-telecoms players face fewer capex challenges and edge is truly embryonic. Telecoms operators could self-fund their edge needs, but the bigger trend is for operators to divest rather than invest in data centres.

One of the stand-out deals of the COVID-19 age has been Facebook's acquisition of a 9.99% stake in Reliance Jio Platforms, the telecoms/digital wing of Reliance Industries. Reliance Jio has an enormously capital-intensive plan to shake up the underdeveloped Indian wireline market in the same way that it shook up the Indian mobile market. It plans to pass 75 million premises with FTTP by the end of 2023.

Government involvement in the telecoms/ICT sector will increase

COVID-19 has made governments get much more involved in economic life, and they will expect social utility trade-offs in return for support. Therefore, they may take broadband connectivity much more seriously; perhaps even as seriously as water, sanitation, power or roads. Some already have an objective of 100% FTTP coverage (for example, in France), but they are as yet a minority. Governments will want to push for resilient and futureproof infrastructure, but they will have spending constraints and may not consider telecoms operators to be most in need of help. This dilemma could be solved in the following two ways.

- Telecoms infrastructure could be part of a broader Keynesian stimulus package with some direct or indirect payback, and with some societal benefits thrown in. In reality, the stimulus would target the civil construction industry, which will face more problems than telecoms operators.

- Regulation could be rebalanced away from pro-competition, thereby spurring greater private investment, but on the condition that there is a greater emphasis on coverage and resilience. One might conceivably see a policy shift away from technology-neutral 'gigabit' targets (whose applicability is never likely to be more than 5–10 years) and towards infrastructure targets (whose applicability is linked to the 30-year asset life of an ODN).

Moreover, more governments may take a more-holistic approach and want a telecoms/ICT tie-in with a sustainability agenda. Only a few have previously made this link. FTTP is not only much greener in itself than its direct alternatives, but plays a pivotal role in improving economies' environmental impact.