REFINITIV STREETEVENTS

EDITED TRANSCRIPT

Full Year 2020 Vocus Group Ltd Earnings Call

EVENT DATE/TIME: AUGUST 19, 2020 / 12:30AM GMT

CORPORATE PARTICIPANTS

Andrew Wildblood *Vocus Group Limited - Chief Executive of Enterprise & Government*
Kevin Steven Russell *Vocus Group Limited - Group MD, CEO & Director*
Nitesh Naidoo *Vocus Group Limited - Group CFO*

CONFERENCE CALL PARTICIPANTS

Andrew Levy *Macquarie Research - Analyst*
Brian Han *Morningstar Inc., Research Division - Senior Equity Analyst*
Craig Wong-Pan *CLSA Limited, Research Division - Research Analyst*
Entcho Raykovski *Crédit Suisse AG, Research Division - Research Analyst*
Eric Choi *UBS Investment Bank, Research Division - Director and Australian Telco and Media Lead Analyst*
Ian Munro *Ord Minnett Limited, Research Division - Senior Research Analyst*
Ian John Martin *New Street Research LLP - Senior Telecommunications Analyst*
Kane Hannan *Goldman Sachs Group, Inc., Research Division - Research Analyst*
Roger Samuel *Jefferies LLC, Research Division - Equity Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Vocus FY '20 Financial Results Presentation. (Operator Instructions) Please be advised that today's presentation is being recorded. I would now like to hand the conference over to your speaker today, Kevin Russell. Thank you. Please go ahead.

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Thank you, Dawn, and thank you, everyone, for joining Vocus' 2020 Financial Results. In the room with me here, I've got Nitesh Naidoo, our CFO; Andrew Wildblood, CEO of Enterprise and Government. And also Bill Frith, who heads up our Investor Relations. Obviously, it has been a difficult period for many people across Australia and the world. So I'd just like to say, firstly, I hope everyone is well and managing through okay.

We have had 2 years into our turnaround at Vocus. Our focus has been on building a strong, sustainable growth business. We've worked with purpose. And we've also worked with patience. Big complex turnarounds do not happen quickly or easily. And we've had a consistent view that this would be 3 years before we unlock the true potential of Vocus. We're now 2 years in. And this reflects, simplistically, 2019 year 1 was absolutely a foundational year: get the team in place; set the strategy; set the values; and then really turn over those rocks, understanding determinations and complexity and most importantly, opportunities.

2020, year 2, a different year. This has been a critical rebuild year for us as a team and as an organization. It has been time to stop talking and start delivering, to demonstrate progress and to build momentum. So today, I will give color and context in the year gone. I also want to talk through the impact of COVID-19 in our business and share our priorities for 2021. Nitesh will talk through the results in more detail.

So moving to Slide 2. So 2020, it was a very important year for us. It has felt like a long year, but upon reflection has proven to be a very, very strong year. The operational teams have settled, and we've enjoyed 12 months to focus on execution. Despite COVID-19, progress and momentum have built solidly throughout the year. In a few short minutes, I cannot justify -- kind of do justice to the sheer volume of change, but just some simple -- so a few highlights. Vocus Network Services has momentum. Our VNS EBITDA growth year-on-year was 10%, but more importantly, we are winning quality market share and building strong recurring revenues.

Our average enterprise deal was 24% larger than just 12 months ago. Our brand awareness is 48%, up from 25% 2.5 years ago. Our pipeline is strong. And in 6 months, we go from battling with NBN to be the #1 reseller of enterprise ethernet. Our Australian consumer business has been clearly stabilizing in the face of legacy revenue erosion. Our core consumer brand Dodo saw, in the second half year, its first net subscriber growth in 3 years. And overall revenue in the second half was stable compared to last year. New Zealand continues to deliver, but significantly is now also pursuing acquisition opportunities. The acquisition of Stuff's broadband business was a clear message of capability and of intent. Throughout the year, our operational capability has improved. In a period of significant change and cost reduction, the operating performance of every single business unit has strengthened, basics of clear goals, priorities and cross-functional alignment and execution. Our technology simplification has momentum. Our infrastructure and operations costs were down $14 million, 9% year-on-year, fantastic progress. We decommissioned 3 business support systems out of 11, [caused a defund], we are switching stuff off.

