# Broadband opportunities during a downturn

It may seem counter-intuitive, but there are many good reasons to keep investing in broadband build-out now. Indeed, inflation, higher interest rates, and concerns about a possible recession are among the reasons multiple fiber providers have reduced their build estimates for 2023. Yet even now, a few smaller players are accelerating their builds, and a number of large cable companies are aggressively expanding some broadband networks. While fiber deployers must consider economic headwinds and the evolving competitive landscape, many industry analysts expect the current caution to be temporary.[1] Several factors could mean that, despite today's challenges, this remains a good time to move ahead, not hold back.

Enterprise demand for bandwidth, continues to surge. In 2022, according to market research firm TeleGeogrpahy, internet bandwidth spiked nearly 30 percent in 2022.[2] In addition, the launch of 5G mobile networks is another source of potential growth, as carriers require new fiber backhaul capacity. Cloud service providers are another source of rising demand for fiber.

Another factor in favor of continued investment: the 2021 Infrastructure Investment and Jobs Act allocated $65 billion for expanding broadband access for underserved populations and into parts of the country that lack reliable internet connections.[3] Serving that pressing public need can also be part of fiber service providers' strategy to continue to grow during the downturn.

Private equity and infrastructure funds remain interested in broadband investments, too. In September 2022, a group of investors that included CPP Investments, British Columbia Investment Management Corporation, Public Sector Pension Investment Board, and other investors closed a $450 million investment into Northwest Fiber, which operates as Ziply Fiber.[4]

M&A involving fiber companies, including the $1 billion acquisition of FiberLight by H.R.L. Morrison and the Australian Retirement Trust, which will accelerate the expansion of FiberLight's fiber network, provides further evidence of investor interest in this space.[5] In December 2022, AT&T and BlackRock announced a joint venture, which will operate under the name Gigapower, that will provide a commercial fiber network that will be leased to internet service providers and other businesses across the United States (Exhibit 1).[6]

While the long-term growth prospect for the sector remains strong, operators will need to manage the near-term economic realities brought forth by the macro uncertainties. There will be higher volatility and downward pressure for some customer segments—for example, high-tech customers, customers who are exposed to consumer spend, and small and mid-size businesses (SMBs)—that will hurt revenue growth and cash flow. Labor shortages and inflation will make deployments and operations more expensive. High cost of capital will impact the ROI of new deployments and edge-outs.

With these realities in mind, fiber service and broadband providers may need to revisit their plans for 2023 and 2024 to position themselves for success when conditions improve. Investments made now will extend beyond any expected downturn.

> While the long-term growth prospects for the broadband sector remain strong, operators will need to manage near-term economic realities and uncertainties.

[1] "A slew of service providers lower 2023 fiber targets," Light Reading, February 7, 2023
[2] "Global Internet bandwidth rose by 28% in 2022, according to TeleGeography," Intelligent CIO, September 13, 2022
[3] "Infrastructure Investment and Jobs Act: Broadband Affordability and Infrastructure," The Council of State Governments, November 7, 2021
[4] "Ziply Fiber raises $450 million for continued network expansion in the Northwest," Searchlight Capital, September 8, 2022
[5] "Fiberlight sells for $1 billion to Morrison and Co., ART, CalSTRS consortium," Dgtl Infra, June 30, 2022
[6] "AT&T, BlackRock joint venture builds a wholesale fiber network," Fierce Telecom, December 27, 2022

