GO internet

Company update

GOing for more growth

Telecoms

GO internet (GO) is provisioning its 100Mbps service, which should drive ongoing subscriber growth. It may also have the opportunity to increase its footprint if it decides to participate in spectrum auctions during 2016. With its proposed €8m fund-raising, management seems to be positioning for this. However, the shares are discounting a slowdown in growth, rather than the prospects for a company gearing up for growth.

Year end	Revenue (€m)	EBITDA* (€m)	EPS* (c)	EV/sales (x)	EV/EBITDA (x)	P/E (x)
12/14	3.9	1.4	0.7	5.6	15.4	NA
12/15e	5.5	2.2	3.6	4.0	9.8	77.9
12/16e	7.6	3.7	14.7	2.9	6.0	19.1
12/17e	10.3	5.3	25.9	2.1	4.2	10.8

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Steady progress during 2015

With its low-cost wireless 4G fixed broadband offer, GO is targeting c 1m mobile-only homes in its two licensed regions of Marche and Emilia-Romagna that have opted to relinquish their fixed phone lines. Over the last year GO has steadily expanded its network and subscriber base. It now covers 12% of the population in its regions and we expect it to report 31.4k subscribers at the year-end (vs 32.0k before). GO is now introducing a 100Mbps service, which improves its competitive position and should help it to speed up the expansion in its coverage in 2016.

LTE roll-out should accelerate subscriber growth

Although subscribers are running slightly behind our previous estimate (we reduce EBITDA estimates by 1% in FY16 and 3% in FY17), they are expanding in line with the network, APRUs are solid and operational leverage is starting to show, with 60% of each new €1 converted to EBITDA. With the LTE network now being introduced, we expect a further acceleration in uptake in FY16.

Opportunities to expand to new regions – new capital

Final terms of the Italian Telecoms Ministry's proposed auction of additional spectrum are expected to be announced in the coming months and we believe GO would be a strong contender for regional licences that complement its existing footprint. Management plans to issue a €4m convertible bond and up to €4m of new equity, which would enable it to continue with its current roll-out, while also providing the flexibility to expand into new regions.

Valuation: Ambitions not reflected in share price

The shares are discounting a sharp reduction in the rate at which GO can add customers. In light of the current performance and the LTE network now being introduced, this seems pessimistic. If GO can continue to accelerate the pace of network expansion as it plans, we value the shares at €4.4 and the expansion into new regions would put this considerably higher.

17 December 2015

Price	**€2.80**
Market cap	**€17m**

Net debt (€m) at 30 June 2015	5.2
Shares in issue (m)	6.0
Free float	31%
Code	GO
Primary exchange	AIM Italia
Secondary exchange	NA

Share price performance

%	1m	3m	12m
Abs	(6.9)	(22.3)	(6.4)
Rel (local)	(4.7)	(20.0)	(19.6)
52-week high/low		€3.93	€2.64

Business description

GO internet provides fixed broadband internet and telephone services using fourth-generation (4G) wireless technology. The service is currently offered in the Emilia-Romagna and Marche regions of Italy, where GO has an exclusive right of use for 42MHz in the 3.5GHz frequency band known as 4G.

Next events

Full year results	March 2016

Analysts

Bridie Barrett +44 (0)20 3077 5700

Katherine Thompson +44 (0)20 3077 5730

tmt@edisongroup.com

Edison profile page

GO internet is a research client of Edison Investment Research Limited

Investment summary

Company description: Italian 4G wireless broadband operator

GO internet (GO) offers fixed broadband internet access using fourth-generation (4G) wireless technology in the Marche and Emilia-Romagna regions of Italy, where it has acquired licences for the exclusive right of use for 42MHz in the 3.5GHz frequency band. It is targeting c 1m homes in its licensed regions that have opted to relinquish their fixed-line connections and, consequently, have no broadband service (other than cellular network based), along with homes in the region that have no DSL access. Since listing on AIM in August 2014, it has accelerated the pace of its network roll-out and now covers c 600k of the population (12%) in these regions. The service is competitively priced and GO has steadily attracted customers, reporting 30.5k subscribers at November 2015, up 37% y-o-y. To date it has installed mainly 7Mbps technology. However, over the summer it started the installation of 100Mbps base stations, a key part of its strategy to increase coverage to 60% of its regions over the next few years. We also believe GO is a strong contender for the forthcoming spectrum awards in Italy, which could enable it to considerably increase its addressable market by moving into other regions in Italy.