Finally, our financial discipline has been good. We haven't chased revenue growth. We're building sustainable margins. We've made solid traction in terms of the moving cost and established a sustainable cost base. And the notable execution of our refinance in the early months of COVID-19 went calmly, and it went smoothly.

To the broader impact of COVID-19 on Slide 3. Our vision for Vocus is to be the challenger our customers deserve and our people are proud of every day. We've absolutely seen the best of Vocus in pursuing this vision over these past 6 months. We have 3 clear groups to look after: Our people; our customers; and our financial stakeholders, investors and lenders. Providing a safe working environment for people has been priority #1. We have successfully worked through the challenges of working from home with minimal impact on day-to-day operations. Our people have been simply outstanding. We trust them, and our focus has been in providing them consistent support, communication and flexibility.

The next critical focus has been to support our customers in their time of need. This is fundamentally our job, and it's been an opportunity for us to make a real difference. During March 2020, we processed service changes for over 400 customers. We expedited changes and verbal request prior to paperwork, which, in every case, we then follow it up. Delivery change is reduced from weeks to days, sometimes minutes. We saw customers of competitors stuck or lost in the machine switch to Vocus for emergency installation. In New Zealand, we've got a contact center capability fully enabled working from home. Through our retail contact centers in Manila, we get manageable levels operated, again, from home in a period of weeks. Overall, I believe our response to our customers has been exceptional.

From a financial standpoint, we have built purposefully with tough decisions, including some reprioritization of CapEx in future state, reshaping our strategy for the small business market and also facing into the painful reality of an employee restructure impacting 6% of our people. We've learned a lot about our culture, our customers, our suppliers, our partners and our business model in the last few months and we will, without question, evolve to be stronger business as a result.

Moving to Slide 4. Today, our business trends have been good. Fiber is absolutely proving to be a valuable asset to own. Cash collections have been very solid in every single business unit. In VNS, we saw strong sales in Q4. We're also seeing increases in RFP activity, but those are balanced off by longer decision time lines. In retail, increased demand for higher speed NBN plans, and as expected we experienced a slowdown in SMB sales. And we do have a heightened focus on possible bad debt in that market. In New Zealand, very consistent trends and robustness in all market segments. Similar uplift to Australia with 40% in broadband traffic and, again, New Zealand has operated very solidly throughout this period. And it's fair to say that our business has felt better and resilient, from now we are performing well.

To Slide 5 and one final reflection on COVID. COVID-19 is clearly accelerating market change that were already underway. We believe that the challenge are benefits in times of change and disruption, and we see opportunities evolving that Vocus can capitalize on in the immediate term. The obvious trends we have seen: first, the acceleration of digital adoption and resulting demand for bandwidth. Our strength lies in high-capacity, fast, we'll-wait-and-see big pipes across Australia and New Zealand and into Asia. We also direct product partnerships to drive more valuable traffic across those pipes. Secondly, increased cybersecurity risk and focus. Time line in our biggest product investments in the last 2 years have been in a secure network capability. Again, we feel well positioned. And finally, expectations on speed, flexibility and value. Customers are less forgiving. My biggest concerns articulated before is that the inertia in the marketplace, that is changing. Our culture is ultimately a differentiating strength in market, and that is no more relevant than ever. Our customers are also seeing clear value in our delivery resources being onshore.

In summary, we are seeing evolving opportunities.

Moving to Slide 6. So some context of my chair as a CEO and our overall results before Nitesh goes through the details. Other group has been a challenging 2 years, but also a critical 2 years to hold the financial shape without compromising our focus on building the right long-term business. There absolutely have been headwinds to absorb heavy retail legacy revenue erosion and Nitesh will outline that in a bit more detail. We've put investment in critical investment and capability to grow VNS and then, frankly, just the time to refocus the core growth engine in VNS into the right target markets. We're critically exiting 2020, those headwinds and the risks are clearly not lessening and the momentum is shifting. It's also been important to get VNS moving. This is a core value creation opportunity focus and 10% year-on-year EBITDA growth, whilst fundamentally rebuilding the business, is a strong result.

