

BigAir Group Limited

February 8th 2010

GICS Sub-Industry: Information Technology – Telecommunication Services

The Big Deal about BigAir

Company Description

BigAir Group [BGL:ASX] is a **telecommunication carrier** that owns and operates Australia's largest metropolitan fixed WiMax broadband network. BigAir provides coverage across major metropolitan areas including Sydney, Melbourne, Brisbane, Gold Coast, Adelaide and Perth. BigAir distributes its services through direct sales to businesses and governments as well through partnerships with other IT resellers and ISP's.

INITIATING COVERAGE

Event

- During FY09 BigAir effectively completed the closure of iBurst, focusing on its Fixed Wireless services:** BGL saw its FY09 on-net revenue increase by 36% to \$5m. The closure of 'iBurst' resale business decreased its off-net mobile revenue by 68% or \$3.1m, however, operating expenses were reduced by \$0.45m. As a result, EBITDA increased by 203% to \$2.1m, and the pre-tax profit rose 703% to \$1.3m.
- Network expansion to continue into FY10:** BigAir expects to continue network expansion in Melbourne and Queensland, as well as new presence in Canberra during the course of FY10. The expansion is being driven by customer take up, and carries low risk with a quick investment return.

Our View

- FY09 numbers vindicated managements strategic realignment of focusing on its "on-net" business. With a sound balance sheet consisting of \$2m cash and zero debt, we are forecasting strong double digit EBITDA growth fir FY10. We believe that BigAir will be able to meet our full-year NPAT expectations based on continued growth in demand for its services and additional network expansion.

Catalyst

- BigAir has successfully transitioned itself from a mix of off-net and on-net operator, to a devoted network operator. Focusing on its core competencies and delivering improved margins. We expect revenue growth to resume in FY10 as BigAir continues to expand it network footprint.

Valuation

Our DCF and Relative valuation methodologies give an average valuation of \$0.21. This represents a premium of 100% over the current market price of \$0.105.

BGL

STRONG BUY

Price Objective: **\$0.21**

Last traded	A\$	0.105
Market Cap	A\$m	9.2
Nº of Shares	m	87.1
2009A EPS	¢	1.1
2010e EPS	¢	1.3
2010e PE	x	7.9
2010e EV/EBITDA	x	2.2x
DPS	¢	0.0
Div Yield	%	0.0
Sales 2009A	m	6.5
Sales 20010e	m	7.0
EBITDA 2009A	m	2.1
EBITDA 20010e	M	2.7
NPAT 2009A	m	1.0
NPAT 2010e	m	1.2

Share Price - 12mth



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COMPANY BACKGROUND

BigAir Group owns and operates Australia’s largest metropolitan fixed WiMAX broadband network. Founded in 2002 by Jason Ashton and Patrick Choi, BigAir specialises in providing fixed “on-net” broadband wireless communications services to the commercial market. BigAir was listed on the ASX in 2006, trading under the ASX symbol BGL.

BigAir is the largest fixed WiMAX service provider in Australia.

Competitive Advantage

The Australian business market consists of nearly one million businesses. In the current fast changing environment, there is an increasing demand for faster, more reliable and secure broadband services. Unlike most of its competitors, BigAir’s WiMAX technology is based on its fully owned network and does not rely upon Telstra’s copper network. As a result, BigAir is able to install business-grade broadband services with symmetric data speeds up to 1000Mbps whilst achieving a higher standard of customer service including rapid connection deployment and direct management of technical support.

BigAir owns the network and does not rely on Telstra’s copper network, resulting in faster and more reliable network services.

Directors

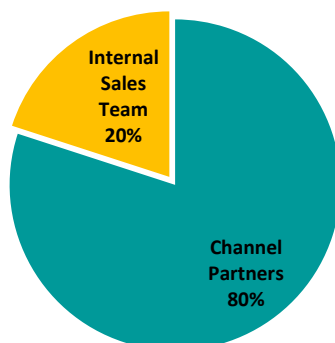
Director	Status	Date of Appointment
Paul Tyler	Non-Executive Independent Chairman	15 September 2008
Nigel Jeffries	Non-Executive Director	9 May 2006
Vivian Stewart	Non-Executive Director	11 June 2008
Jason Ashton	Executive Director, Chief Executive Officer	7 June 2002
Patrick Choi	Executive Director COO/CFO	27 July 2008

Customer Base

With the recent closure of iBurst, BigAir’s customer base focuses on SMEs. BigAir hopes to achieve a higher presence in the corporate market, currently only accounting for a small segment of BigAir’s revenue. BigAir recently won a tender with a high profile ASX100 company with a multi-site contract to provide broadband services. The contract win represents BigAir first significant foray into the enterprise market.

BigAir focuses on selling its services to SMEs with hopes to achieve a higher market share in the corporate market.

Revenue Source



BigAir’s distribution channel primary consists of around 50 channel partners that deliver BigAir’s network services with other optional managed services to final clients in addition to data and telecommunication services. BigAir also has a small internal sales team that sell and market its services directly to clients. BigAir continues to seek potential channel partners as its primary method of service distribution and revenue source, with a particular focus on wholesale

partners. 80% of revenue is generated from channel partners and this trend is expected to continue (*Source: BigAir Mgmt*). The industry profile of BigAir's customer base is broad, including:

- Multimedia/post production and other media sector
- Advertising/marketing
- Hospitality (e.g. Sheraton Four Points)
- Professional Services (Legal, accounting, etc)
- Entertainment Venues (e.g. Luna Park, Sydney Convention and Exhibition Centre)
- Secondary and tertiary educational institutions
- Other technology based companies

Due to the nature of its customer base, BigAir differentiates itself from first and second tier broad band companies by focusing on SMEs instead of the residential market that does not demand nor can afford, premium business grade data telecommunications services. BigAir's client profile is therefore centered upon SME's that demand premium grade symmetrical speed data communications. BigAir's ARPU is approximately \$600-\$800. An average contract has a minimum duration of around 12 months, but typically last for 24 months.

Competitors

BigAir's competitors are not limited to wireless service providers, such as Clever Communications and Unwired, but also large Telco's and ISPs such as TPG, Pipe Networks, Telstra, Optus etc.

Within the WiMAX technology, BigAir's competitors include; Allegro Networks, Digital River Networks, Adam internet and other private ISP's and network operators. The geographic footprint of BigAir's competitors can best be described as regional with no significant competitor (with the exception of Clever) having such a wide geographic network or spanning such a wide area of coverage. It is our view that there exists ample potential for consolidation to take place within the WiMax network providers themselves or other Telco providers that do not own a WiMAX network.