Financials: Increasing coverage key to driving growth

LTE base stations can handle double the number of subscribers as the 7Mbps equipment, which should enable GO to accelerate the rate at which it deploys its network, for a similar level of capital expenditure in FY16 and FY17 (€3.5m). The broader network coverage and competitive advantages that come with the 100Mbps service ought to drive a further pick-up in subscriber growth, and we forecast year-end subscribers of 42k (FY16) and 54k (FY17). To date, GO's operating cash flow is being reinvested into network expansion and, with €5.2m of net debt, of which €2m is short term, additional financing will be required if it is to continue to expand at this pace. Management plans to issue up to €4m in new equity and €4m of convertible bonds, which would enable it to continue to expand, while providing headroom in the event that it is awarded additional spectrum. The proposed capital increase would be dilutive to our near-term earnings estimates. However, assuming the additional capital was deployed in expanding the network, with a lifetime ROI on each new base station of c 70%, we would expect it to be value accretive.

Valuation: Network growth and spectrum value

GO trades at a significant discount to our base case DCF of €4.4/share, which assumes our published forecasts to FY17 with subscribers then peaking in FY22 at 87k on 55% EBITDA margins. To deliver forecasts, we look for evidence that the network roll-out is progressing and that there is an acceleration in subscriber growth, without sacrificing ARPU. DCF valuations increase in a fairly linear fashion with network footprint, and if GO were awarded additional capacity in one other region during 2016, on similar terms to the existing licences, it would be highly value accretive. We estimate that for every 50% increase in coverage, it could add approximately €1.4 to the value per share to our base case DCF (although additional financing may be required to fund the expanded network), and management would target up to four additional regions. Investors should also be aware of the appreciating value of GO's spectrum; a number of equipment manufacturers plan to include 3.5GHz chipsets into high-end smartphones, which could generate new commercial uses for GO's spectrum, such as wholesaling to the MNOs.

Sensitivities: forecasts are sensitive to the efficiency and pace of network expansion, the rate at which new subscribers join and their loyalty. With a larger share of customers coming out of their two-year contract, we highlight the risk that churn rates differ from our forecasts. ARPU is also a key sensitivity that will be affected by the share of new subscribers to the new LTE vs 7Mbps service and general competitive pressures in the market place.

Company description: 4G wireless broadband

GO internet provides fixed wireless internet and IP telephone services using 4G technology. The service is offered in the Marche and Emilia-Romagna regions of Italy, where GO has acquired licences for the exclusive right of use for 42MHz in the 3.5GHz frequency band (until 2023). It started rolling out its network in 2011 and the majority of its current coverage supports speeds of up to 7Mbps, with an average speed of 4Mbps, comparable to the average DSL speed in Italy. During 2015, GO also started the installation of 100Mbps equipment. It currently provides coverage for about 600,000 people, corresponding to 12% of the population in these regions. It plans to expand its footprint by continuing its roll-out of LTE services to increase coverage in these areas and potentially in other regions. It reported 30,501 customers as at the end of November 2015.

GO listed on AIM Italia in August 2014, raising €5m from the issue of 1.8m shares at €2.75 per share, and recently announced its intention to raise a further €4m of equity and issue a €4m convertible bond to support its plans. It is 52%-owned by Gold Holding, the holding company of the Umbrian industrialist Franco Colaiacovo's family (Giuseppe Colaiacovo is GO's chairman) and 17% by WN, which is jointly owned by CEO/CTO Alessandro Frizzoni, CFO Alessandro Ronchi and COO Flavio Ubaldi.

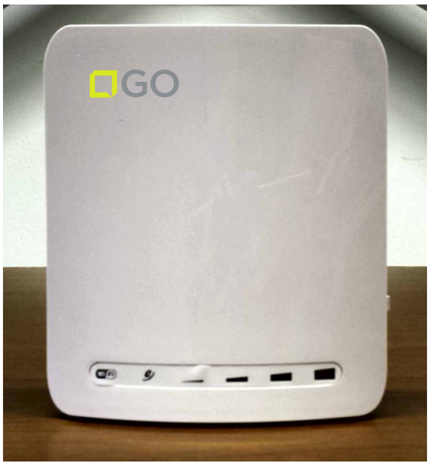
GO uses 4G (3.5GHz) – WiMAX/LTE technology

WiMax and LTE are wireless technology standards that come under the umbrella of 4G services. Typically associated with mobile phone services, the technology can also be used for "last mile" connectivity (the most difficult and expensive to build for wire line services) to provide a fixed broadband service. This requires the installation of a base station on a networking tower (Exhibit 1), connected to a customer's home with customer premises equipment (CPE) or modem (Exhibit 2).

Exhibit 1: Tower with a GO base station

Source: GO Internet

Exhibit 2: GO internet's indoor CPE



Source: GO Internet

GO's commercial offer

The basic service costs €19.90 per month (including 22% VAT), which covers the broadband connection and unlimited data plan, or €25.25/month including unlimited free national calls to landlines. The faster 100Mbps service is charged at €24.90 a month. The vast majority of customers opt to rent the CPE as the rental is currently waived for two years, although GO offers it for sale at €120 per box. GO also charges a one-off service activation fee (€49.9 or €99.9 depending on the payment method). Subscriptions are paid by direct debit two months in advance, or by postal order, giving GO a visible and recurring revenue stream.

