AUSTRALIAN IT

Broadband drives small fry out

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WITH two major acquisitions in the past few days, the long-predicted move towards major consolidation of the internet and access provider sector may finally be rolling, with the increasing popularity of fast DSL services giving it much-needed momentum.

Yesterday, regional front-runner SP Telemedia announced it had picked up the still-warm remains of service provider Comindico.

Seemingly ill-fated from the start, Comindico in September ran out of favours with vendor-financier Cisco Systems after burning more than $350 million in start-up cash over its four years.

While coy about how much it paid, SPT claimed it got Comindico for “a fraction of its original construction cost” from Cisco-appointed administrator McGrath Nicol, which was called in to help retrieve the estimated $80 million the company still owed the networking giant.

Along with Comindico’s infrastructure, SPT also picked up about 40 wholesale internet service provider customers.

The announcement followed last week’s revelation that ISP Chariot would buy out Perth’s Datafast. Once complete, the move would make Chariot the sixth largest ISP in the country, boasting 250,000 subscribers, with 20,000 on broadband.

“We’ve been acquiring companies for the past two to three years, as have Datafast and others like iiNet,” Chariot managing director Robert Horlin-Smith said.

“Size is a critical factor in this game – to be a true competitor you have to be a good size. We’ve said we want to be 5 per cent of the market, and 5 per cent is 300,000, and you have to do better than that to be a true competitor. Do I think further consolidation will occur? Absolutely.”

Although rated by many as overpriced at a reported asking price of $100 million to $120 million, big-name ISP OzEmail still has the for-sale sign in the window.

Nevertheless, interest in acquiring OzEmail – once an acquisition target for Telstra – from parent MCI remained high, telecoms industry analyst Paul Budde said.

“There’s plenty of interest because it’s a good brand and it’s still seen as a good Aussie company, but it has been underperforming for the past five years,” he said.

“If it finds a good owner it will boom. It’s waiting for MCI to unshackle it – to be realistic about the price and flog it off.”

Industry watchers say the increasing uptake of broadband is likely to give extra impetus to consolidation in the sector. According to Telstra, Australia's 500-plus ISP sector is the one of the most fragmented in the world. Only Japan has more ISPs per user.

With some ISPs now starting to install their own infrastructure, the need to grow customer bases will increase, as service providers seek the scale to justify their investment. The fastest way to acquire those customers is to buy them.

"Most of the tier-two ISPs – Primus, iiNet, Swiftel and those guys – are pretty keen to acquire any subscriber base that's around," IDC analyst Landry Fevre said.

Indeed, Primus has completed the acquisition of Brisbane-based Dart in the past week, giving it an extra 2400 ADSL customers.

While medium-sized players are often seen as the most likely predators, larger telcos could also enter the market defensively, depriving their rivals of opportunities to scale up. Either way, the most likely takevoer targets are the small ISPs that grew up around dial-up internet access.

"What you're seeing happen in the ISP market is that size does matter – it's a commodity product and only when you have a very large number of subscribers can you generate sufficient margins," Mr Budde said.

"Being a medium-sized provider is not going to work because margins will be low. It's no use – you need about half a million subscribers to be a success."

However, by focusing on niches or a particular style of service, small players may be able to "defy gravity", Mr Budde said.

Mr Fevre said: "With Australia making a definite move towards broadband, small dial-up-only players may decide it is easier to sell out than to try to set up what would have to be, in effect, a whole new business.

"It was okay to run a dial-up business from your garage. With broadband you can't.

"Those smaller guys will start to lose subscribers going on to broadband," he said. "There will probably be 50 to 100 fewer ISPs in Australia by this time next year."

IiNet's Michael Malone also said the broadband market was "radically different" to dial-up.

"To be able to do a national dial-up infrastructure you have to do 66 call collection areas, whereas with ADSL, it's 2500 exchanges, of which Telstra has enabled about 1000," he said. "Even if you don't build, you have to get access to someone's network, and your cost structure is going to be guided by that also."

Smaller players point to Telstra's wholesale ADSL prices as a key problem, but Telstra denies the charge, saying it has offered wholesale customers a choice of several pricing schemes.

The market was extremely volatile, Mr Malone said. “Every three-to-six months you think it’s going to hit bottom, then there’s another shift.” Yet despite dire predictions for small ISPs, Telstra is understood to be on the verge of launching a “virtual ISP (VISP) in a box” service that will allow anyone with the inclination to get into the internet access market.

Netspace managing director Stuart Marburg said consolidation was gathering pace, but “the most interesting thing, of course, is going to be how well everyone pulls it off”.

“Simply buying a larger customer is not in itself a guaranteed recipe for success,” he said.

Even though Netspace was starting to put its own equipment into exchanges, it was not doing so on a scale that required a big jump in customer numbers, and it would only buy if the price was right, Mr Marburg said. “We’re not looking at putting in 200 DSLAMs, so we’re not looking at anything like the scale of Telstra or Optus. Ours are targeted at the areas where we already have bulk in customers.”

Nevertheless, DSL was changing the market dynamics, he said. “If you’re not already offering DSL and don’t have a good number of customers so you can get some economies of scale, you should be worried.”

Last week, Optus made a major move in retail broadband pricing, offering up to four months free broadband access to customers who bundled their home phone, mobile, or both, with a broadband package.

“Success in the Australian telecommunications market is dependent on achieving scale and owning infrastructure,” Optus consumer and multimedia acting managing director Scott Lorson said. “Today’s announcement is a critical step in achieving the former.”

As well as bulking up its customer numbers before the launch of its own DSL network, Optus is betting that its broadband bundles will be tough for internet-only operators to match, putting even more pressure on small players. Nevertheless, many small ISPs are eagerly awaiting the Optus entry into the wholesale DSL access market, said Zac Swindells, managing director of wholesaler ispOne. “Another major supplier of infrastructure out there will deliver a bit more value to the wholesale space.

“Small ISPs cannot successfully run a broadband service on a commodity basis, and have to find ways to add value in order to survive.

“These ISPs are running on negative margins and trying to run a cashflow business,” Mr Swindells said.