Network Coverage

BigAir has recently successfully completed its network expansion in Adelaide, Perth, and the Gold Coast, on top of increasing its existing coverage in Sydney, Brisbane and Melbourne. With 25 base stations in Sydney (10 of which are located within 3km of CBD enabling low cost deployment of 100M-1000M services), 12 in Queensland, 12 in Victoria, 1 in Adelaide and 2 in Perth. BigAir now has near blanket coverage across major Australian metropolitan areas with a network footprint exceeding 15000 square kilometres.

Network Expansion Planned for FY10

More aggressive network expansion is expected in FY10, especially in Southeast Queensland and Victoria where there has been increasing demand for wireless broadband services. (*Refer to Page 5 for more details*). BigAir will also continue to broaden its existing network coverage and capacity in its current existing regions. As a result, BigAir will maintain its extensive network footprint and retain its position as the largest metropolitan wireless carrier.

BigAir successfully defended against an unsolicited bid from Clever Communications on the basis of inadequate premium.

The successful network expansions increased BigAir's network footprint to over 15,000 sq km, making it the largest network of its kind in Australia.



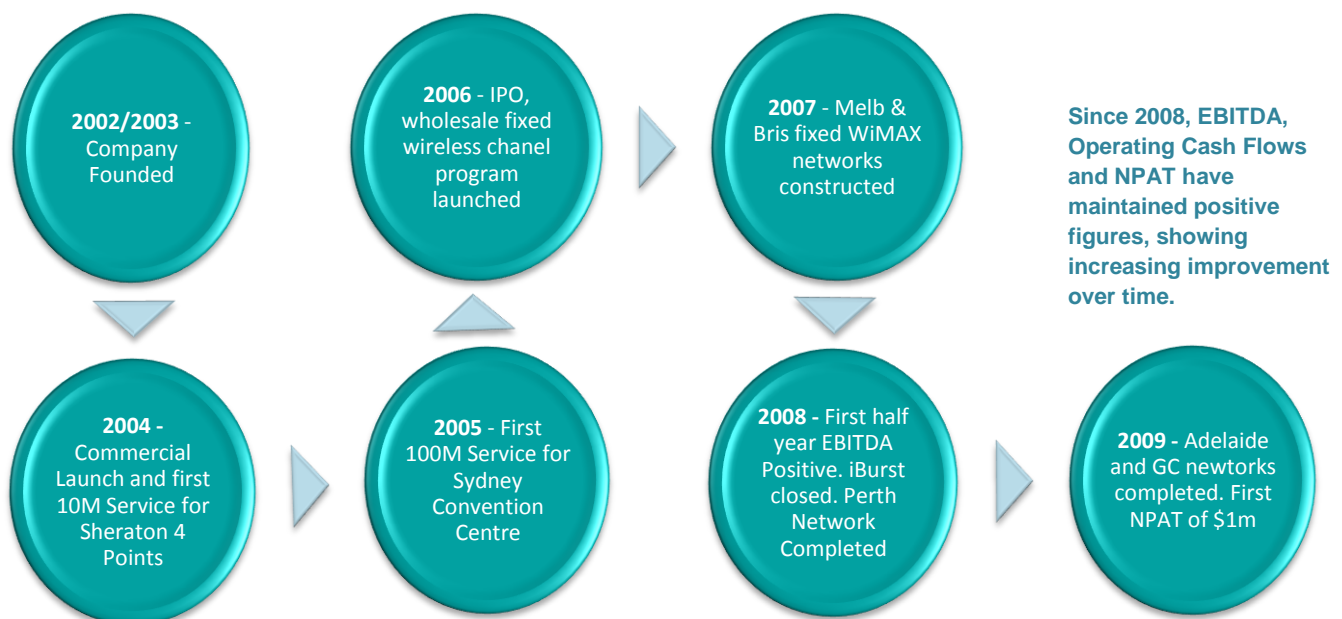
Network Capacity

BigAir's current network is operating with significant excess capacity. It is able to support twice its existing customer base without any additional equipment (assuming that new customers are evenly distributed within the network coverage area). Consequently, profit margin are likely to increase as additional customers that fall within BigAir's current network provide for improved marginal gross margins.

BigAir is operating with large excess capacity, which drives profit margin with the assistance of low incremental cost per customer.

As well as the above, Big Air's incremental cost is relatively low. New installations can be rapidly deployed and have relatively low CAPEX costs. As such, BigAir is able to provide flexible services to more regions at often lower costs than its competitors, e.g. Telstra.

Company Timeline



Source: BigAir AGM Presentation

INDUSTRY OVERVIEW

Market Size

The Australian telecommunication sector is approximated to be \$36 billion in FY08 by IBISWorld.¹ This compares to estimated revenue of \$21 billion in 1998, indicating an average annual compound growth rate of 5.5% over the past 10 years. The wireless market operates as a small niche within the sector, and can be further subcategorised into fixed and mobile wireless markets. The corporate market, including SMEs, accounted for ~60% of the total industry revenue.

The Australian telecom sector is estimated to be worth \$36 billion in FY08.

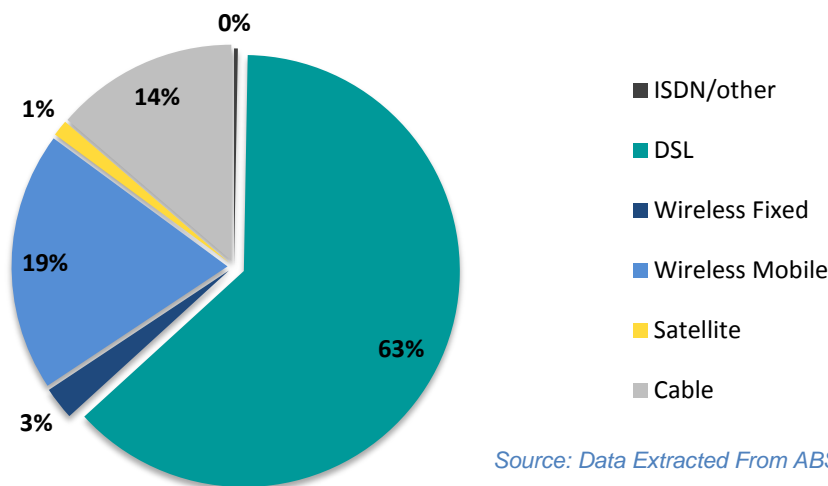
¹ Source: IBISWorld, Telecommunications Resellers in Australia, 22 February 2008, unless otherwise stated.

Market Categories

The Australian telecommunication services market can be broadly divided into three categories²:

- Network owners – Companies with complete – end-to-end network infrastructure (such as wire, cable, fibre or mobile network infrastructure). Examples include Telstra and Optus.
- Partial network owners – Companies with some but not the entire required infrastructure to deliver services to their customers. Examples include AAPT and iiNet.
- Resellers – Companies who source all of their services on a wholesale basis from other network owners or resellers. Wholesale resellers tend to rebrand their products. Examples include M2's acquisition of People Telecom.