## Exhibit 1: Fiber optics and broadband deals announced in 2022

| Announced date | Target | Type | Total value ($US million) | Buyers / investors |
|---|---|---|---|---|
| December 23 | Gigapower, LLC | JV | 1,500 (estimated) | AT&T; BlackRock Alternatives |
| November 11 | Mercury Broadband | M&A | 230 | Northleaf Capital Partners |
| September 8 | Ziply Fiber (Northwest Fiber, LLC) | M&A | 450 | CPP Investments; British Columbia Investment Management Corporation; Public Sector Pension Investment Board; Searchlight Capital Partners, L.P.; WaveDivision Capital LLC |
| August 22 | Archtop Fiber, LLC | PE | 350 | Post Road Group LLC |
| August 8 | Ting Inc. | PE | 200 | Generate Capital, PBC |
| July 22 | Omni Fiber, LLC | PE | 250 | Oak Hill Capital Management, LLC |
| July 11 | LiveOak Fiber | PE | 150 | InfraRed Capital Partners |
| June 30 | FiberLight, LLC | PE | 1,000 | H.R.L. Morrison & Co (US), LLC; Australian Retirement Trust |
| March 7 | Greenlight Networks, LLC | PE | 300 | Oak Hill Capital Management, LLC |

## Tailwinds for fiber growth

In today's digital-focused workplace, SMBs and large corporate enterprises continue to look for enhanced broadband capabilities. As these businesses migrate an increasing share of their operations to cloud-based services, and as more and more of their interactions with customers become digital, businesses require faster, more reliable broadband infrastructure to provide ready access to their applications and data stored in the cloud.

At the same time, with a significant portion of employees still working remotely or adopting hybrid schedules, consumers require higher bandwidth at home—and not just to ensure seamless video calls. Their experience during pandemic lockdowns, when streaming entertainment and app use soared, has also required better, faster, and more reliable internet connections. From 2020 through 2022, for example, the percentage of households streaming ad-supported video services increased from about 60 percent to almost 78 percent.[7]

According to a recent survey, the average American spends about six hours a day on the internet, and for those who work from home at least part of the time, usage is much higher.[8] And the fact that almost eight in ten respondents believe access to broadband should be available to everyone only adds to the pressure to expand current networks.

Furthermore, the rising importance of advanced 5G wireless networks is resulting in demand for an expansion of wired fiber networks. As mobile traffic grows exponentially, fiber backhaul connections, which link the mobile network to the wired infrastructure and the data centers that host internet content and applications for mobile users, are crucial. The predicted growth in private 5G networks could also fuel incremental demand. The mobile backhaul market is expected to grow 14 percent annually through 2025.[9]

[7] "Number of connected TV households streaming video services in the United States from March 2020 to March 2022, by platform," Statista, August 9, 2022

[8] "Broadband for All: Who Pays?" Recon Analytics, April 7, 2021

[9] "Mobile Backhaul Market: Growth, Trends, COVID-19 Impact, and Forecasts (2022-2027)," Mordor Intelligence, October 14, 2022

## A timely infusion of federal money expands another potential market

Most of the new federal money, much of it distributed through state and local programs, will be spent during the next two years, when economic conditions may be challenging. And broadband, fiber, and last-mile connectivity providers will be the primary beneficiaries of the funding. For example, a chief goal of the Broadband Equity, Access and Deployment (BEAD) program, which will dispense $42.5 billion through matching grants to the states, District of Columbia, and Puerto Rico, is to deploy or upgrade high-speed internet connections to unserved and underserved areas. Another $2 billion is allocated to the Tribal Broadband Connectivity Program, and $1 billion will go to Middle Mile Grants, "for the construction, improvement, or acquisition of [broadband] infrastructure (Exhibit 2)."[10]

### Exhibit 2: How $65 billion will be spent

Key provisions of the 2021 Infrastructure Investment and Jobs Act that will address broadband affordability and infrastructure include:

**$42.5 billion** allocated to establish and fund the BEAD program, administered to states through matching grants

**$2.75 billion** to invest in Digital Equity Act Competitive Grant Programs to improve broadband access for underserved groups

**$2 billion** to support the Tribal Broadband Connectivity Program

**$14.2 billion** to support and make permanent the Affordable Connectivity Program, which provides subsidies for low-income families to purchase internet service

**$1 billion** to invest in Middle Mile Grants for the construction, improvement, or acquisition of broadband infrastructure for underserved areas

[10] "Infrastructure Investment and Jobs Act: Broadband Affordability and Infrastructure," The Council of State Governments, November 7, 2021