For self-install customers, there is a five-day full refund return policy; if users cannot get satisfactory coverage with the box in their home or if they simply change their minds, they can return it for no charge within five days. For more remote homes, where quality of service may be an issue with the indoor CPE, customers can opt for an outdoor CPE. In this situation, there is a €60 charge for installation and no grace period during which the customer can change their mind about taking the service. After the five-day trial period, customers are locked into a two-year contract, although under Italian law they may terminate this contract early for an €80 fee.

Management

As the team that originally launched ARIA (which it left due to strategic differences with new owners), the executive management team brings considerable experience. During their time at ARIA, the team members grew the company to 50,000 subscribers within four years, despite the poorer technology available at the time. Management also brings valuable experience with respect to the logistics of building a network and navigating the bureaucracy involved in placing sites with base stations in key areas, as well as other financial and operational experience. Senior management members have agreed to a 36-month lock-up on their shares (20 months remain) and a 48-month, non-compete restriction. For further details on the management team, see page 12.

Market overview and opportunity

Broadband access in Italy – no cable offering

Broadband penetration in Italy has increased considerably in the last couple of years, but still only ranks 29th in the OECD countries with 23 connections per 100 inhabitants, leaving headroom for structural growth. The Italian market is fairly unique in that it has no cable offering and fibre is not very developed when it comes to the residential customer. Consequently, there are only two main delivery mechanisms for broadband access: ADSL and 4G.

- **ADSL:** Telecom Italia (TI) is the dominant fixed broadband provider, with a 47.5% market share (down 1.3% on June 2014). Of the other licensed operators (OLOs), Wind is the largest (15.3% share), followed by Fastweb (14.7%), Vodafone (12.7%) and Tiscali (3.2%).
- **4G:** three 4G licences for 3.5GHz spectrum have been awarded in each region in Italy. In its regions, GO faces two main competitors, both offering coverage nationwide: Linkem, which has a share of the national 4G market of around 56%, and Aria (which is merging with Tiscali), with a 38% share; the remainder is held by several regional operators such as GO.

Higher speed networks: increasing broadband access and speed is a priority for both operators and the government. According to AGCOM (the Italian regulator), high-speed internet or next-generation access (NGA) networks (ie where download speeds are above 30Mbps) account for around 7% of all fixed broadband connections. Network operators are under pressure to improve bandwidth to meet the directives of the EU Digital Agenda for Europe. Investment by the main operators has been stepped up over the last year and the regulator reports c 30% fibre coverage. However, this coverage is currently restricted to Fibre to the Cabinet (FTTC) or is targeted at businesses in Milan and Rome. There is virtually no fibre to the home and, for cost and logistical reasons, it seems unlikely to be a priority in the coming years.

Service bundling: bundling of three or more services (fixed-line telephony, broadband, mobile and TV) is now the norm in other markets. For structural reasons, Italy has been slow to follow suit (no cable). However, bundled offers have been introduced: TI has launched a pay TV over DSL service and Sky Italia has entered into a number of partnerships with broadband providers. These offers are currently relatively expensive and GO, with its no-strings service, is targeting a different demographic. However, if bundled services start to catch on in Italy, GO may be disadvantaged.

Growth strategy

Target market – mobile-only homes

To subscribe to ADSL services, customers are required to also pay for TI's fixed-line connection for €15 per month. However, as VOIP services improve and as the price of mobile packages declines, consumers increasingly consider this expensive fixed-line connection, often referred to as a 'wireline tax', as a redundant service and many Italians are choosing to relinquish their fixed lines. TI is responding with discounting, yet fixed-line penetration in Italy as a whole continues to decrease – from about 95% at the peak in the late 1990s to around 62% at the end of June 2015, with more than one million homes 'cutting the cord' over the last two years.

900k Italians have abandoned their fixed line in GO's two regions: in the two regions where GO currently operates, there are 900k[1] households (34% of homes) that no longer have a fixed-line phone from TI; and consequently have no broadband service (other than cellular network based). These mobile-only homes are GO's main target market.

A further 120k 'digital divide' customers are also a natural fit for GO's 4G services: both Linkem and ARIA also hold 4G licences in GO's regions and arguably, for mobile-only homes, they represent the most direct competition. However, their licences were awarded on the basis of bridging the so-called digital divide (ie areas where there is no broadband coverage) with specific rural coverage requirements.[2] GO places greater focus on mobile-only households and households that would like to be free of the Telecom Italia wireline tax, although the c 120,000 digital divide households in Emilia-Romagna and Marche also offer an obvious fit for its products. Effectively, this means that both ARIA and Linkem have much more rural coverage than GO and to date rarely compete on the ground in either region where GO currently operates. The June 2015 announcement that Tiscali and ARIA are to merge may ultimately result in a more competitive market for GO, but given Tiscali's heavily indebtedness and the logistics involved in rolling out base stations, we do not envisage much impact from this proposed deal for the foreseeable future.