Subscribers by Access Connection:



2007-2008 trends in internet subscriber by access points showed that Digital Subscriber Line (DSL) continued to dominate as the most used access connection for non dial-up subscribers, increasing by 4.2million subscribers (~63%). The total number of broadband subscribers reached 7.3 million by mid 2009, representing a 17% increase over the previous 12 months. This recent growth has been driven by further sustained subscription of DSL services, despite a slower growth rate.

ABS reported that wireless connections tripled in 2008, accounting for 21% (or 1,462,000) of all broadband subscriptions, up from 481,000 (~304%) in December 2007³. This niche market is expected to continue enjoying its high growth as the remaining consumers make their transition to broadband services due to an increasing awareness of the benefits of wireless networks.

Whilst DSL continues to dominate as the most used access connection, wireless services is growing at a rapid pace.

² People Telecom Scheme Booklet Page 9

³ <http://www.abs.gov.au/ausstats/abs@.nsf/mediareleasesbyReleaseDate/F2D32B785378BC9CCA25758D002B6804?OpenDocument>

National Broadband Network

The government has established a new company that will invest up to \$43 billion over a period that could extend up to eight years to build and operate a National Broadband Network capable delivering high speed broadband to Australian residential and commercial customers. The Australian telecoms market will likely face dramatic changes depending on the outcomes of the NBN roll-out and the regulatory framework that is used to govern and commercialise the network.

Whilst NBN will have significant impacts on the general telecom industry, it is unlikely to have negative effects on BigAir.

There is considerable uncertainty on both the NBN and its effects on the market structure within the telecommunications industry. Whilst it is obvious that NBN throws up the “X” factor question mark over any Australian telecommunication service provider, given the seminal phase of the proposal, the expected time span of implementation (projected to be around 5-9 years) and the political uncertainty surrounding the plan, it is beyond the scope of this report to make a credible assessment on its likely impacts on BigAir. We note however, that the NBN currently represents uncertain outcomes for all providers, and uncertainty translates to risks.

Industry Outlook

Australian operators are likely to have more than 25 million mobile subscribers in 2011 as migration and business adoption continue to drive growth. Growth in the number of services in both the residential as well as business market continues to be driven by the increased dependency in on-line access and usage. Telstra continues to dominate the market with more than ten million subscribers, Optus has around eight million and VHA has roughly six million subscribers.

Despite subscriber penetration rates being between 110% and 115% of the population, growth is likely to continue for the foreseeable future although the overall rate of growth may slow slightly.

Between 2010 and 2012 revenue growth is expected to be influenced by the following three major factors. The broader economic environment is perhaps the largest influence and economic growth in 2011 and 2012 is starting to look more optimistic than expected. Revenue growth will also be impacted because of price competition. The extent to which new telephony services are developed will influence the pace of revenue growth.

WiMAX TECHNOLOGY

WiMAX stands for Worldwide Interoperability for Microwave Access. WiMAX is a telecommunications technology that offers transmission of wireless data using different transmission techniques. The WiMAX forum created the name Wimax technology to promote its usage and operability. Most of the products around WiMAX technology are based on the IEEE 802.16 standard.

WiMAX technology is created by WiMAX Forum in mid June 2001.

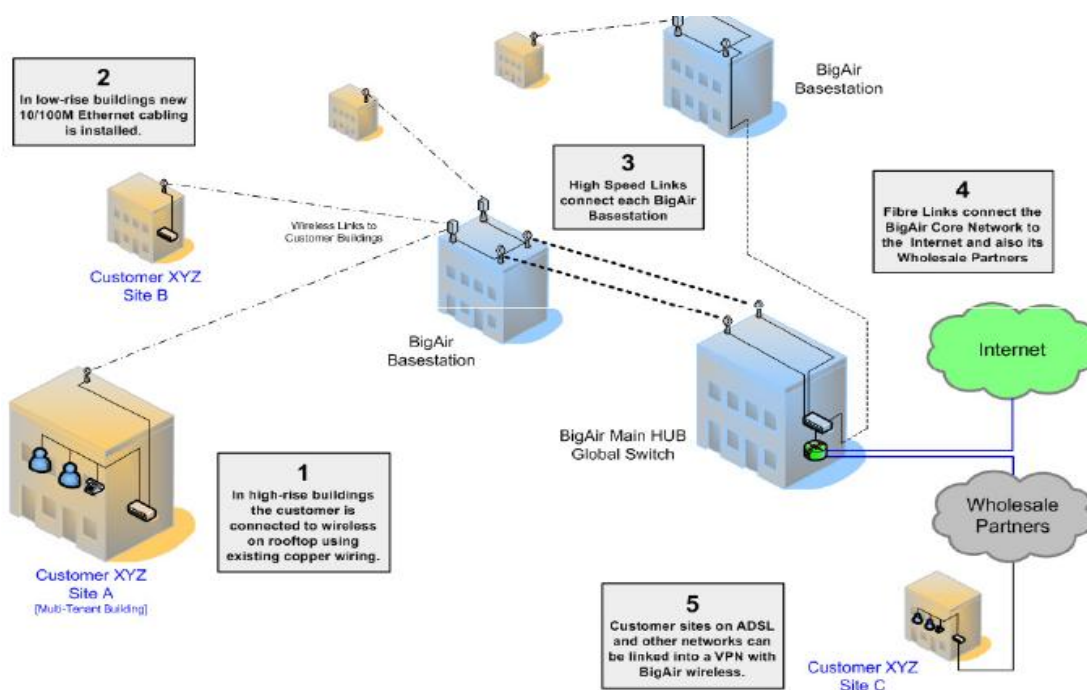
HOW WiMAX WORKS

WiMAX uses base stations (a place where WiMax signals are broadcast) typically located on the roof of a high building structure or edifice to broadcast radio signals. The range of these signals can vary between 10km up to 50km depending on the topography and technology used. Signals

emanating from these base stations will be delivered to WiMAX receivers. From the receivers the signal is transmitted to the end user via standard copper wire (in high rise buildings) or the via the installation of Ethernet cabling in low rise buildings. The backhaul of the network is typically a Main HUB Global Switch which is then connected to the backbone network using external providers.

BigAir's deployment

BigAir has deployed a fixed wireless broadband network using a series of overlapping wireless cells. These cells consist of a base-station with multiple sectors operating point-to-multipoint wireless transmission equipment. The cells have an effective footprint of more than 109km sq. Office buildings are then connected to this network using carrier grade wireless equipment.