# What businesses can do now

Operators need to balance efficiency and capital preservation with growth and positioning for the future. This means developing strategies to invest in growth by taking advantage of the new federal and private funding while maximizing resiliency, operational efficiencies and agility to counter the effects of the economic downturn. Several crucial steps for fiber operators to consider:

### Optimize capital programs.

For fiber service providers, 2018 through 2021 saw dramatic broadband network footprint expansion and broader sales targeting. To compete now will require optimizing your company's near-term revenue opportunities as well as your competitive stance. You'll need to target your network and sales programs to promote faster return on investment in coming years. With higher cost of capital, getting better clarity on the allocation and ROI of expansion and maintenance capital will become increasingly important. As capital is being deployed, having tighter management and controls of deployment programs to mitigate schedule and cost variance will become paramount.

### Focus on resiliency and retention.

A major risk during a downturn is that both consumers and SMBs, looking for ways to cut costs, could cancel service or switch to a competitor offering better pricing, and a longer, deeper recession would only increase this risk. To avoid the cost of replacing customers, consider establishing active retention programs that may provide creative pricing packages. In addition, utilizing rolling 12-week cash modeling could help ensure that your business has sufficient flexibility to withstand any loss of customers.

### Revisit costs of operations and selling, general, and administrative expenses.

After boom years of high growth and consolidation, some broadband operators may find that their costs have risen to unexpected levels, especially in cases where operations and systems from acquired entities have not been truly integrated. Now your company may need to look for areas that could help you achieve rapid performance improvements. That might include eliminating excess leased circuits or fiber, unmanaged collocation, and excess office or warehouse space.

### Establish partnerships.

Local municipalities, departments of transportation, state broadband agencies, and utilities all are eager to collaborate in expanding broadband infrastructure and access, and many are actively working to find federal funding to create richer connectivity in their markets. Partnering with them in joint builds, fiber or access swaps, and establishing shovel-ready programs could help you tap government funding to support your operations.