Mobile broadband – compete at the margins: GO does not offer a mobile broadband service and hence does not consider itself as an alternative to the cellular operators that operate in Italy (TIM, Vodafone, Wind and 3), but more as a complement to them. That said, for consumers who currently subscribe to a mobile broadband service but use it predominantly in the home, GO's offer presents a more economical alternative, and at the margin GO's offer could represent a challenge. The cellular operators (due to the much higher cost of their networks) limit the level of data that can be used (offers are typically for 2-30GB for €10-30 per month), after which point they charge an additional fee per GB used. GO's plan is unlimited, and subscribers use on average 40GB of data per month. At this level of data consumption, mobile broadband offers are unaffordable; we estimate GO's offer to be a factor of 10-20 times cheaper.

Competitive positioning – cheap, convenient and fast

GO's competitive advantages include its pricing, the plug & play nature of the equipment and the quality of the connection. With the roll-out of the 100Mbps network, this should also strengthen GO's position.

Competitively priced: ADSL competitors have considerably reduced the price of their basic bundles over the last 12 months, so the differential in pricing is not as pronounced as it was a year

1 AGCOM.

2 The EU's Digital Agenda for Europe (DAE) target is for 100% coverage of basic broadband service by 2013. 4G is an excellent technology for remote areas where it is uneconomical for DSL and fibre providers to lay down networks, hence the basis of the licence allocation.

ago. However, even taking account of special offers, without the need for the TI fixed-line rental, GO's offer remains the cheapest on the market (Exhibit 3).

Convenience: GO's small and lightweight indoor CPE's for almost all (85%) subscribers, provide a no-hassle plug & play installation. This compares to ADSL customers who typically need to wait a few days for activation and which may also involve installation by an engineer. 4G competitors ARIA and Linkem can only provide plug & play to 40-60% of their customers, a function of the distance of the customer's home to the nearest base station.

High speed: the basic service runs at a maximum speed of 7Mbps with an average speed of 4Mbps, comparable with ADSL services in Italy. However, GO recently started rolling out its 100Mbps base stations and with little fibre to the home in Marche and Emilia Romagna, it can now claim to offer the fastest network in the regions.

Mobility: the plug & play modem can be used anywhere in the coverage region, for instance, customers may take it to second homes for the weekend.

High quality connection: GO's exclusive right of use of 42MHz within the 3.5Ghz band means it does not have to deal with the congestion issues that other operators face in terms of frequency saturation which reduces the quality of service during peak usage times.

Exhibit 3: Competitor pricing

€	GO internet	ARIA	Linkem	TI	Tiscali	Fastweb	Infostrada-Wind
Landline requirement	No	No	No	Yes	No	No	Yes
Price/month	19.9 (24.90 100Mbps)	23.1	24.9	38.0	25.0	30	35.0
Box rental	0	0	3	4.0	3		3
Total monthly charge	**19.9**	**23.1**	**27.9**	**42.0**	**28.0**	**30**	**38.0**
Introductory special offer	After two years, the price increases to €22 (€29.9 for 100Mbps)	14.95	N/A	22.9 (on line) or 24.90. Free activation	N/A	19.0/month, no activation fee	19.95 for one year, €24.95 year two
Length of special offer		12 months	N/A	Holiday period, min. 2 yr. contract	Ends early Dec 2015	6 months	To 14 Dec 2015
Activation fee	49.9*/99.9**	0*/40**/110.83	99	97.6	29/89 (if a new line)	119	39.99

Source: Company websites. Note: *If paid by direct debit/credit card. **If paid by postal order.

Network roll-out – introducing 100Mbps LTE

GO acquired its first licence in 2008 and its second in 2012 and commercial operations started in 2011. With the funds raised from its IPO in August 2014, it has accelerated the installation of base stations to c 15-20 sites a month, and at the end of October 2015 had an installed base of 695, covering 12% of the population (c 600k) of Marche and Emilia-Romagna (from 8.7% at the time of the IPO). Subscribers have increased in line with the pace of the network expansion and in November, GO reported 30.5k subscribers. The majority of the current installed base stations relate to 7Mbps technology. The introduction of 100Mbps capability is a key pillar to management's strategy to double coverage to 30% over the next three years and to continue to increase take-up of the service.

