

Who will blink first on NBN pricing?

The showdown on NBN CVC pricing has been a long time coming. The expiry of the 40% uplift in CVC capacity might well be the trigger for either the NBN or RSPs to change their models.

The conflict between RSPs and the NBN was set up when NBN planned to grow ARPU to about \$100 wholesale at 2040 (2012-2015 NBN Plan). This ran contrary to the global model of delivering faster speeds year by year with largely flat industry revenues and flat ARPU. This model has continued in the 60 countries that are above Australia in fixed broadband speeds. Gains in these countries have come from assiduously driving down industry costs rather than heroic and ill-advised investment.

The conflict between the NBN'S need for revenue and the successful global model could be foreseen at the beginning when the NBN chose to match Telstra's copper based prices rather than charge a flat \$75 per line that would have made a modest return on the investment. NBN dodged a bullet back then as it would have been seen for what it was – highway robbery.

The NBN counted on customers migrating to its higher speeds (AVCs) and the growth in traffic (leading to more purchases of CVCs) to increase its ARPU. But the first has not happened as quickly as hoped and the latter is feeding the resentment of its wholesale customers who have committed themselves to retail plans with unlimited data.

Retailers used to charge for monthly data allowances and that would have allowed retail and wholesale revenues to rise along with the recovery of NBN costs. At the start of 2010 no RSP had an unlimited plan. By September both TPG and Internode had a terabyte ADSL2+ plan. But when the NBN was available in 2012, no retail plans over either ADSL2+ or the equivalent NBN offer had unlimited retail data. Then in 2014 all TPG's plans over both ADSL2+ and the NBN offered unlimited data. Others followed with Telstra holding out until 2018.

So why did retailers move to unlimited plans that they must have known would see margins squeezed on the NBN? The retailers have overwhelmingly chosen to offer unlimited plans at prices that Australians are willing to pay – not because they are unusually generous or blind, but because customers are prepared to pay a premium for budget certainty.

Telstra and Optus went along with this because they had to maintain market share at least until the generous PSAA payments were made for transferring their customers to the NBN and while waiting for the cavalry to arrive in the form of 5G with lower costs.

Now in 2020, most of the NBN's costs have been incurred, but the ARPUs needed to recover those costs aren't tracking upwards according to the 2012-15 plan - despite NBN's best efforts. Simultaneously, the margins of the RSPs are disappearing as their NBN wholesale costs rise with video streaming.

The NBN bestowed an extra 40% of CVC capacity to make lockdown due to COVID-19 more bearable. But it is only temporary. The ending of the 40% uplift inserts a decisive event into what was previously a slow boil. At a time when retail margins are becoming exhausted, something has to give. Either retail prices rise, or performance falls at busy times, or the NBN accepts that ARPUs won't rise any further and moves to a flat rate (AVC charging alone).

The adoption and performance of Australian fixed broadband hangs in the balance. Australia ranks 62nd in the world in June 2020 for broadband speed with nearly 52mbps according to Ookla. Sixty other

countries improved faster over the last 10 years. New Zealand has managed a very respectable 21st with 121mbps owing to spending much less per premise. The Australian speed ranking isn't a reflection of the underlying NBN network capability but the impact of the magnitude of the spend and the pricing model.

High fixed broadband prices and low relative speeds will also cause more to shift to cellular alternatives. Fixed broadband adoption may actually fall below the level when NBN was announced leaving nothing gained by the expenditure

The Optus 5G Home broadband offer shows what is happening at the dawn of the 5G era: over 50mbps is guaranteed and one reviewer experienced 120mbps in the evening – down from 200mbps at other times and a peak of 300mbps. This unlimited cellular plan costs \$70 versus \$75 for an unlimited NBN service also from Optus that typically delivers 44mbps, or about 1/3 the speed in the busy period. Price sensitive Australians, of which there are more than ever before following Covid-19, will find much faster speeds and a lower price a good deal. Competition will cap NBN's ARPU growth – perhaps this year, perhaps later.

If NBN tries to keep growing ARPU this year, RSPs might choose to keep prices steady and simply advertise slower busy period speeds and allow the lead of 5G services to grow.

The right long-term answer for Australia remains finding ways to drive down industry costs with new technologies and simpler networks to allow ever faster services to be delivered without paying more. NBN's immediate problem is burying the costs incurred over the last decade because they aren't going to be paid back over the next three decades as was planned.

The next 24 months will be interesting for all and like all good shootouts, we must expect some casualties. Our guess is that the largest tombstones will have CVC and ROI on them – or maybe it's better for all that the graves go unmarked.

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