ADVANTAGES OF WIMAX

- High speed: WiMAX is able to provide broadband speeds from 64Kbps to up to 100Mbps with the aid of other proprietary technology, which is far greater than that of fixed line technologies such as ADSL, ADSL2+, and VDSL2+. BGL does not use WiMAX exclusively but also makes use of other proprietary fixed wireless technologies to deliver services with speeds up to 1000Mbps.
- Quick deployment: as no fibre or wires need to be laid wireless broadband can be rapidly deployed
- Subscribers can be added or moved (to a certain extent) without modifying the infrastructure.
- Long range: wireless technologies are able to provide reliable and robust connections in excess of 20km (which is far greater than fixed line technologies without the use of repeaters)
- Cost effective: WiMAX presents an extremely cost effective delivery mechanism for high-speed broadband as it doesn't require copper or fibre between the high-speed network and the end user. In addition, much of the provisioning (turning the service on)

There is a diverse range of advantages of WiMAX over fixed line technologies such as ADSL(2+).

is able to be completed remotely, with fewer field service technicians required to maintain and manage fibre access nodes, DSLAMs, etc.

- Easily upgradeable: for new technology or greater capacity
- Well suited to remote/regional areas:
- Subscribers in remote areas can be brought into a network without the need for laying new cables or optical fibre across non metropolitan areas/
- Wireless technologies are tolerant to environmental factors that are common causes of service disruptions for terrestrial fibre installations in regional areas, such as flooding, fire, etc.
- Environmentally conscious: wireless technologies do not rely on disturbing terrestrial conditions, erosion, local vegetation, flora or fauna habitats, etc.

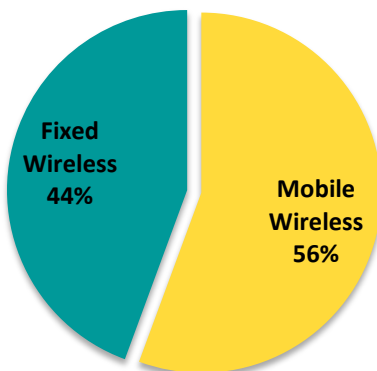
BigAir has transformed itself from a mixed operator of mobile and fixed wireless operator to the entity today that specialises in providing fixed wireless services.

BUSINESS MODEL

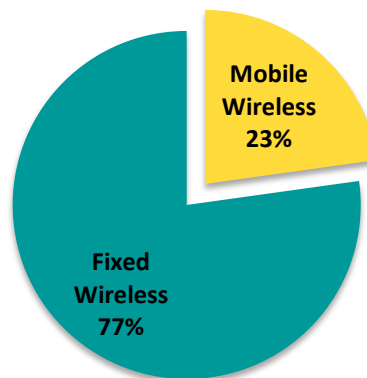
Business Transformation

BigAir has transformed itself over the years from being a mixed operator of On-Net and Off-Net services to the business today that completely focuses on selling its own fixed wireless services. The closure of iBurst is a significant strategic decision which will impact heavily on BigAir’s revenue, cost structure and its future prospects. Fixed wireless services have a much higher gross margin compared to mobile “Off-Net”, and as such, the closure of iBurst will significantly reduce COGS. Overall gross margin is expected to increase as a result,

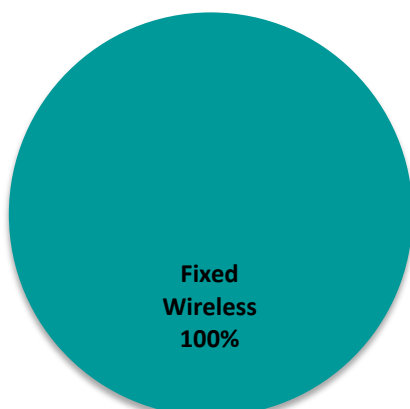
Revenue Breakup FY08



Revenue Breakup FY09



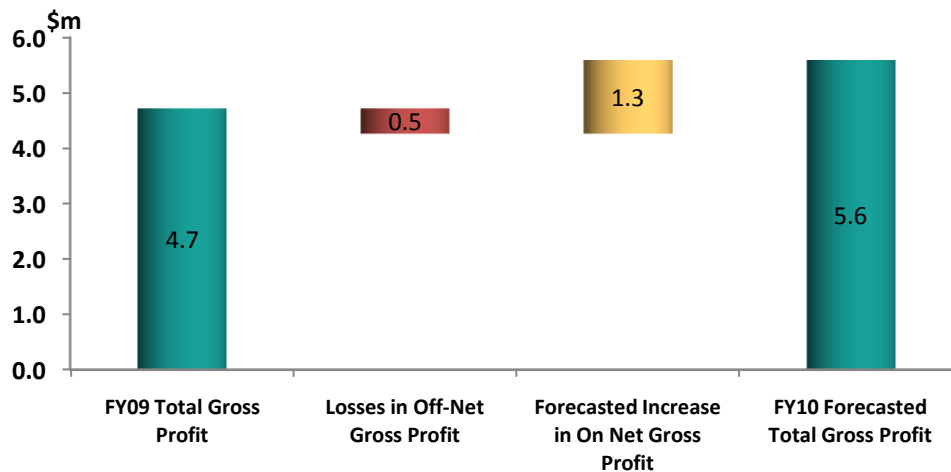
Rev Breakup Forecast FY10



Over the last 3 financial years, proportion of mobile wireless revenue has decreased significantly from 76% in FY07 to 23% in FY09, at the completion of the closure of iBurst. FY10 revenue forecast will be completely composed of fixed on-net revenue

Source: BigAir and Microequities

ON-NET TO DRIVE GROWTH



Source: Data obtained from BigAir's Annual Report FY09 and Microequities' Estimates

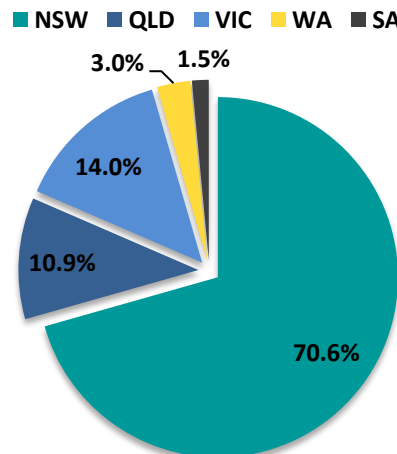
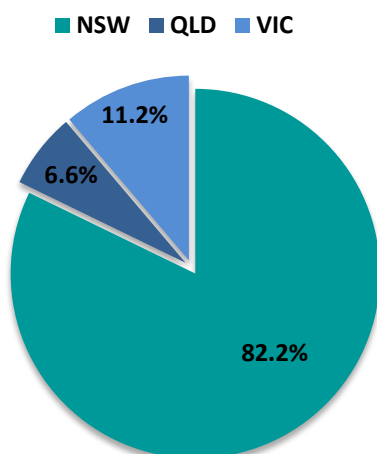
The above graph illustrates that total gross profit in FY10 is forecast to increase despite the closure of iBurst. The implication of this is that the forecast organic growth in fixed wireless exceeds the losses from the closed off-net division.