Huawei 100Mbps base stations: in December 2014, GO announced that it had contracted with Huawei for the supply of $10m of 100Mbps base stations over the next four years. Permits for the installation of the 100Mbps base stations have been granted, and the LTE network started to be introduced over the summer 2015 with first subscribers on board (at the higher price of €25/month vs €20/month for the 7Mbps service). The new LTE base stations will enable GO to offer a higher-quality service to customers, reaching speeds up to 100Mps with an improved signal performance, particularly indoors. In addition, it enables a more efficient network roll-out (supporting a higher density of customers per base station), which is critical as network towers are becoming increasingly crowded and sites are harder to find.

Sites secured: Italy has some of the most restrictive rules on the installation of sites and the bureaucracy surrounding site planning applications can present obstacles to the pace of network roll-out. GO has many tower providers, but during 2015 extended its contract with one of its largest, and secured access to additional strategic towers via an agreement with EI Towers (one of Italy's leading transmission tower companies), giving it ample capacity for the near term. The Italian government is working on a set of measures to stimulate broadband diffusion in Italy. New policies being discussed include an increase in the number of site permits made available, an increase in the speed of approval of site applications and, crucially, an increase in the electromagnetic emissions permitted per site, which would enable more base stations to be installed in each site, improving the ROI of each site installed.

Marketing: marketing is mainly direct, supported by price discounting in certain towns as the network roll-out has progressed. However, to coincide with the introduction of LTE base stations, GO increased its digital marketing and refreshed its brand in September, emphasising its USPs of wireless connectivity, no landline and self-install modem.

Future opportunities – expanding into new regions in Italy

Earlier in the year (at the request of the EU), AGCOM announced its intention to release 200MHz of spectrum in the 3.6GHz frequency band (currently used by the military and broadcasters). The government is keen to add services in areas of the country that currently have poor or no reception (digital divide areas). As a result, AGCOM has indicated that some of the spectrum will be allocated following a 'beauty contest' based on the applicants' business plans, rather than for a fee. We think GO is in a strong position to apply for additional licences, having already proved its capabilities in Marche and Emilia-Romagna. Final terms are expected to be announced in the coming months, with the auction pencilled in for the first half of 2016. At this stage it looks as if there may be both a national and a regional spectrum auction, and we would expect GO to apply for regional licences that complement its existing footprint.

Longer-term opportunities – new uses for 3.5GHz spectrum

According to Cisco, by 2018 more than 50% of internet traffic will be generated by mobile devices and the volume of data being transported is forecast to increase exponentially over the coming years. As a consequence, the lower frequencies currently used by mobile service providers are rapidly becoming saturated and operators will need to use higher frequencies to manage these data. Governments around the world are already starting to free up frequencies in the higher 3.6-3.8GHz band and phone, and chipset manufacturers are developing products that will support these frequencies across a wider array of equipment; during the Mobile World Congress (MWC) 2015, Intel, Qualcomm and Huawei presented chipsets that support 3.5GHz frequency for tablet and smartphone reception. At a conference hosted by GO and Huawei in Bologna (under GO's coverage area), Huawei presented the first Huawei rugged smartphone that connected directly to GO's LTE network in the 3.5GHz frequency. Chipsets are expected initially to be used in high-end smartphones later in 2016 and are compatible with GO's network. This opens up a number of new possibilities for GO longer term, from wholesaling its spectrum to MNOs to potentially even adding a mobile offering to its fixed wireless broadband services.

Financials

Performance to date: Steadily expanding

With 90% of revenues generated from subscriptions, GO has a visible and recurring revenue stream. Subscribers are expanding steadily in line with the network, APRUs are solid and, at the EBITDA level, with the largely fixed operating cost base, operational leverage is starting to show. At the H115 results, EBITDA of €897k grew 44% y-o-y as more subscribers become profitable and EBITDA margins expanded to 36% from 34% in the previous year.

While solid, the pace of subscriber expansion in recent months has been behind our estimates and **we reduce our FY16 and FY17 EBITDA forecast by 1% and 3%** to capture the most recent data. We also reflect a higher interest charge to more appropriately capture the balance of the vendor financing with Huawei, which reduces our EPS forecasts by 7% in FY15 and 17% in FY16, although it is worth remembering that earnings are coming from a low base and so small changes to net income can have quite a large impact on EPS. Our forecasts do not reflect the proposed equity and convertible bond issue which, depending on the terms of issue and deployment of the funds, could be dilutive to earnings estimates.

Exhibit 4: Summary forecast changes

€000s	2015e			2016e			2017e		
	Old	New	Difference (%)	Old	New	Difference (%)	Old	New	Difference (%)
Revenue	5,605	5,495	(2)	7,915	7,636	(4)	10,832	10,293	(5)
EBITDA	2,235	2,235	0	3,722	3,675	(1)	5,457	5,287	(3)
Net income	232	215	(7)	1,054	879	(17)	1,804	1,554	(14)
Capex	(3,406)	(3,473)	2	(3,481)	(3,550)	(2)	(3,619)	(3,568)	(1)

Source: Edison investment research

Outlook: LTE should enable acceleration in subscriber growth

On the whole, the KPIs are trending well, the operational profile of the group is strengthening and, with the LTE network being introduced, we expect to see a further acceleration in adoption in FY16. We forecast a three-year CAGR to FY17 in revenues of 38%, EBITDA margin expansion to 51.4% in FY17 (36.5% last year) and an improving cash conversion.

