

A SEPTEMBER TO REMEMBER – THE FIBER PIVOT IS (FINALLY) HAPPENING

Northern-burbs-of-Chicago greetings from a recovering sell-side analyst! Jim is taking the Editor on a well-deserved beach break, but before leaving town he asked me to babysit his beloved *Sunday Brief* (just for this weekend). One of the things I miss most about my former role is the writing aspect of my job. So, thank you Jim (and Editor) for giving me this opportunity!

For those on Jim's expansive distribution list who don't know me – my name is Jennifer Fritzsche, and I've been an equity research analyst with a global financial institution following the telecom / cable and communications infrastructure space for 25 years. I left that role in July (now being followed by the great team I left behind) and am now working on a new project. My new bestie is this girl on my right.... we have been spending LOTS of quality time together these days.



During my walks with this girlie, I have been listening to earnings calls, webinars, and conference presentations, taking in all the happenings through my new lens. When Jim asked me a few weeks back to fill in for him, my head was swirling with so many ideas – the sector's news flow has been 24/7 of late! The "typical" September is indeed a busy news month for the Communications space, and September 2020 (a very non-typical year!) is no exception! In thinking of all the possible topics to tackle.... I kept going back to one of my old favorite subjects.... FIBER!

Historically *The Sunday Brief* has been a champion of fiber. I agree. One consistent theme since I left my past life this summer is the 'connective tissue' nature of fiber – and the need for more of it. This should not be overly surprising, especially in this time when so many companies are making a commitment to digitize their business in the wake of COVID.

While there has been much fiber news flow these past few months, I think the history books will show that September 2020 represented an important pivot moment for some of the players. In fact, the reading on the 'fiber thermometer' may be indicating an all new high.

How so, you ask? I point to 3 important developments all occurring in this past month:

Take-Away # 1 - The RLECs Are Standing Up, Dusting Themselves Off and Taking a Very Front-Footed Approach to Fiber

The RLECs are an area which I continue to think is under appreciated and worth watching. If "*wireless needs wires*" (a quote I love repeating from the great Ray LaChance of ZenFi) - RLECs control a lot of hard to reach pipes. Granted, as many of these players focused on dividends and de-levering, many pipes became a bit rusty. Copper doesn't cut it in the new world we find ourselves in, and some of these players took longer to get the memo than others. Fiber enhances value; copper does not. As evidence of this point, I was recently speaking to a rural fiber company that sold their fiber asset and noted they received almost 50 bids to buy it...yes 50. While CenturyLink has led the way with the RLECs on the fiber march.... this past month, it seems like others in this group have more than leaned in here.

Some examples....

Windstream – Windstream (now emerged from bankruptcy) is waving the fiber flag very high. Specifically, today Windstream has ~ 200k homes that have access to 1Gbps speeds. The plan is to increase that to 1.9 million homes over the next five years, using Uniti's GCI contributions. This would represent just under 50% of its Kinetic footprint. The company just announced a new Board line-up featuring members with deep fiber experience (it is worth noting one of the few legacy Board members that stayed on is Bill LaPerch). In addition to many other roles, LaPerch was CEO of AboveNet, which became one of the foundational acquisitions for ZAYO (now part of the growing fiber assets of Colony Capital).

Frontier - While Frontier is still going through the restructuring process, an announcement that did not seem to get the attention it deserved was the news on 9/1 that John Stratton, former President of Operations (in addition to many other roles) at Verizon, would become the Executive Chairman of Frontier's Board of Directors. Why is this important? Many see Stratton as the main architect behind Verizon's current fiber push. Stratton was talking about fiber LONG before his closest peer (more on that below). In my 2017 interview of Stratton at a conference almost every other word was about fiber: "it is like we [Verizon] are hiding in plain sight, right?" That was almost THREE years ago, long before others even started talking about fiber (in fact some were actually putting on the fiber breaks).

Stratton's quote in Frontier's press release was telling. "*There is significant opportunity to drive operational efficiency, deliver an exceptional customer experience, **expand Frontier's fiber footprint** and achieve profitable growth* (emphasis supplied)". Simply put, Frontier just added a huge asset to their brain trust. With a lighter debt load the company should be better able to realize the underlying potential of its assets. Frontier now covers 3 MM of 14 MM homes served with fiber, but estimates it can cover an additional 2.5MM - 9MM potential homes passed (depending on target IRR thresholds). Even if they only achieve the midpoint of this range, Frontier would increase it's fiber coverage to 41% of its footprint.

