Holly Springs Presentation 2021 Transcript

Elliot Noss [President and Chief Executive Officer]

[00:00:05] Oh, thanks for joining me today in my terrarium here. A couple of you have been kind enough to visit me here over the years.

[00:00:14] Today, we're going to be providing a video that will hopefully help you understand some of the fiber economics as they evolve in our business.

[00:00:29] And what we're going to be doing a deeper dive into today, is essentially a market study on our Holly Springs experience.

[00:00:37] The first two markets that we entered the fiber space with were in early 2015. We completed an acquisition of Blue Ridge Internet in Charlottesville, Virginia.

[00:00:50] And in the middle of 2015, we entered into, and launched, a public private partnership with the city of Westminster, Maryland.

[00:00:59] Both of those approaches allowed us to learn and grow and understand a lot of the puts and takes of operating a fiber business, of operating essentially an ISP on top of a fiber network.

[00:01:15] So as we turned to Holly Springs, North Carolina, our first fiber build where we were doing the construction ourselves, we already had a little bit of experience.

[00:01:29] Now we entered the fiber space and started to put chips in the pot with a set of very simple assumptions, and the ones we first shared with you all were essentially a 20% take rate in a year and a 50% take rate after five years.

[00:01:48] In addition, we expected to have build costs. We talked at that point around $3000 a customer and gross margin of roughly a thousand dollars a customer per year.

[00:02:04] Now, subsequently, we changed the way we presented our build cost and started instead to talk about the cost per pass as opposed to the cost per customer at scale.

[00:02:16] The reason that we did it the way we did in the first place with the $3,000 number was to really try and make it simple for investors to see that you would have a payback at a gross margin level of 3 - 3 1/2 years on these fiber investments.

[00:02:33] We switched as it became too confusing as much of the rest of the marketplace talked about the cost per pass.

[00:02:42] And so we went in with those variables prior actually to our Charlottesville acquisition.

[00:02:50] It's amazing to me how consistent they are and how much they are still part of the way we talk about this business.

[00:02:58] Now you've all heard us talk lots about the fact that we are not cash-constrained and we are not opportunity-constrained in the fiber business.

[00:03:09] Holly Springs was one of our first lessons in this regard.

[00:03:13] We were actually first approached by a senior I.T. person for the city of Holly Springs at a conference sometime in, I'm going to say, early 2015.

[00:03:27] And, you know, in his words, he had spent he had come to this conference to meet us and had spent his time trying to track us down.

[00:03:37] We engaged. We very quickly saw that there was a great opportunity in Holly Springs.

[00:03:44] Now, what's also interesting about Holly Springs was it was our first experience with fiber envy. Google Fiber at that point was all the rage and had announced a number of fiber builds in and around Raleigh, North Carolina.

[00:04:01] Holly Springs was left out, so they were eager to not be left behind.

[00:04:07] Ironically, where Holly Springs is with their fiber today is far ahead of a lot of the other footprints in and around Raleigh that were causing the envy in the first place.

[00:04:22] So Holly Springs had a bunch of good things going for it. It had a mayor who was engaged and was deeply interested and understood the importance of fiber.

[00:04:34] It was a classic suburb. So you really had a lot of uniformity in the nature of the build.

[00:04:45] The lot sizes were a little bit bigger than his typical, which of course adds something to the costs.

[00:04:52] By October of 2015, we had gotten to an announcement. We had announced the preorders we press released and announce the preorders were starting.

[00:05:03] We collected preorders for a period of time, really for the better part of the year, and by October of 2016 we were putting a shovel in the ground.

[00:05:18] So that's pretty quick from initial engagement to kind of planning a build and to getting started on construction.

[00:05:27] Now, it's amazing to me when I look back on this now, you know, kind of four and change years later how different we are organizationally.

[00:05:37] You know, at that time, for instance, we did not have a network architect or a network designer, a fiber network designer.