Revenue Structure

As evident in the following graphs, proportional revenue contributions from VIC and QLD have been growing faster than Sydney during FY08/09 and it is expected this trend will continue in FY10 following further expansions in these regions.

Aggressive expansion enabled BigAir to rely less on revenue generated from NSW, albeit the fact that it is still accounting for 70% of total on-net revenue. However, 50% of new sales have come from regions outside of NSW. This decreasing reliance and revenue diversification provides a hedge against any unanticipated drop in demand in NSW. This trend is expected to continue in FY10 following management's indication of further expansion, particularly in Victoria and Southeast Queensland where demand has been picking up. Whilst NSW will continue to dominate as the major revenue contributor, there will be increasing weighting from the other states as the expansion is rolled out.

Jan 2009 Revenue Breakdown July 2009 Revenue Breakdown



Increase in organic growth in "On-Net" gross profit is forecasted to well exceed the losses incurred as a result of the closure of iBurst.

Planned aggressive network expansions in Victoria and Queensland will result in higher growth in these

BigAir has historically experienced very low churn (below 1%). This is to be expected due to the sticky nature of the business-grade services that BigAir provide. Some factors that account for the low churn include:

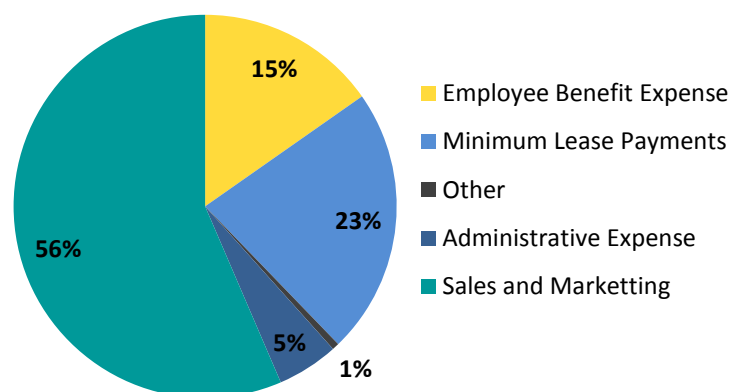
- BigAir achieves a high level of customer satisfaction through providing reliable services, fast installations and responding efficiently to any technical issues.
- Unlike residential markets, business-grade services generally have a lower churn rate as businesses tend to develop an on-going relationship with their carrier.
- BigAir experiences little competition in urban regions that are not covered by most of its competitors.
- BigAir experiences low pricing pressures with their mid to upper end customers.

BigAir enjoys a negligible churn rate.

Cost Structure

FY10 Projected Cost Structure

Total: \$2.9m



*Source: Microequities' Forecasts

The three main operating costs for BigAir include general administrative, occupancy and employee benefit expenses. Occupancy expenses essentially consist of leases payments for the receivers/transmitters installed on office roofs as well as the base stations. General administrative expenses include office administrative, sales & marketing and impairment expenses. We anticipate a \$0.3m (11.5%) increase in total operating expense to \$2.9m in FY10, driven by higher lease payments due to further planned network expansions and higher sales & marketing expenses as indicated by management.

Total Operating Expenses is forecasted to be \$2.9m in FY10, driven by higher lease payments and Sales & Marketing expenses.

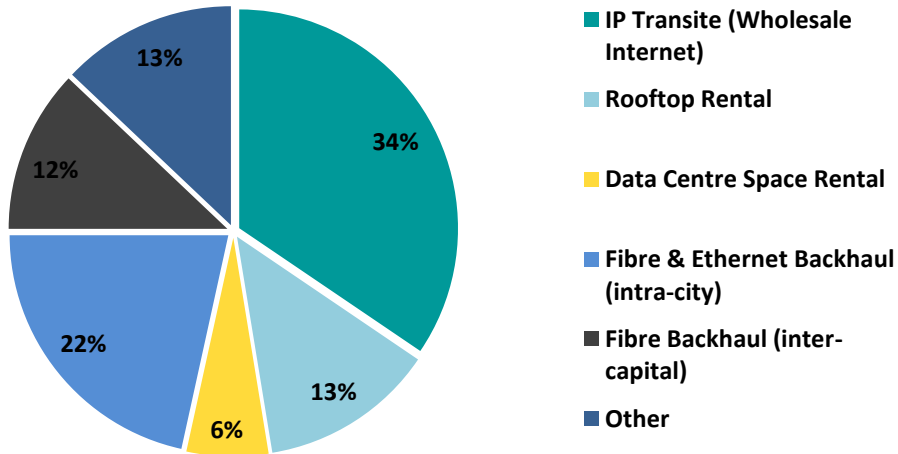
Cost of Goods Sold

BigAir purchases wholesale internet which it then packages and delivers to its customers through channel partners or directly. Intra-capital as well as inter-capital fibre access is purchased from various fibre suppliers. Other cost of sales include rooftop leases for the receivers/transmitters, as well as data centre space rentals (e.g base stations). It should be emphasized that BigAir's fixed wireless services enjoy a high gross margin. For FY10 COGS is projected at 20% of sales (\$1.4m), in-line with historically experienced margins.

COGS is projected at a margin of 20%, in-line with historical and management guidance.

Approx. Monthly COGS

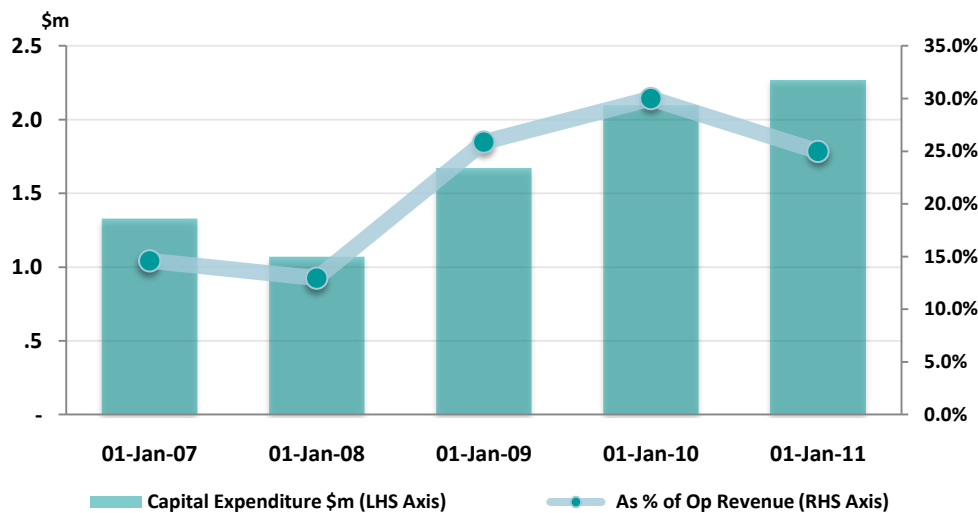
Total: \$116,000



Source: BigAir and Microequities

Capital Expenditure

BigAir has announced further more aggressive network expansion in FY10 (outlined on page 5), implying an increased capital expenditure budget relative to FY09. We expect a capital expenditure figure in excess of \$2.0m for FY10, at 30% of sales.



