ASX Announcement : 21 June 2012

MD on FY2012 Guidance and Company Outlook

NetCommWireless

Open Briefing with Managing Director David Stewart

NetComm Wireless Limited
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NetComm Wireless Limited (ASX: NTC) is a developer of innovative broadband products sold globally to major telecommunications carriers, core network providers and system integrators. For 30 years NetComm has developed a portfolio of world first data communication products, and is a respected global provider of 3G and 4G wireless devices servicing the major telecommunications carrier, Machine-to-Machine (M2M) and Rural Broadband markets. NetComm's products are designed to meet the growing needs of today's data-intensive home, business and industrial broadband applications and customized to optimise performance in line with global network advancements. Headquartered in Sydney, Australia, NetComm has offices in New Zealand, North America and the Middle East.

Market Capitalisation: $12 million

In this Open Briefing®, David discusses

- Outlook for FY2012 EBITDA and revenue
- NetAssure business to be discontinued with one-off pre-tax write down of $805,000
- NBN and Cubic contracts
- Strategic focus and growth outlook

Record of interview:

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NetComm Wireless Limited (ASX: NTC) in an earnings update in September 2011, said results for the current year ending 30 June 2012 would be broadly in line with last year (excluding the impact of last year's one-off inventory write-down), that is revenue of $67.7 million and EBITDA of $5.1 million. Given revenue of $25.2 million and an EBITDA loss of $0.5 million in the first half, this implies revenue of $42.5 million and EBITDA of $5.6 million in the current second half. Do you remain on track to achieve this guidance?

MD David Stewart
Traditionally our second half is much stronger than our first half, and we expect full-year EBITDA from Continuing Operations of between $4.6 million and $4.8 million.

We expect revenue to be between $57 million and $58 million, which would be between $9.7 million and $10.7 million lower than last year. As reported in our half year results, this is largely due to lower than expected sales to Telstra. Telstra has focussed substantially on promoting its fixed-line business in preference to the fixed wireless routers that we supply.

Our sales to Telstra have been relatively lower margin so while overall revenue is projected to be lower than last year, gross profit has improved due to a favourable product sales mix and is forecast to help us achieve a stronger EBITDA margin compared to last year.

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Last year you incurred a $2.5 million write down on the carrying value of inventories relating to the Company's services business, NetAssure, in Australia. What is the current status of this business?

MD David Stewart
Given other substantial growth opportunities available to NetComm Wireless in the Machine-to-Machine ("M2M") and Rural Broadband market segments, the Board has made a decision to discontinue our services business, NetAssure, effective immediately.

This will result in a write off of the remaining assets of this business, which are largely software licences, of $805,000. This write-off will reduce Profit after Tax for the year ended 30 June 2012 by $714,000.

The NetAssure business will be reported separately as a Discontinued Business in the Company's 2012 annual accounts. This write-off has no adverse impact on the Company's cash flows.

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You've stated that the current year continues NetComm's transition from a consumer products connectivity company into a supplier of wireless broadband products to major telecommunication carriers and commercial and industrial users of Machine-to-Machine technologies. What is the rationale for this change and where are you in the transition process?

MD David Stewart
We continue to evolve as a communication devices business. We were in the consumer products area for some time but recognised a few years ago that there were significant opportunities in the telecommunications carrier market through our work with Telstra and the other work that flowed from that.

The market segments our strategy focuses on are Machine-to-Machine, Rural Broadband, Wireless Carrier and The Connected Home. We've had considerable success in the Wireless Carrier and the Connected Home segments but see tremendous market potential in the M2M and Rural Broadband areas.

Ericsson projects that by 2020 there will be 50 billion connected devices in the world, with a lot in the M2M, telecommunications or 3G and 4G space. Visiongain projects that the market size for M2M will be US$66 billion by 2016 and growing at a Compound Annual Growth Rate (CAGR) of 22%. We believe NetComm Wireless has the potential to become a major player in the growing global M2M market. We have many existing products well suited to the M2M market and a number of new and innovative products to be released over the next 6 to 9 months.