[00:05:46] We didn't hire the first person in a formal network design role. I want to say, until probably the fall of that year, until the fall of 2017.

[00:06:02] So what's particularly interesting there is we were doing this with some smart engineers, who had experience running ISPs, but of course, in that context, they're going to be suboptimal.

[00:06:17] You know, one of the themes you're going to hear me talking about is lessons we've learned and places where there is for improvement. There's a big one right there. And so now here we were in October 2016 and we're off and running.

[00:06:32] Now, I want to walk you through some of the flow of funds with our actual experience in Holly Springs.

[00:06:40] So first, watch the flow of capital. Now, here is a series of expenditures.

[00:06:51] I note that these are 12-month periods, not calendar years. So this is going to be starting in September/October of 2006 when you see year one there, that's the 12 months forward.

[00:07:05] The first thing that I would call out here, you know, when we're looking at this for and change years later, is how slow this build was.

[00:07:13] Now, it wasn't that slow to first dollar. So we were churning out neighborhoods, I'm going to say, we probably had our first revenue sometime around the early summer of 2017 as we're now getting into it.

[00:07:32] But, boy, when we're talking about doing, if we were doing a build like Holly Springs today, I would expect that we would probably imagine that we'd be 12 months from shovel in the ground to built. So obviously you're going to see a faster flow of funds.

[00:07:52] The other thing I really want to call out here with Holly Springs is you can see here very clearly in the capital, we're laying out the distinction between building out the initial city footprint and some of the greenfield from growth.

[00:08:08] So when you're in a geography where new homes are being added, you're going to have some amount of perpetual capital going out in a greenfield build. And we kind of break that out for you here to look at.

[00:08:21] So, again, you know, here's this flow of funds. It's quite fine at a cost per pass, but it is certainly very slow.

[00:08:32] So characteristically about Holly Springs, I would say, you know, this as our first build was a lot slower than it than subsequent builds and certainly than a build we'll undertake in '21.

[00:08:43] And second, it's a particularly high growth area, so you see these kind of continual greenfield expenditure.

[00:08:52] Now, when we look at the operating side of the ledger, you know, here I would say that Fiber met our very lofty expectations.

[00:09:02] You know, we were a kind of 18 months into the whole city build when we had a month that was now positive at an operating level.

[00:09:13] You don't quite see that in the way this flow of operations looks, primarily because there's about four or five months from the first sort of shovel in the ground to the first neighborhood.

[00:09:26] But from the time we're actually operating at an ISP level, you know, it was, I want to say, the 19th month when we actually turned cashflow positive.

[00:09:36] And then what you can see from there is a steady ramp in operating contribution.

[00:09:41] So I would say, again, at an operating level, the fiber business in our very first market, as we were just learning what to do, taking on a lot of lessons, I would describe our performance as fantastic for a first market and, you know, mediocre at best relative to, to sort of how we would do today.

[00:10:07] Around things, really everything there from marketing to installations to customer service and the information that's available to our customer service reps, etc.

[00:10:18] And here you can see kind of what that flow of capital and operations looks like overlaid on each other.

[00:10:30] And again, you know, here we're going to have a payback period that would be dragged out because of the slow construction.

[00:10:39] You're going to have operations that will be more efficient as we go along. [00:10:46] But amazingly, you still have a cost per build. That's quite tolerable.

[00:10:54] And very importantly, you have IRRs when you're looking at a model like this that are meeting or exceeding our thresholds, depending on what terminal value you want to put on this asset and how you want to calculate the IRR, you're looking here at kind of a high teens, low 20s IRR, which is a fantastic return, especially given, again, that this was our first build.

[00:11:21] All of you have heard me talk for years about how take rate is the most important variable in any fiber build.

[00:11:30] And in Holly Springs, our experience was one where it really reinforced for us our hopes, expectations around 20% in the first year, 50% after five years.

[00:11:44] First with the 20% we in most neighborhoods in Holly Springs, we exited the preorder process with between 20 - 25 % take rates.