Revenue Drivers

- **More Focused Approach** – The closure of iBurst allows BigAir to focus all its resources on its own higher gross margin fixed wireless services. The usual operating costs associated with iBurst, in particular the sales and marketing expenses, will be redirected to drive BigAir's on-net revenue. Given the 80% projected gross margin for the fixed wireless services, the aggressive network expansion into the geographic markets of Victoria and Southeast Queensland as well as further consolidation of network coverage in existing areas, we are expecting a sustained double digit EBITDA forecast in FY10.

- Low Incremental Cost, Lead Time and Payback Period** – BigAir enjoys a relatively low lead time and payback period due to its fast and low cost installations. For customers outside the coverage area, a new base station can be built at a cost of under \$100k per base station with a lead time of approximately 2-3 weeks depending on the location. This is considerably cheaper and more flexible than the fibre network, allowing for more efficient expansions as well as enabling a low payback period (4-6 months depending on the demand).

Due to fast implementation of network expansion and the fast payback period, we believe network expansion is a leading indicator of expected future revenue growth (though it does not account for increases in revenue under the existing network). As management has already indicated further aggressive network rollout in FY10, we believe our projected double digit revenue growth has a sound basis.

- Increased Demand for Wireless, Disaster Recovery and Data Backup Services** – Aside from observing increased demand for wireless services in Victoria and Southeast Queensland which underpins future expansions, BigAir has continued to experience increased growth in areas such as redundancy networks and data centre backups.

Redundancy networks enable load sharing to reduce bandwidth congestion when the primary link ceases to operate. BigAir also provides a wireless link from offices to data centre servers ensuring that any critical data is not lost or delayed. Increased demand in those particular areas recently has been fuelling revenue growth.

Sensitivity analysis returns an approximate 1 to 1 relationship between % change in sales and % change in EBITDA.

FY10 & FY11 FORECASTS

Figures in A\$'mn	2009	2010(F)	2011(F)
Revenue	6.5	7.0	9.1
Cost of Good Sold	1.7	1.4	1.9
Op. Expenses	2.6	2.9	3.2
EBITDA	2.1	2.7	4.0
<i>% Change</i>	2.0	0.3	0.5
<i>% of Revenue</i>	0.3	0.4	0.4
Dep. & Amortisation	1.0	1.2	1.3
EBIT	1.2	1.5	2.7
<i>% of Revenue</i>	0.2	0.2	0.3
Net Interest Income (Expense)	0.1	0.1	0.2
EBT	1.2	1.6	2.9
Tax	-0.3	-0.5	-0.8
Net Profit	1.0	1.2	2.0

We view BigAir's market as relatively untapped. Within the business segment there is a growing demand for high volume data services delivered on highly reliable networks. We expect this trend to continue as cloud computing becomes a more prevalent force within the Australian business market. Data consumption is likely to continue to rise, underpinning BigAir's growth prospects. The high operational leverage from BigAir's operations means that incremental increases in revenue will deliver significant increase in earnings. We view the market over the coming 24 months as still very much in a "land grab" phase. The companies that deploy their networks in uncovered areas will have first mover advantage and will provide a strong disincentive for alternate fixed wireless networks to be deployed under the same areas of coverage.

* Source Microequities

SENSITIVITY ANALYSIS

Below is a sensitivity analysis on EBITDA for FY10 given percentage changes in sales and COGS margin. The left-hand table shows the absolute EBITDA figures at various input levels whilst the right-hand side table shows the percentage change in EBITDA relative to the FY09 EBITDA of \$2.1m. This is conducted on the basis that operating costs are estimated accurately and fixed for each level of variable input. The highlighted cells represent Microequities' estimates and the resulting changes in EBITDA accordingly.

Sensitivity analysis returns an approximate 1 to 1 relationship between % change in sales and % change in EBITDA.

Change in EBITDA (\$m)	% Change in Sales						
	0%	10%	20%	30%	40%	50%	60%
COGS Margin (As % of Sales)							
5%	1.8	2.6	2.8	3.3	3.7	4.2	4.7
10%	1.6	2.3	2.5	2.9	3.4	3.8	4.3
15%	1.4	1.8	2.2	2.6	3.0	3.5	3.9
20%	1.1	1.5	1.9	2.3	2.7	3.1	3.5
25%	0.9	1.2	1.6	2.0	2.3	2.7	3.1
30%	0.6	1.0	1.3	1.7	2.0	2.3	2.7
35%	0.4	0.7	1.0	1.3	1.7	2.0	2.3
40%	0.1	0.4	0.7	1.0	1.3	1.6	1.9

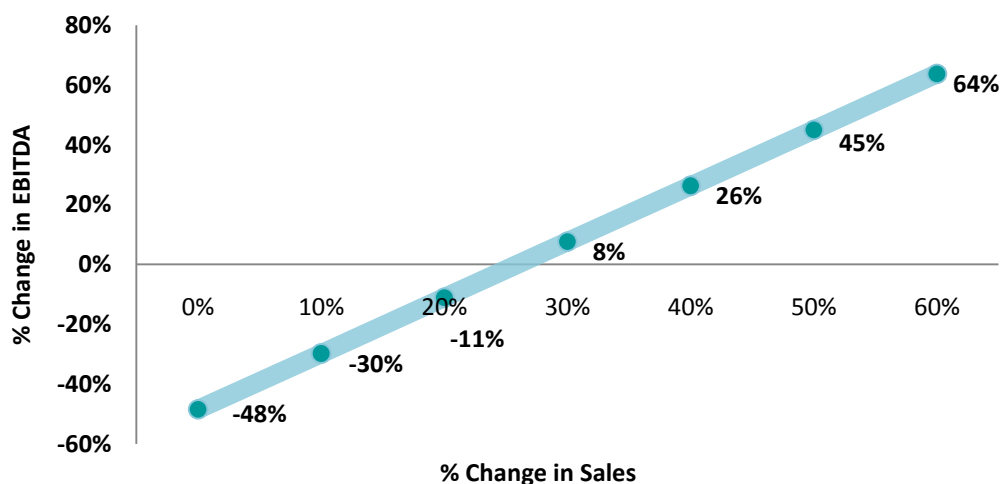
% Change in EBITDA	% Change in Sales						
	0%	10%	20%	30%	40%	50%	60%
COGS Margin (As % of Sales)							
5%	-13%	20%	31%	53%	75%	98%	120%
10%	-25%	6%	17%	38%	59%	80%	101%
15%	-37%	-17%	3%	23%	43%	63%	82%
20%	-48%	-30%	-11%	8%	26%	45%	64%
25%	-60%	-43%	-25%	-8%	10%	27%	45%
30%	-72%	-55%	-39%	-23%	-6%	10%	26%
35%	-83%	-68%	-53%	-38%	-23%	-8%	8%
40%	-95%	-81%	-67%	-53%	-39%	-25%	-11%

Source: Microequities

The graph below illustrates the sensitivity of sales at our estimated COGs margin of 20%. The resulting graph defines a positive linear relationship between % change in sales to % change in EBITDA. Additionally, the gradient is 1:1, translating into an approximate 1 to 1 relationship between the two quantities.