My final point on financial year '20. We've got plenty of challenges and opportunities ahead, but the pieces are clearly coming together and the execution risk of a successful turnaround is correspondingly reducing. So Nitesh will walk us through the numbers.

Nitesh Naidoo ***Vocus Group Limited - Group CFO***

Thanks, Kevin. I'll start on Slide 8 with the group results. Vocus today reports a solid set of financial results, which demonstrate more than just resilience during the pandemic, our continued opportunities to grow and improve within the core business units. Recurring revenues were broadly stable for the year whilst overall revenues declined 6% due to the completion of the Coral Sea Cable build in half 1 FY '20. We continue to disclose large infrastructure revenue separately as we expect similar builds in the future. Vocus Network Services and New Zealand have continued to have strong momentum, both delivering 6% year-on-year revenue growth.

In the Australian retail division, significant progress has been made in stabilizing the business over the last few years. This saw year-on-year revenue declines improved from minus 12% in half 1 to minus 6% in half 2 FY '20. Despite the improving revenue trends in the Australian retail division, the gross margin erosion from legacy products and the migration to NBN was significant at $50 million in FY '20. Vocus underlying EBITDA in FY '20 is stable as disciplined cost reductions, growth in VNS and New Zealand offset the margin declines that I just outlined in retail.

Moving to Slide 9. Vocus has shown clear progress in the turnaround, having now established 3 business units on a solid platform for growth. The strategy to grow the VNS and New Zealand businesses is being consistently executed and the Australian retail consumer segment has now stabilized in half 2 with majority of legacy revenues behind it.

There's now a clear line of sight to profitable growth through bundling, broadband, energy, mobile, and TV. The small and medium business segment, however, faces increasingly challenging market conditions. As a result of this outlook, Vocus has taken a decision to limit investment for the period and manage the economics very carefully.

Moving to Slide 10. The results of focus, as seen in previous slides, have been impacted by industry transition from legacy revenue streams and the shift to reseller margins in NBN. This has been clear from the other results in the market. Vocus, during this period, has been disciplined in reducing overheads, especially within retail whilst investing in capabilities to strengthen the growth engine, which is the Vocus Network Services business. Retail overheads have reduced 24% since FY '18. There will be continued cost focus within the organization, which is required by a market challenger. However, the major cost out has been delivered and not the same quantum is expected going forward.

Moving to Slide 11. Vocus continues to invest CapEx for the future. In FY '20, this constituted 11% CapEx to sales, down from 16% in the previous year. This reduction is due to the completion of the Australia Singapore cable build, and underlying growth CapEx has been stable year-on-year.

Modernization investment has also been at higher levels driven by the future program, which will deliver new capabilities, improved customer experience and cost savings.

On Slide 12, you can see that there has been significant increase in operating free cash flow. This was from a reduction in CapEx, as discussed earlier, following the completion of the ASC build last year. Operating free cash flow was impacted by the timing of interest payments as a result of the Vocus securing financing of its syndicated bank facility. This brought forward interest payments at financial close, which would have normally been due in July. Additionally, working capital was also impacted by upfront payments received in the previous year relating to the ASC bandwidth sales. Cash conversion remains a focus with 93% delivered in FY '20, which was within the guidance range of 90% to 95%.

On Slide 13, you see Vocus' commitments to strengthen the balance sheet with net leverage ratio reducing consistently from the high point of the ASC investment, which was funded through debt. Net leverage ratio was 2.7x at 30th June FY '20 versus a covenant of 3.25x. We will continue to reduce leverage in the coming year, although, as part of the recent refinance, a covenant of 3.25x was maintained for the next testing period, which is December '20 before reducing to 3x by 30th June '21. This does provide Vocus with ample liquidity and a debt tenure just under 3.5x.

Moving to Slide 14. Vocus Network Services has delivered a standout performance in the market. Recurring revenue grew 6%, and importantly, data network revenue grew 3% for the year. This growth was impacted by the loss of VHA wholesale revenue following the merger with TPG. Gross margin grew 5% for the full year, and recurring margin was stronger in the second half of the year, which demonstrates good momentum. Overall, EBITDA grew a solid 10% for the year, with 6 percentage points higher EBITDA margin due to the lower mix of large infrastructure revenues.