Subscribers are tracking the network expansion: GO is installing c 15- 20 base stations a month and has an installed base of 695 (482 in December 2014). Subscriber growth has tracked this network expansion; subscribers are up 37% y-o-y to 30,503 at the end of November 2015. This is slightly behind our previous forecasts and we reduce our subscriber estimate in the current year to 31.4k from 32k. However, with the introduction of the LTE equipment, we still expect an acceleration in adoption in 2016 (albeit at a more measured pace than previously) and forecast FY16 net subscribers of 42k.

ARPUs trending upwards: despite early adopters coming out of their initial two-year contracts during the course of the year, we have not witnessed any significant pricing pressure. In fact, as customers revert to the slightly higher pricing point after the initial discounted period (€22 vs €15), and as GO starts to attract subscribers to the higher-priced LTE service (€25), we expect average ARPUs to trend up (by 2% this year and 4% in FY16).

Churn rates are low, but more customers now out of contract: with the upfront costs involved in signing each customer, keeping churn low is key to driving profitability. Churn is running at a very low 5% due to the fact that 70% of GO's subscribers are still tied into two-year contracts. As customers come out of this period we would expect churn to track gradually up towards industry norms (c 15%). We forecast churn of 8% and 9% in FY16 and FY17 respectively.

Expanding EBITDA margin profile: GO outsources customer service and base station installation. This strategy has allowed it to keep the FTE count to only 11, below the level (15) that would trigger stricter labour restrictions. Subscriber acquisition costs (SAC) reflect mainly the cost of installation for the c 15% of customers that cannot self-install, the cost of the CPE (capitalised and depreciated over four years) and sales commissions paid to the 300 or so retailers. Once the service is up and running, ongoing costs comprise data transportation paid on a wholesale basis to a variety of fibre providers (backhaul), the costs of renting the base station sites where GO's equipment is installed, depreciation of the network equipment and customer service costs (eg box replacements, inquiries). Backhaul is the only cost that is directly related to service usage and consequently the model is operationally geared with 60c in every €1 converted to EBITDA. We forecast EBITDA margins increasing to 51.4% by FY17. Management targets a 55% EBITDA margin, which we believe could be achievable at c 70k subscribers.

Capex mainly relates to network equipment: GO has contracted with Huawei for the procurement of $10m of 100Mbps base stations (at c €5.5k a unit) over four years, and no longer acquires 7Mbps kits from Telrad, although it still purchases the CPEs from Telrad (€55 per unit, paid after two to three years). We forecast capex of €3.5m in FY15. Although the 100Mbps kit is more expensive than the previous kit, it supports a greater number of subscribers and so we believe the network can be expanded at a faster rate for a similar overall cost in FY16 and FY17.

Improving cash conversion: the network roll-out has largely absorbed operating cash over the last three years. However, we estimate that two-thirds of GO's current subscriber base has moved beyond the initial payback period. With a growing profitable subscriber base, the cash conversion of the group should also start to improve and we forecast that it will move into an FCF-positive position during 2017.

Balance sheet: Proposed equity placing and convertible

GO's debt comprises two bank loans of approximately €3m (c 3.5% interest) repayable in annual instalments by 2019 and 2023 respectively, and sale and leaseback arrangements mainly with Huawei for €2m, the outstanding payments due on the licence acquisition for the Emilia-Romagna region of €0.5m (repayable in annual instalments to 2024) and other credit lines.

To honour its existing commitments and to provide flexibility to accelerate the pace of network roll-out – both within and potentially beyond its current regions in light of the forthcoming spectrum auctions – GO has announced its intention to issue €4m of new equity and a €4m convertible bond. Our current forecasts are pre-money.

Valuation

GO's listed ADSL peers are more mature and have a different capital structure, so we are wary of making direct comparisons, although it is worth highlighting that on an FY16e EV/ EBITDA of 6.0x, it compares favourably despite the better EBITDA growth profile.

We prefer a DCF valuation. Given the interesting juncture the group is at, with the roll-out of the LTE network, the possibility of greatly enhancing its footprint by participating in spectrum tenders and early adopters coming out of contract (posing churn risk), we present a number of scenarios.

In all our scenarios, it is important to bear in mind the potential 'option' value that spectrum ownership may have on GO's value in light of the current developments regarding the incorporation of 3.5GHz technology into mobile phones (evidenced by the jump in the share price during the MWC conference last February). While hard to quantify, the value of GO's spectrum is likely to increase as this technology becomes more widespread.