Sensitivity analysis is conducted for sales and COGS margin on the presumption that OPEX is accurately estimated and fixed for each input.

EBITDA Sensitivity Analysis at 20% COGs Margin




* Source Microequities


INVESTMENT CASE:


- ✓ **Independent “Last Mile” carrier** – As a “last mile” infrastructure owner, BigAir does not rely on other carriers to deliver fixed wireless services. Its network is completely insulated from breaks in fibre-optic and copper networks which often result from civil works and other operations. BigAir can deliver an uptime of up to 99.99%.
- ✓ **Higher profit margin as a result of realignment and other factors** – As a “last mile” carrier, BigAir’s fixed wireless service has, on average, a high sustainable gross margin of 75-80%. Management has undertaken a substantial reduction in operating expenses as a result from the closure of iBurst. These factors are combined with the network’s current high excess capacity, and network expansion we believe will drive earnings growth over the FY10 & FY11.
- ✓ **Low incremental cost and lead time** – BigAir owns all its required installation hardware. The carrier-grade wireless equipment usually installed on roofs or edifices have rollout times that usually range 2-3 days for the entire process. We see the responsiveness of BigAir’s rapid deployment as a competitive advantage. BigAir’s low incremental cost results in a smaller payback period which in turn drives profit margins.
- ✓ **Improved FY09 financial margins** – BigAir has a solid balance sheet with no debt, and \$2 million in cash. It delivered its maiden positive NPAT of \$1.0 million with improvements in EBITDA margins and net operating cash flows. Given the completed business realignment into high margin fixed wireless services and further network rollouts, we are expecting continued improvements in profitability for FY10.
- ✓ **Attractive valuation:** Our Discounted Cash Flow valuation on BigAir is \$0.23, representing a 119% discount to the current market price of \$0.105. The valuations coupled with the relative valuation of \$0.18 means that BigAir is trading at a considerable discount to our assessed price objective of \$0.21.
- ✓ **High growth expectations due to further aggressive network expansion** – The successful expansion in FY09 has already seen positive results in terms of revenue growth, especially from Victoria and Queensland. More aggressive network rollout is planned for FY10 and this will in turn drive growth of sales in these regions, reducing dependence on revenue streams from NSW. We believe that based on the incremental revenue derived from the planned network expansion our revenue forecasts are attainable and contain upside risks, particularly if BigAir is able to win additional clients within the established network which has ample capacity.
- ✓ **Growing presence in urban areas** - As most networks do not provide sufficient wireless coverage in the urban areas of NSW and other regions, BigAir is continuing to extend its already significant network footprint. This results in a fixed proportion of secure revenue stream for BigAir.
- ✓ **Likelihood of a Maiden Dividend Payout in FY10** – Management has flagged the possibility of issuing BigAir’s first dividend in FY10 under the normal presumption that no significant events occur such as merger & acquisition deals. We note that given BigAir’s unleveraged balanced sheet and the forecast cash flow from operations, BigAir has the capacity to instigate a maiden dividend.
- ✓ **Scope for Industry consolidation-** BigAir is a relatively minor player within the Australian Telecommunications industry. We expect significant consolidation to take place with second and third tier players. Given the relative scale of BigAir’s operations we believe that it is a potential prospective candidate to be either an acquirer or target in a consolidation play. We note that during the course of 2008 Clever Communications (CVA:ASX) launched an unsuccessful hostile bid for BigAir. Clever Communications currently owns 8.04% of BigAir.


RISK ANALYSIS


Some of the investment risks have been outlined as follows. (Note that the list is NOT exhaustive)


- 


Sole Revenue Source - BigAir's revenue is currently sourced uniquely from providing carrier service to its clients. BigAir therefore has a divisionally concentrated revenue source; exposing the company to earnings risk should it experience an adverse change in demand for its network wireless services.
- 

Technology Risk – BigAir operates in the highly technologically dynamic market of telecommunications services. Whilst its carrier network technology is a service differentiator, and it has a number of significant advantages, its competitive standing is still subjected to potential technological advancements that might substantially devalue BigAir's service offering or its competitive standing.
- 

Pricing Pressures due to Competition – BigAir operates in an aggressive and competitive telecom sector. Adverse changes to the pricing structure from BigAir's competitors could negatively impact revenues and profitability of the group.
- 

Wireless Service is a niche market - Despite the growing market for WiFi-based solutions, Wireless Broadband markets still remain as a niche deployment. Growth could also be limited by expected WiMAX deployments in the foreseeable future. BuddeComm predicts total wireless broadband market will be worth \$1.4 billion, majority of which is accounted for by 3G mobile wireless revenues. Comparatively, fixed wireless market is only enjoying modest growth. The continued outpacing of 3G mobile network development over WiMAX could potentially render the fixed wireless services as a niche market only.
- 

Reliance on Contracted Resellers – BigAir drives most of its promotion, marketing, new customer acquisitions and revenue through its 40-50 resellers. The channel partners account for up to 80% of sales. BigAir's internal sales and marketing team is comparatively much smaller in size. Any adverse changes that cause a reduction in the amount, or migration from any or some of its resellers could significantly impact on BigAir's source of revenue and earnings.
- 

Low barriers to industry entry - The *Telecommunications Act* provides no limitations on the number of carrier licenses that may be issued to, and applied by, corporations, partnerships, or public bodies for entry into any telecommunication service sectors. Furthermore, the Act encourages increased self-regulation, does not restrict carriers from building or operating communications infrastructure, and contains minimal guidance on adopted technology standards. Certain obligations also accrue to carriers including contribution to the Universal Service Obligation cost.
- 

Rollout of National Broadband Network (NBN) – The construction of NBN will have a major impact on the Australian telecommunications industry. Despite analyst reports predicting a long lead time (connecting 90% Australian homes by 2025), and the fact that BigAir operates its own independent network which is less likely to be subjected to regulatory changes, there are still many uncertainties surrounding the NBN its coverage, pricing regime and network access that could adversely impact BigAir.