Moving to New Zealand on Slide 15. Yet another year of top line and bottom line growth, now 5 consecutive years of growth in New Zealand. Mark and the New Zealand team continue to drive profitable growth through the bundling of energy and mobile to broadband customers. And in the half, as Kevin mentioned earlier, completed the acquisition of Stuff fiber. This grew the broadband base by 10% half-on-half. Overall EBITDA grew 4% year-on-year with stable EBITDA margins.

Moving on to the Australian retail business on Slide 16, and I'll take a few slides to talk through the transition in the Australian retail business. There is clear improvement in the trends within retail. In FY '20, revenue declined 9% compared to 15% in the previous year. Substantial legacy revenue and margin erosion has been experienced in the retail market in Australia. Antony and the retail team have demonstrated the challenger mindset in cost management and turning around the business to establish a platform for growth. Overall, EBITDA declined 22% from the revenue pressure and migration to NBN margins. However, EBITDA margin remained broadly stable at 11%.

On Slide 17. The platform for growth in consumer is clear. In the second half of the year, the Australian retail consumer business was stable. The small and medium segment outlook in the current market conditions remain weak and is expected to be challenging in the near term.

The scale of the legacy revenue and margin erosion is shown on Slide 18. Legacy margin, legacy gross margin has reduced during the turnaround period by $130 million, offset partially by growth in the current products. The transition to growth has been substantially completed for the consumer business. However, SMB, which is predominantly the Commander brand still has another year to go.

Moving to my final slide on Slide 19. Vocus as a part of preparing the FY '20 financial statements has assessed the carrying value of assets in each business unit. The strong growth and momentum in the Vocus Network services business at New Zealand continue to support the carrying value of assets, including goodwill. In the Australian retail business, specifically SMB, given the uncertain outlook for the foreseeable future, Vocus has shifted its strategy to limit investment for period. This has resulted in an impairment of goodwill by $202 million in this financial year. This has been -- this can be seen in Vocus' reported net profits for the year and has no impact on cash flows.

In summary, a strong financial performance for the year that has had negligible impacts from COVID on the business cash flows to date and in difficult general market conditions continues to find opportunities for growth.

With that, I'll hand back to Kevin, who will look forward to FY '21.

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Thanks, Nitesh. So a couple of comments. We are starting to now see the longer-term financial shape of our different businesses. So Vocus Network Services in New Zealand, you can see good operational leverage in these results growing margin across reducing overheads. And retail working through legacy and the business is trending towards stabilizing with numbers over $600 million of revenue and over $200 million of gross margin. Again, 2020 was a big rebuild year. 2021 is a different balance. Our focus is moving now more to winning, to lead and to capitalize on the progress we have made during the course of the last 12 months.

So moving to Slide 21, our priorities for the year ahead. First and foremost, we're in our target markets in Vocus Network Services, and we've got our restructure behind us. We've got good operational rhythm. We've got strong pipeline of opportunities, and we do see evolving COVID tailwinds. Finally, the overall market from a competition standpoint feel as positive and good for us just now.

Traction in future state. This is a multiyear program, and we have reprioritized towards digitizing customer experience and looking for progress and better customer interaction through Vocus' website and APIs over the next 12 months and ongoing traction in retirement of legacy platforms and networks. For retail consumer, 2021 is that we're getting back to revenue growth during the course of the year, that would be a significant breakthrough for us after a difficult few years. So small business, for retail, small business, it is a different market. We do expect economic headwinds, and our focus really is on smart, tight commercial management.

How do we manage margin erosion? How do we minimize that exposure to bad debts? In New Zealand, again, it's not -- it's more than business as usual. And within a few solid years with -- it's a different phase in New Zealand. We have good acquisition opportunities. And like VNS, Mark Callander has got that business very well positioned to capitalize on the evolving COVID tailwinds. So I do see a very exciting year ahead in New Zealand.