The rural broadband sector has just started to emerge. The World Bank estimates that over 3 billion of the world's population live in rural and regional areas. Australia is a world leader in the rural broadband market. The wireless component of the NBN rollout, which is being undertaken by Ericsson, utilises NetComm Wireless developed equipment for deployment at and inside the premises. The NBN project has a substantial global profile and has given us exposure, through Ericsson and others, to several other rural broadband projects around the world.

Both M2M and Rural Broadband are global growth opportunities for us. They have higher profitability and longer life cycles than consumer products, where people are constantly looking for the latest thing. M2M and Rural Broadband are longer term plays, and because they're new and emerging sectors, there are no dominant competitors so we're finding it relative easy to move into these markets.

Whilst these are early days in the M2M and Rural Broadband market segments, we expect NetComm Wireless to be a significant participant in these markets over the next 10 years.

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What is critical to your successful execution of this new strategy?

MD David Stewart
As a small Australian company, we understand the risks and investment inherent in adopting a global expansion strategy. In order to minimise risk and investment required, we have adopted a “coat-tails” strategy where we pick partners like Ericsson, Alcatel-Lucent, Alvarion, Airspan and other large system integrators that have well established market positions and need us to provide the specialised client premises equipment (CPE) for their networks.

A key benefit of the “coat-tails” approach is that we can direct our efforts to opportunities sourced and qualified by our partners. This negates the need to have large sales offices deployed globally. Another benefit is the credibility gained with end customers because of our relationships with highly respected industry players.

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How are you positioned as a supplier of wireless broadband equipment versus major global competitors given Australia’s relatively high cost as an operational base?

MD David Stewart
We’re based in Australia and do our R&D here. We have over 30 engineers in Australia who are world class in terms of capability and innovation.

We use contract manufacturers in China and our pricing, for our target segments, is globally competitive. We chase very distinct market segments, and focus on first world opportunities and don’t believe the highly competitive, low cost, volume markets of China or India are sensible strategic markets for us.

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In the first half NetComm had negative free cash flow of $2.6 million, reflecting operating cash outflow of $1.0 million and investment of $1.6 million. What is the outlook for free cash flow for the full year? What level of investment will be required for product development and to complete your strategic transition? Will you be able to fund growth internally?

MD David Stewart
Free cash flow for the full year will be positive due to the EDITDA turnaround in the second half. The write off of the NetAssure business has no impact on cash flows. We’ll continue to invest in technology development, evolving our NBN solution and developing products for the M2M market. In the second half, our investment in product development will continue at the level of the first half, and we plan ongoing annual spend of $2 million to $3 million on product development.

We expect strong ongoing organic growth in future years based on our contracts, including the contract with NBN, and that should create sufficient cash flow to enable us to remain self-funded. Apart from our spending on sales and marketing, our overhead structure is predominantly fixed and staffing numbers are sufficient to handle revenue multiple times the current level without any significant increases. The only staff increases we plan are strategic sales people in selected markets. Given our costs will be fairly static, we expect our revenue growth to create more cash and profitability in future years.

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NetComm is contracted to supply Ericsson with wireless network termination devices (WNTD) for the fixed wireless broadband network Ericsson is building for Australia's NBN. With only 4 percent of Australian premises requiring wireless access to the NBN, how much revenue and earnings will the contract generate for NetComm?

MD David Stewart
That 4% represents 512,000 premises. These are businesses and households the NBN classifies as outside a town centre and many currently have very little to no broadband access. The NBN will be rolling out the wireless network over the next four years. All base stations were originally due to be deployed by December 2014, however this may be slightly delayed.

Residents can nominate to have a wireless connection installed free of charge by the NBN. We expect there will be a significant take-up rate, in the range of 50% to 75%, as the people it addresses currently don't have any other form of broadband.

Strict non-disclosure agreements between us, NBN Co. and Ericsson prevent us from discussing contract revenue in detail. But I can say that the revenue from this contract over the 3.5 year roll out period will be very significant. However, predicting the timing of the revenue inflow is difficult as it will progressively ramp up as base stations are installed and enabled. Our contract isn't capped for any time period. While the bulk of the revenue will flow in the next 3.5 years, after that there will be a long tail of sales to new homes and people who may not have signed up initially.

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What are the risks to the NBN contract in terms of a potential change of government?