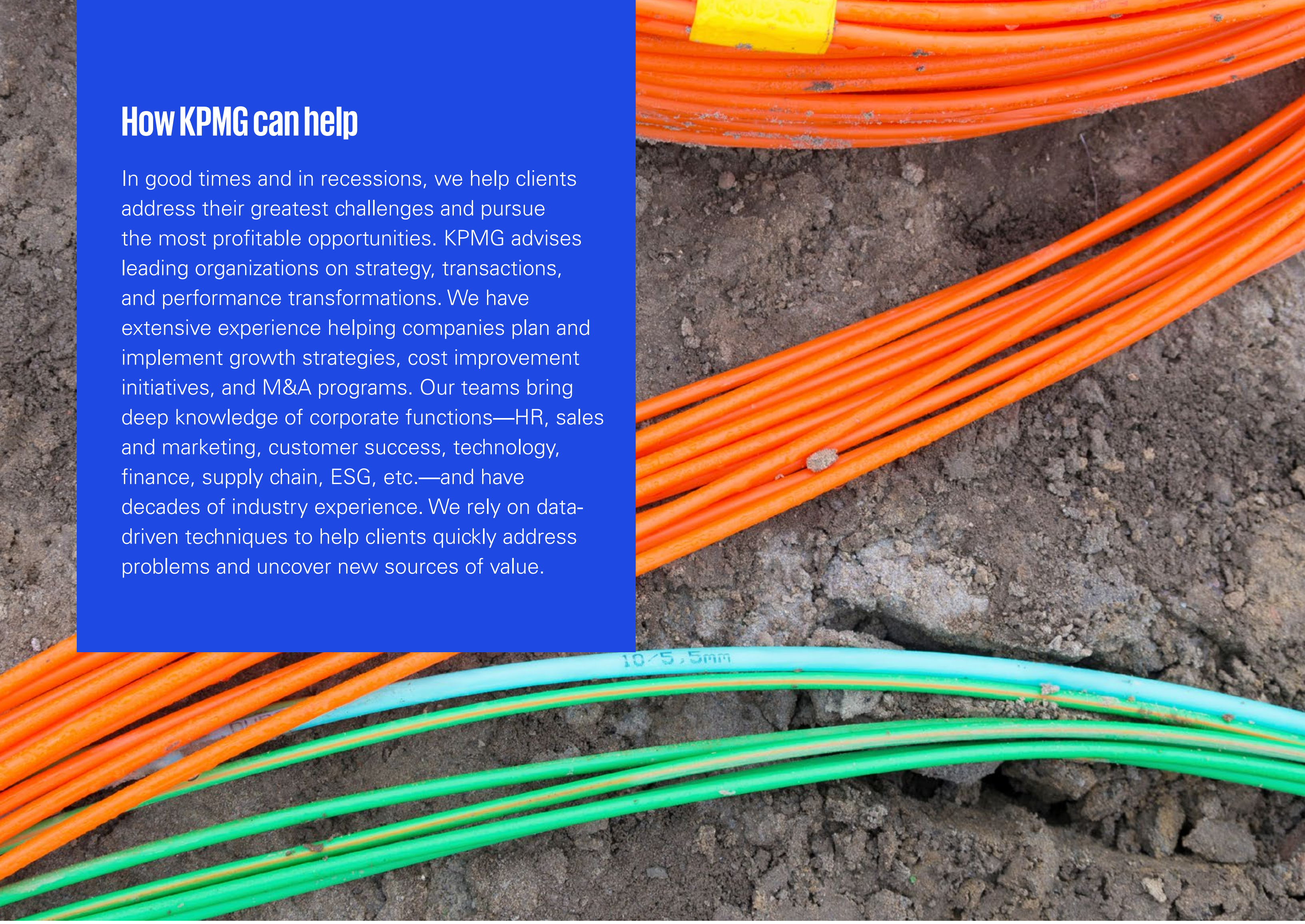
### Look for M&A opportunities to add scale.

Scale matters in network businesses, and the next wave of consolidation, affecting fiber service providers of all sizes, is already underway. Evaluating expansion opportunities to increase geographic coverage, targeting new customer segments, or expanding product offerings could all be crucial in positioning your company for post-downturn success.

### "What if" scenario planning.

Plan various growth and cost-control scenarios to navigate the near-term uncertainty. Model different up- and downside revenue scenarios based on macro trends and business trajectories. Identify potentially two to three tranches of potential cost actions—go through the exercise of "what goes first" and is discretionary and expendable if revenue were to decline 10 percent, 20 percent, or even 30 percent.

> Do the work to fully understand what KTLO (keep the lights on) mode might look like and ensure that your management team and board are fully aligned with the decisions to be made should a downside scenario come to pass. Identify areas that may impact future growth and snap-back revenue potential and embed this flexibility into your investment plan, upcoming contract renewals, and large overhead commitments.

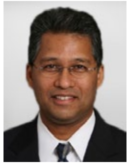


## How KPMG can help

In good times and in recessions, we help clients address their greatest challenges and pursue the most profitable opportunities. KPMG advises leading organizations on strategy, transactions, and performance transformations. We have extensive experience helping companies plan and implement growth strategies, cost improvement initiatives, and M&A programs. Our teams bring deep knowledge of corporate functions—HR, sales and marketing, customer success, technology, finance, supply chain, ESG, etc.—and have decades of industry experience. We rely on data-driven techniques to help clients quickly address problems and uncover new sources of value.

## Contact us


**Philip S Wong**
*Principal, TMT*
*Deal Advisory and Strategy*
617-899-8999
philipswong@kpmg.com



**Tyronne J Singh**
*Partner, Financial Due Diligence*
*Telecom Deal Advisory & Strategy Leader*
201-970-1409
tsingh@kpmg.com



**The authors would like to thank Rajesh John for his significant contributions to this paper.**




DASD-2022-11428