Consolidated Communications - Perhaps the biggest '*RLEC fiber shot across the bow*' moment came on 9/14 with news of Consolidated Communications (CNSL) entrance into an agreement with Searchlight Capital Partners for a \$500MM investment (through both equity and a convertible note). Consolidated will be using proceeds to paydown debt and "*immediately*

*accelerate our growth plans.... which will benefit us as we launch our **multi-year fiber investment** (emphasis supplied)" (Bob Udel, CEO). This is a company I know well....and I know this decision did not come lightly. Giving up equity dilution to fund fiber may seem backwards to some, but history will show that each of these companies will obtain higher returns from these respective fiber investments than they ever did from their (now long forgotten) dividends.*

Take-Away # 2 - Verizon - Moving Fast and recent mmWave news may indicate this fiber reach may be even as (more) important than spectrum

Earlier this month, a major announcement was made in the mmWave world which would indicate the propagation of this spectrum is much better than originally thought. Specifically, Qualcomm, Casa Systems, and Ericsson completed testing of the first extended range 5G NR data call. During that test, they achieved a connection range of 3.8 km (or ~ 2.4 MILES!). To put this development in perspective, at its Analyst day not even two years ago, Verizon management talked with great enthusiasm that this propagation could be as much as 2,000 feet! So, to say this was a welcome announcement to the team under Ed Chan at Verizon is likely a massive understatement.

But the critical lynchpin for mmWave spectrum to realize its full potential is to have fiber behind it. With Verizon now building out fiber in 70 US cities, this news makes the efficiency of that spend all the greater.

Although many beat Verizon up for lacking mid-band spectrum, it is worth noting the carrier has more mmWave spectrum than any player today. Specifically, Verizon owns 1715 MHz of mmWave spectrum per market – 64% more than AT&T and 47% more than T-Mobile.

While it is naive to think Verizon won't continue to be aggressive in expanding its mid-band spectrum assets, if mmWave spectrum has further reach / propagation than originally thought, Verizon's first mover status in expanding its fiber infrastructure looks all the smarter!

Take-Away # 3 - AT&T - Stankey's Menu Is Open -- After Many Hungry Years

But perhaps the biggest story in the September fiber pivot has come from AT&T itself. While some may quickly wonder if they have missed a big press release, it is nowhere on the IR website. BUT, if you listen closely to what they are saying, you will notice some very important breadcrumbs.

Exhibit A - John Stankey (CEO of AT&T as of 7/1) at the September 15th Goldman Sachs' conference (link to transcript [here](#)) - Question # 1 was about AT&T's "key priorities". Here was Mr. Stankey's answer: "*And I would tell you, from our point of view, what we think is important is we have a great franchise and connectivity, **specifically broadband connectivity. So, anything that we can do to put more fiber out into the network, serve both our consumer and business***

segments and use that to power what over time is going to become a much denser and more distributed wireless network (emphasis supplied)". Question #1, folks!

Then there was Jeff McElfresh's (CEO-AT&T Communications) September 21st interview with CNBC (link [here](#)). When asked about the 'one goal' McElfresh would want to accomplish in the next year here was his reply: *"It would be to have -- and I won't disclose the number -- but a **significantly larger number of fiber-passed homes**...(emphasis supplied)". Somewhat amazingly, McElfresh even brought the DirectTV history into a positive fiber spin. When asked if he felt in hindsight if buying DirectTV was a mistake, McElfresh replied: *"I don't. I actually don't, because the cash flows that DirecTV brought to our business at that point in time actually helped us accelerate a very massive investment in fiber."* (Huh? I may have to respectfully disagree with this one...)*

But the main point is AT&T is talking a LOT about fiber these days. And if one was listening carefully, the talking points were starting to change well before September. Going back to AT&T's Q2'20 earnings call (on 7/23/20) in answering another question on priorities, here again was the answer from Mr. Stankey: *"...on the broadband side, look, I have an appetite to get back to building footprint on fiber, and I think I've indicated that before."*

The funny thing about this quote is Mr. Stankey is indeed correct: he did say this before (multiple times, in fact). If we look back to our notes from the 2015 AT&T analyst day (in Dallas after DTV close) we find John Stankey (who then was COO of AT&T) referencing this very topic. On 8/13/2015 I wrote: *"FIBER FEVER IN TEXAS-What surprised us most was constant theme of the importance and focus and push for fiber coming out of AT&T....fiber touches each piece of AT&T's current strategy and per John Stankey, **'part of a 10-yr cycle.'**"* (10 yr. cycle!)