[00:11:56] And we had really excellent conversion on those preorders into orders. So we saw that that kind of 20% in one year comfortably exceeded.

[00:12:06] Now on an ongoing basis where we are today, four and change years into the build. Remember that what we do when we're measuring take rate is we do a weighted average of the age of each neighborhood, and I'll remind again that you saw the slow build before.

[00:12:27] Today on a blended basis, we're seeing take rates in Holly Springs in the mid to high 30s at a place in time where that meets or exceeds that tracking to a 50% take rate.

[00:12:45] So our experience in Holly Springs, again, kind of leaves us feeling like we have been reaffirmed in our views around take rate, in our hopes around take rate.

[00:12:58] I think that, you know, for me, if we get into year six or seven and Holly Springs, I might even be looking for a take rate in the mid 50s.

[00:13:08] Now, I also think that Holly Springs is probably a little bit better than the typical footprint we're going to build in. So we'll see.

[00:13:16] And I'll note with all of this, we have not yet really sharpened our knives, built our muscles around going into existing neighborhoods, you know, with existing 30, 35, 38, 40% take rates and grinding out the next three, five, seven, 10 percentage points.

[00:13:40] That's a muscle that we're going to be working on very hard over the next couple of years, and I think that we've learned a lot in our time to date.

[00:13:48] So again, on take rate, we are extremely encouraged with the Holly Springs experience.

[00:13:55] When I think of where our organization is today, where the fiber business is today relative to where it was when we started in Holly Springs, I am struck by how much change there has been.

[00:14:10] And I'd really call change and improvement and learning in two areas, marketing and construction.

[00:14:21] Now, I talked earlier about how green we were when we got into this. You know, we didn't even have what I would call professional, although it was still, you know, quite amazing under the circumstances, but professional network design.

[00:14:35] So that obviously is going to impact on your construction costs, your processes, etc.

[00:14:42] Boy, when we were building in Holly Springs, I want to say that over the first two or three years of that build, again, stretched out much more than usual. We went through three sets of contractors until we really settled on one that we could work with.

[00:14:59] And, you know, we've stayed with them through a lot of the Fuquay-Varina build and some of the other stuff in the footprint, so huge learning there about how to work with contractors, what to look for in contractors, what we should insource, what we should outsource.

[00:15:15] And then again, around marketing, you know, we were lucky enough in Holly Springs to get the opportunity around Ting Park.

[00:15:25] And I mean, Ting Park, which is the best sporting facility, not just in Holly Springs, but also in a couple of neighboring towns, including Fuquay-Varina, really was a great marketing vehicle for us and our brand awareness in Holly Springs is quite impressive.

[00:15:48] But there is still so much more that we've learned about how to market day-to-day and, by the way, how much more I think we will learn in the next 12 and 24 months there.

[00:16:01] In conclusion, I hope that this video gives you a sense of our experience in Holly Springs, gives you some visibility to the flow of CapEx.

[00:16:14] To the quick and really strong OpEx performances, I didn't note that we're comfortably seeing a net operating margin at a city level north of 70 percent. I think it should give you a view of take rates, which really are the number one driver of IRR.

[00:16:36] And of course, if those take rates are good, you know, to me, when I'm looking at IRRs in the high teens, low 20s, solidly in our first experience, I would say that a typical experience for us, we're going to have a much a stronger to a much stronger performance.

[00:17:00] Now, Holly Springs might be a particularly strong footprint that will mitigate that. But, boy, do I think that all of that is so encouraging.

[00:17:09] You know, we look at all of those things and we hope that in sharing a bunch of this, you come away from it as excited as we are and probably more than excited.

[00:17:24] Have the same amount of affirmation, the same amount of confirmation of what we believe to be true about this COAX to fiber transition that's taking place in the U.S. and what a fantastic financial opportunity it provides.

[00:17:41] Thank you.