On financial discipline, improving focus on ROIC and product profitability. There is just a general maturing of our commercial insight and management office business. And critically, Nitesh has the right industry background and knowledge to drive that improvement.

Finally, I do want to give clarity in our strategic decisions on capital allocation by our mix set of results in February. It is timely. I've always talked about building options, but I've always talked about building a platform of strength. I see that's where we are now. Our core Vocus network business is growing. New Zealand is in a strong place and retail consumers are coming to growth, very different phase for us. And then also as a team, we just have a different level of head space to be able to review strategic options.

So moving to guidance on Slide 22. Our progress over the last 6 months has given us confidence in giving guidance for the coming financial year. Vocus Network Services, we do believe has market-leading growth opportunities, and we see revenue growth in Vocus Network Services for the year of at least 5% or higher. And we have -- see underlying EBITDA growth in an 8% to 12% range. Again, I think, leading by any benchmark in the market. For the overall Vocus Group, we're going towards an underlying EBITDA, including the impact of AASB 16, our range -- our guidance was a range of $382 million to $397 million. If I back out the impact of AASB 16, that would equate to a range of $360 million to $375 million. So the impact of AASB is about $22 million on an EBITDA level. On CapEx, we're guiding towards $160 million to $180 million. And again, we are focused on continuing to delever. So we expect net leverage to continue to reduce over the coming 12 months.

So the final slide and just to summarize some key takeaways in today's updates. The past year '20, was a very strong year of execution. It was a critical year for us to deliver. And we're exiting the year with a 3-year turnaround firmly on track. Vocus Network Services is winning market share, and we have momentum. And we expect to deliver 8% to 12% EBITDA growth in financial year '21. Both Vocus Network Services and New Zealand are well positioned for accelerating market trains in COVID, and we've got the right fiber and it's in the rate place. Our retail consumer business is stabilizing. And we're targeting return to revenue growth during the course of the year, but we do recognize that small business is likely to be impacted by COVID-19. We see our legacy headwinds substantially passed by the end of financial year '21. And then finally, we do expect to give direction on capital allocation for the group by our next results announcement, by the latest, by our next results announcement in February 2021. So with that, I would like to open up for questions. Operator, if that's okay.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first questions comes from Eric Choi from UBS.

Eric Choi ***UBS Investment Bank, Research Division - Director and Australian Telco and Media Lead Analyst***

Word on executing on your targets as well, first question is just around the FY '20 outlook. And just wondering if that's consistent with what was provided to the lenders during the refi. I'm just trying to get a sense of if conditions have improved or worsened since then. And even if you could just share what leverage we're targeting by the end of FY '21, that would be helpful. Second question, just on VNS recurring revenues. It was sort of up 6% with the Vodafone drag in there and sort of thinking it might have been up 8% without that drag.

Can you just talk us through, at high level, what we're assuming for that growth rate to drop to 5% next year? And then lastly, just, I guess, longer term, NBN looks like it might meet or even exceed its business revenue targets and Telstra is being a little bit more competitive on price and enterprise as well. So my question is what impact more off-net products and competition has on medium-term margins? VNS gross margin sort of in the low-60s, so can we maintain that medium term?

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Eric, let me just walk through those, and I'll probably miss some because there's a few in there. In terms of working through with our lenders, we worked through in an April May time frame. It's absolutely fair to say that March was much of the quieter month, and activity definitely has stepped up through April, May, June, July, across the market, but just in terms of working through business plans with our banks, we've obviously had a more appropriate conservative view on projections.

So I think our business sentiment, if I -- maybe just talk about general business sentiment. Our business sentiment today is absolutely more positive than it was in March and April. We've got another 4 or 5 months on the uncertainty is less. The traction in the business in Q4 was strong, and we've started the year with good momentum. So the month -- as the months have gone by, that sense of uncertainty, which all of us felt in March, time has reduced significantly.

On targets on leverage, for now we'll just guide to leverage reducing. I think we reduced by [0.2] during the course of this year. We'll track that during the course of the year. We do see potential opportunities coming during the course of the year. So let's just see if it will continue to move down.