Whether you like John Stankey or not, his reputation shows (for good or bad) he is a straight shooter. He may not be subtle but looking back to the quote from that hot Dallas day in the Summer of 2015, Stankey knew then what he seems to confirm now. Fiber is a critical ingredient needed to accomplish many of AT&T's goals (on both the wireline AND wireless side). Maybe if the company had done what Stankey said in 2015 and committed to fiber these past 5 yrs., the road would not have been so "twisty and turny" as it has been.

Fast forward to today: Stankey and his team very much knows that DTV will not go down favorably in the AT&T history book. But that is the rear view mirror. The next big acquisition is not. Time Warner is at an important tipping point. If Stankey and the AT&T team march toward fiber, they are working toward answering the question many investors have had since that hard-fought acquisition was approved (in June 2018). That nagging head scratch question was this: *'Why buy content if you are not going to spend aggressively on the network on which that content will be monetized?'* These were the dots that were never able to be connected in a Time Warner / AT&T merger. Now Mr. Stankey may be ready to do just that by going back to AT&T's roots!

Some Parting Thoughts.....

During a recent presentation, an analyst compared a list of the 1990 Fortune 100 to the 2020 list. The movement of some companies was quite fascinating.

Some on the list may not surprise you: GM (# 1 in 1990) is # 32 today, Boeing (#15 in 1990) is #68, and Dupont (# 9 in 1990) is #100 (barely hanging on). There was not only downward movement, of course. Apple (#96 in 1990) is #11 today.

While AT&T and Verizon were not on the 1990 Fortune 100 list (as they were much smaller companies then), they are now. Specifically, AT&T is # 9 and Verizon is #20.

This got me wondering: how will the Fortune 500 rankings for AT&T and Verizon fare 20 yrs. from now? Directionally up or down?

Hard to know – but the KEY factor to judge their path for the next 20 years will be their respective approaches to their networks. The decisions they make NOW will be instrumental (at this key 'pivot time' for so many) in deciding their place on the 2040 (!!) Fortune 100 list. To quote the late great Herb Brooks *“This, is your time! Now go out there and take it!”* (can you tell I live in a house surrounded by hockey players?). If they don't make the right decisions now – someone else will take it from them (T-Mobile, Comcast, etc.), and fiber has to be a key tenant in such decisions.

So, for all these reasons, we believe September 2020 should be thought of as 'fiber appreciation month'. Maybe it took a pandemic to do it – but the lesson has now been learned. (my hope is it will not take my junior in high school as long to learn such important lessons – colleges won't give us 5 yrs.!). But fiber is a long ball game. And those who get in it know that.

Finally, I would be remiss in not mentioning that I cannot help but realize the irony that there is one story right now which I believe had the foresight to get in this fiber game before it became as in vogue as it is today. And yet now this same company finds itself in the precarious position of defending this decision to an activist questioning this strategy. It is also ironic to note that this same activist came knocking on AT&T's door just over a year ago. In the letter this activist wrote to AT&T (Fall, 2019), there were very limited comments about their need to do more of a fiber push (in fact, if you word search the entire 8,523-word letter, there are only 2 (TWO) mentions of the word fiber). This is an important point, because as mentioned above one could argue it was this fiber retrenchment / pause that was one of the roots (DTV being the other) of a lot of the woes AT&T has had for a number of years. It is also worth noting that AT&T's stock is down ~ 24% since this activist letter was written on 9/9/19. Quite ironic indeed!

To summarize - > those with fiber.... they are the ones standing “tall” these days – and I don't think that will change if we look 5, 10 or even 20 years from now!

Enjoy the beach, Jim! Thank you for this honor to take up your beloved pen!

Thanks, Jennifer, for filling in – terrific insights. Next week, we will be picking up on the six 3Q earnings themes discussed in last week's Brief. Until then, from our breakfast friends the porpoises, Go Chiefs!