In all our scenarios we assume an 11.5% discount rate (down from 12% previously given the progress the group has made over the last year in establishing the credibility of its business model) and a 2% perpetuity growth from 2022. In each scenario, we assume that EBITDA margins peak at 55% at 70k subscribers (although the date of achieving this varies in each scenario) and that GO funds the capital expenditure required based on its current capital structure, ie this is before any additional fund-raising.

- **Base case:** our base case DCF assumes our published forecasts to 2017, with subscribers then peaking at 87k five years later in 2022. This returns a value of €4.4 per share, 57% above the current share price.
- **Regional expansion:** here, we assume GO is granted a licence for a region that covers three million people at a cost of €2m (0.025c per MHz per population – two-thirds more than the cost of its existing licences), which could enable it to increase its footprint by 50% and, as a result, it increases annual net subscriber additions by 50% a year from 2017, with total subscribers peaking at 122k by 2022 (vs 87k in our base case). Additional funding would be required to support the roll-out of the network in the new region. However, assuming this is secured, our DCF returns a value of €5.8/share, adding €1.4 per share to our base case valuation.
- **Slower subscriber growth (current share price):** the current share price implies the rate at which GO adds new subscribers slows down next year by 25% and remains at this level, with subscribers peaking at 45k, only 14k more than currently.
- **Higher/lower ARPU:** GO's LTE service is priced c 25% above its basic offer. If a higher percentage of new subscribers take the LTE service, ARPU could be higher than forecast (or lower if the reverse happens). All else being equal, if APRU is 10% above or below our base case by 2017, our DCF would increase or decrease by 15% and 20% respectively.

Exhibit 5: Summary scenario analysis

	Base case	Lower sub growth scenario	Higher ARPU	Lower ARPU	Regional expansion
DCF value (€)	4.4	2.9	5.0	3.5	5.8
Subscribers end 2015 (000s)	31.4	31.4	31.4	31.4	31.4
Subscribers end 2017 (000s)	54.8	40.3	54.8	54.8	63.3
Subscribers peak – 2022 (000s)	86.8	45.99	86.8	86.8	122.30
EBITDA margin 2015e	40%	41%	40%	40%	40%
EBITDA margin 2017e	51%	51%	52%	49%	49%
Capex/revenues 2015	59%	59%	59%	59%	59%
Capex/revenues 2017	37%	17%	37%	37%	55%
Capex/revenues terminal	15%	10%	14%	17%	15%

Source: Edison Investment research

Sensitivities

As well as the sensitivities outlined above, investors should consider the following:

- **Refinancing:** management has announced its intention to raise up to €8m of new capital which, depending on its cost and deployment, may have a dilutive impact on earnings in the near term. If we assume an interest rate of 5-7% on a €4m convertible bond, this would reduce FY16 EPS by 15-20%. If we assume €4m of shares issued at a 5-10% discount to the current price, this would imply a share dilution of c 10%. However, it is worth noting that this does not reflect the potential benefit to the group from the deployment of the additional capital, for instance by expanding its footprint regionally (outlined above).
- **Cost of the network:** the cost of the network depends on a number of variables including the terms on which GO can secure new 100Mbps base stations (fixed for four years under the Huawei deal), the cost of CPEs and the density of subscribers on each base station. Before embarking on a base station installation, GO performs market research to assess the economic viability of each site and so the risk of over-provisioning is fairly low.
- **Economy:** while GO's low price offer confers some protection against cost-conscious subscribers looking to economise, the difficult economic climate in Italy could affect demand.
- **Competition:** the market does seem to have become more competitive over the last year, and more sustained discounting by the ADSL providers, or a step-up in network investment by the other 4G operators could have an impact on GO's strategy.