MD David Stewart
We see the risk to us due to a potential change in government as neutral to positive. The opposition Coalition has publicly stated on numerous occasions that it would use wireless as a faster, cheaper way of connecting more people in a quicker timeframe.

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Apart from the Ericsson contract, what further opportunities are there for NetComm in the NBN roll-out?

MD David Stewart
The NBN deployment will replace ADSL. Accordingly, every broadband internet connection within Australia will need a replacement in-home gateway/router. This is a replacement market of approximately 8 million devices. We currently hold about 20-25% of the market for ADSL devices and we expect to maintain that market for the replacement in-home gateway/router.

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NetComm also has an agreement to supply its NTC-8000 3G gateways to Cubic Transportation Systems for the New South Wales government's electronic ticketing project across the state's public transport network, which is to be rolled out from 2013. What is the potential significance of the contract for earnings and potential future opportunities?

MD David Stewart
In itself the contract with Cubic is not significant compared with the NBN. However, the partnership with Cubic is very appealing in that Cubic is considered the leading global player in the area of contactless ticketing systems. Cubic, which is US-based, created the Oyster card for the London underground and the Octopus Card for the Hong Kong subway. It's currently bidding for a number of new generation contactless ticketing systems for governments and transport companies around the world, including Canada, the US and Europe.

So the strategic appeal to us is that once we've designed a product specifically to suit Cubic's system, it can be incorporated in the system and offered on a global basis. This is another example of our 'coat-tails' strategy. We believe we can potentially turn this one contract into multiple contracts, both here in Australia and in overseas markets.

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What are NetComm's criteria for securing and entering into contracts? What is your strategy in relation to securing contracts in international markets?

MD David Stewart
Very early in the piece we recognised that as a small Australian company it would be difficult to win big contracts on our own. We decided that if we were to go into international markets we would have to pick our battles: that is pick the markets most suited to the type of products we build; and pick our partners: picking major infrastructure players with established networks whose 'coat tails' we can ride into new markets.

In terms of markets, we look mainly at first world countries, like Australia where we work with Telstra and NBN. Or we look at countries that don't have other established infrastructure, for example parts of the Middle East or Africa that don't have copper in the ground, and so are suited to using wireless technologies.

In terms of partners, we supply the major telecommunications infrastructure players with the equipment connecting end user premises to their networks, and we're bidding with them on projects around the world. There are approximately 100 WiMax networks we know of that are planning to upgrade to LTE over the next couple of years, mostly time-division duplexing (TDD) LTE, which is the same technology being used in Australia's NBN. These are target markets for us. We supply the infrastructure providers who in turn supply the network operators, which gives us a low cost and low risk entry into these markets. We don't have to establish our own offices or staff locally; we simply work with the infrastructure company as a contractor.

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At 31 December 2011, NetComm had net debt of $3.9 million and gearing of 28.5 percent. What level of gearing do you see as optimal for your new business structure, in light of your growth plans?

MD David Stewart
We expect our debt to go down over time as our revenue increases and profitability improves. We have a $17 million rolling 180-day trade finance facility with National Australia Bank that provides working capital. Our need for debt is very short term, to cover us between buying components to build a device, building it in the factory, shipping it and being paid for it. Our credit needs are directly related to the new business we win.

It's also worth pointing out that nearly all our business relates to the contracts we have with high credit worthiness customers. We're not making any significant speculative purchases or having to hold equipment in inventory until an order is placed. Also, all our manufacturing costs are denominated in US dollars and we sell in US/Canadian dollars, even here in Australia to our major customers. So we have a natural hedge.

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NetComm has paid dividends twice in the last five years. What is your dividend policy and how will you seek to balance the need to reward shareholders with the need to fund growth?

MD David Stewart
Our immediate plan is to reinvest earnings in the business: we're going through a growth period and we need to invest in R&D for new products, particularly in our key market segments of M2M and Rural Broadband. As the business matures after the transition, we

believe we'll be able to revert to paying dividends, but the timing will depend on the growth of the business. In our current thinking, we could return to paying dividends in two to three years.

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Thank you David.

For more information about NetComm Wireless, visit www.netcomm.com.au or call Managing Director David Stewart on (+61 2) 9424 2022 or Finance Director Ken Sheridan on (+61 2) 9424 2018 or +61409 157 588.

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