VALUATION | RECOMMENDATION

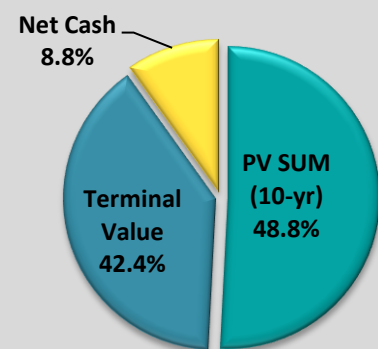
DCF Valuation

Our DCF valuation provides us with a value of \$0.23 per BigAir Share, representing a 119% premium on the current price of \$0.105. Our model has assumed a CAPEX program of \$2.1m for FY10 and \$2.3m for FY11. We have assumed a long term growth rate of 1%.

Discount rate accounts for risk

We have applied a WACC of 15.3% and hence reached our base case DCF valuation of \$0.23.

DCF Inputs		As at 7 February 2010	
Equity Beta:	1.30	Interest-bearing Debt:	0.0
Risk free rate:	5.55%	Cost of Debt:	N/A
Return on Equity:	15.3%	WACC:	15.3%



Relative Valuation *

Forward FY10 EV/EBITDA comparisons



* Source Microequities, Microequities forecasts and consensus estimates

BigAir's competitors are Clever Communications, Macquarie Telecom Group, Pipe Networks Limited, iiNet Limited and TPG Telecom. The average EV/EBITDA excluding BGL is 5.8, which gives us an estimated price of \$0.18 and implies a premium of 71% above the current price of \$0.105

Investment Opinion

We believe that BigAir is a profitable business within a niche area of the Australian Telecommunications services industry. FY09 was a pivotal year for BigAir in terms of business model maturity and traction in its realigned "on-net" strategy. With continued momentum its core business and expansion of its network coverage areas, we believe that our forecasts are attainable, and contain some upside risk to them. The company has no debt on its balance sheet and enjoys healthy gross margins. Based on our combined valuation methodologies which provide us with a price objective of \$0.21 cents per share, a 100% premium to the current share price. In concert with a recommendation we are attaching a **Strong Buy recommendation**.

FINANCIAL SUMMARY

INCOME STATEMENT			
Year to June	2009A	2010e	2011e
Revenue	6.5	7.0	9.1
Cost of Good Sold	1.7	1.4	1.9
Op. Expenses	2.6	2.9	3.2
EBITDA	2.1	2.7	4.0
% Change	2.0	0.3	0.5
% of Revenue	0.3	0.4	0.4
Depreciation & Amortization	1.0	1.2	1.3
EBIT	1.2	1.5	2.7
% of Revenue	0.2	0.2	0.3
Net Interest Income (Expense)	0.1	0.1	0.2
EBT	1.2	1.6	2.9
Tax	-0.3	-0.5	-0.8
Net Profit	1.0	1.2	2.0

BALANCE SHEET			
Year to June	2009A	2010e	2011e
Cash & cash equivalents	2.0	3.3	5.5
Receivables	0.1	0.2	0.2
Inventories	0.0	0.0	0.0
Total Current Assets	2.2	3.4	5.7
Trade and other receivables	0.0	0.0	0.0
Property, Plant & Equipment	2.5	3.5	4.4
Deferred tax assets	1.6	1.2	0.3
Other intangible assets	0.1	0.1	0.1
Total Non-Current Assets	4.3	4.7	4.9
TOTAL ASSETS	6.5	8.1	10.6
Trade and other payables	1.1	1.2	1.6
Provisions	0.1	0.1	0.1
Income received in advance	0.0	0.0	0.1
Interest bearing borrowings	0.0	0.0	0.0
TOTAL LIABILITIES	1.3	1.4	1.7
NET ASSETS	5.2	6.8	8.9
Issued Capital	10.6	10.6	10.6
Reserves	0.2	0.2	0.2
Retained profits (Accum. losses)	-5.5	-4.3	-2.3
TOTAL EQUITY	16.2	6.4	8.5

KEY RATIOS			
Year to June	2009A	2010e	2011e
Sales	6.5	7.0	9.1
% Chg YoY	-0.2	0.1	0.3
Price/Sales	1.5	1.4	1.1
EPS (cents)	1.2	1.3	2.3
% Chg YoY	51.5	0.2	0.8
P/E	9.6	8.2	4.7
Enterprise Value	7.5	6.3	4.1
EV/EBIT	6.4	4.2	1.5
EV/EBITDA	3.5	2.3	1.0
DPS	0.0	0.0	0.0
Dividend Yield	0.0	0.0	0.0
ROE	0.2	0.2	0.2
Debt to Assets	0.0	0.0	0.0
Debt to Equity	0.0	0.0	0.0

CASH FLOW STAMENT			
Year to June	2009A	2010e	2011e
EBITDA	2.1	2.7	4.0
Decrease/(Increase) in Work. Cap	-0.4	0.1	0.3
Net Interest	0.1	0.1	0.2
Increase/(Decrease) in Provisions	0.0	0.0	0.0
Tax Paid	-0.3	-0.5	-0.8
Other Op. Cash items	0.3	0.5	0.8
Cash from Operations	1.9	2.9	4.5
Payments for PPE	1.1	1.5	1.9
Payment for intangible assets	0.2	0.2	0.3
Loan to subsidiary	0.0	0.0	0.0
Cash from Investing	-1.4	-1.7	-2.2
Incr/(Decr) in Equity	0.0	0.0	0.0
Incr/(Decr) in Debt	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0
Cash Flow From Fin	0.0	0.0	0.0
Net Cash	0.5	1.2	2.3
Cash and cash equivalents at BoY	1.6	2.1	3.3
Cash and cash Equivalents at EoY	2.1	3.3	5.6
Equity FCF	3.0	4.4	6.3
Oper. Cash Flow Per Share	2.4	5.8	10.9

IMPORTANT DISCLOSURE INFORMATION:

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RECOMMENDATION GUIDE

Recommendation	Market Price undervalued/overvalued to Microequities price objective
Strong Buy	Above 40%
Buy	20 to 40%
Hold	0 to 20%
Sell	0 to -20%
Strong Sell	Greater than 20%

ADDITIONAL VOLUNTARY DISCLOSURE BY MICROEQUITIES*

Investment Banking	Staff Interest	Analyst personal interest	Equity Stake By Microequities Associates	Disclosure to Company	Business Relationship
NO	✓	NO	✓	✓	✓

* To promote transparency, Microequities voluntarily discloses potential conflict of interests covered by this research document.

Additional disclosure: Microequities Asset Management and its associates currently have a relevant interest in the shares of BGL.