Exhibit 6: Financial summary

€000s	2013	2014	2015e	2016e	2017e
31-December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	2,645	3,899	5,495	7,636	10,293
Cost of Sales	(1,170)	(1,780)	(2,461)	(3,070)	(3,969)
Gross Profit	1,475	2,119	3,033	4,566	6,324
EBITDA	887	1,425	2,235	3,675	5,287
Operating Profit (before amort. and except.)	166	373	662	1,520	2,551
Intangible Amortisation	0	0	0	0	0
Exceptionals	(54)	(26)	0	0	0
Other	0	0	0	0	0
Operating Profit	111	347	662	1,520	2,551
Net Interest	(202)	(292)	(423)	(314)	(286)
Profit Before Tax (norm)	(36)	81	240	1,207	2,266
Profit Before Tax (FRS 3)	(90)	55	240	1,207	2,266
Tax	(10)	(48)	(24)	(328)	(711)
Profit After Tax (norm)	(46)	33	215	879	1,554
Profit After Tax (FRS 3)	(100)	7	215	879	1,554
Average Number of Shares Outstanding (m)	4.16	4.93	5.99	5.99	5.99
EPS - normalised (c)	(1.11)	0.67	3.59	14.67	25.94
EPS - normalised fully diluted (c)	(1.11)	0.67	3.59	14.67	25.94
EPS - (IFRS) (c)	(2.41)	0.14	3.59	14.67	25.94
Dividend per share (€)	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)	55.8	54.3	55.2	59.8	61.4
EBITDA Margin (%)	33.5	36.5	40.7	48.1	51.4
Operating Margin (before GW and except.) (%)	6.3	9.6	12.1	19.9	24.8
BALANCE SHEET					
Fixed Assets	6,536	8,117	10,017	11,413	12,245
Intangible Assets	2,404	2,465	2,463	2,356	2,285
Tangible Assets	4,132	5,652	7,554	9,056	9,960
Investments	0	0	0	0	0
Current Assets	2,023	6,527	5,330	5,427	5,525
Stocks	166	814	830	847	864
Debtors	1,729	3,429	4,000	4,080	4,162
Cash	128	2,284	500	500	500
Other	0	0	0	0	0
Current Liabilities	(3,065)	(5,093)	(4,922)	(6,098)	(5,251)
Creditors	(1,384)	(3,839)	(2,458)	(3,080)	(2,914)
Short term borrowings	(1,681)	(1,254)	(2,465)	(3,018)	(2,337)
Long Term Liabilities	(4,515)	(3,911)	(3,140)	(3,140)	(3,140)
Long term borrowings	(4,368)	(3,771)	(3,000)	(3,000)	(3,000)
Other long term liabilities	(147)	(140)	(140)	(140)	(140)
Net Assets	979	5,640	7,285	7,602	9,379
CASH FLOW					
Operating Cash Flow	1,297	1,842	1,696	3,638	5,246
Net Interest	(202)	(292)	(423)	(314)	(286)
Tax	(10)	(48)	(24)	(328)	(711)
Capex	(1,844)	(2,670)	(3,473)	(3,550)	(3,568)
Acquisitions/disposals	0	0	0	0	0
Financing	0	4,324	0	0	0
Dividends	0	0	0	0	0
Other	(29)	6	0	0	0
Net Cash Flow	(788)	3,162	(2,224)	(553)	681
Opening net debt/(cash)	5,152	5,921	2,741	4,964	5,517
HP finance leases initiated	0	0	0	0	0
Other	19	18	1	0	(0)
Closing net debt/(cash)	5,921	2,741	4,964	5,517	4,836

Source: GO Internet, Edison Investment Research

Contact details	Revenue by geography
Go internet s.p.a. Via degli Artigiani 27 City – Postcode, Italy +39 348 643 1609 ir@gointernet.it www.gointernet.it	N/A

Management team

Chairman: Giuseppe Colaiacovo	CEO and CTO: Alessandro Frizzoni
Giuseppe Colaiacovo is a graduate in business and finance and has an MBA from UCLA. He has been professor of educational economics at the Perugia University since 2001. From 1994 he has been on the board of directors of companies such as SNAM Rete Gas, Maire Tecnimont, MCC, Fineco (Unicredit Group), Financo, Colacem, Colabeton. He is the chairman of the GDS Group and the CEO of the Goldlake Group (the sixth-largest enterprise in Umbria in terms of profit).	Alessandro Frizzoni has an MSc in software engineering from Essex University (UK) and a BSc in statistics and computer science from Perugia University. He was in the R&D department of Ericsson in Ireland, subsequently at 3 in London and from 2003 was a consultant for Logica CMG working for mobile operators such as 3, Vodafone and Tim. In 2005 he was founder and CEO of Aria, and managed the firm's start-up phase, raising €63m from private equity and venture capital investors for the construction of a 4G network providing service in the digital divide areas of Italy.
CFO: Alessandro Ronchi	**COO: Flavio Ubaldi**
Alessandro Ronchi graduated from the Siena University in economic sciences. From 2001 to 2004 he was the controller of the distribution chain of Carlsberg Italy and from 2004 to 2006 the controller at Colacem. He was founder and CFO of Aria and managed the firm in its start-up phase, raising €63m from investors and venture capital for the construction of a 4G network aimed at eliminating the digital divide in Italy.	Flavio Ubaldi has a Master's degree from the Bocconi University in Milan. From 1984 to 1993 he worked as a programmer for Olivetti systems and in 1993 he founded Archimede (commercialisation of voice recognition devices). In 1999 he founded BVTC, active in IT systems for travel agencies. In 2006 he became the chairman of the BoD of Aria and he was responsible for commercial development in Riccardo Ruggiero's team.

Principal shareholders	(%)
Gold Holding Srl	52.1
WN Srl	17.4

Companies named in this report
Huawei 002502:CH, Telecom Italia TIT IM, Tiscali TIS IM, Vodafone VOD LN