On revenue uplift, plus 5%. I think the important point here is the quality of the revenue uplift. We expect to be stronger next year. You will see that our data networks uplift, the course of this year, was up 3%. We believe that the revenue outlook next year will be strongly supported by data networks revenue improvements. We have relied quite significantly on NBN revenues over these last couple of years in VNS. And that impact of the mix on growth will be less next year. So what you're going to get next year is better quality revenue growth coming through, particularly in relation to how we think about data network revenue.

On competition market, I might just let Andrew talk about competition in market, how you're seeing comparative response from Telstra. And the other point, Eric, I think, was influence of NBN. So just general market dynamic, Andrew.

Andrew Wildblood ***Vocus Group Limited - Chief Executive of Enterprise & Government***

Eric, it's Andrew. There's no question that a lot of the incumbent players have sort of [retreated] to try to retain their customer base rather than being aggressive on acquiring new customers. That's good and bad for us in terms it stables up our revenues. And certainly, we've really done a cracking job this year of controlling churn and price erosion. Therefore, all of our net sales are dropping to revenue, which is really good news.

On the overall competitive pricing, obviously, you probably referred to the pricing that Telstra put into market. We were already 3 to 4 months ahead of them on that. And we reviewed and simplified our Internet products, which is what that relates to. Against that, we've done an assessment of what it means. And actually, we still remain some 20%, in many cases, better than them. And they have a lot of caveats to that pricing, must be a 5-year term, must have multiple products. So on a stand-alone basis, we're confident that it's not really going to impact us so much.

We do see them being a little bit more aggressive now on retaining and, therefore, it just tightens up where we play. And certainly, the work I have done in the last 12 months and the restructuring in the organization for this year plays much to more -- being very, very clear about where we can win and not waste our time where we can't win. And that means that I don't really foresee competitive position being any further threat to the revenue forecast that we've declared today. So I think that would be my -- probably my comment on that, Eric.

And with that, as far as NBN goes, we've done a really good job of working out where and how we work with NBN, and on some of the wins we've had in the last few months, including a number of wins over the time period, it's been the best of breed of our fiber network and NBN access. And I think we've found a happy medium of where we can make good returns and we can demonstrate that there's value in owning the asset and combined with NBN.

Operator

Your next questions come from Entcho Raykovski from Crédit Suisse.

Entcho Raykovski ***Crédit Suisse AG, Research Division - Research Analyst***

3 questions for me. So the first one is like you don't have any project revenues (inaudible) but if you could confirm that for the avoidance of doubt.

Just secondly, the CapEx number, it's obviously a step down from FY '20. This is the FY '21 guidance for CapEx. Is that reflective of an ongoing run rate? Or is it perhaps a reflection of lower investment in the SMB segment that you mentioned? And I'm just conscious that when you spoke about CapEx at the Investor Day last year, you had a step-up in future state-related CapEx in FY '21. Are you still expecting that? Or is that perhaps being pushed out?

And then finally, cash conversion. I know there's no specific guidance into FY '21, but how are you thinking about it? Should we expect similar sort of cash conversion levels?

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Okay. So I think, Andrew, the first question was on -- we don't have -- we're not promoting or projecting project revenues for next year. I think that was the first question, which is correct. We had the benefits in the last 2 years of Coral Sea Cable. And we continue to see large infrastructure opportunities, and they will come forward. I will say very directly that our ability to execute those large infrastructure projects is best in market, in my experience. And we do see opportunities coming, but we are not guiding towards that in the next 12 months.

On CapEx numbers, you're right, we have stepped down. And if you look through our response to COVID during March, April, May, we absolutely reprioritized our future state activity. We have a stronger focus on deleveraging the balance sheet, but we're also recognizing that customers are demanding quicker delivery, more flexibility. And we have reprioritized our activity on future state to move towards areas that improve customer experience over the next 12 months. So there's a -- yes, there's an influence of tightening cash and pushing out 12 to 24 months on the network consolidation side, but it has absolutely made logical sense also in terms of the evolving market trends we are seeing. So you'll see some of that future state spend come back in, in '22, '23. So you'll see an increase in '22, '23.

And then on cash conversion, again, we see run rates are consistent with where we are, obviously, by definition, guiding towards ongoing leverage improvements here that we're expecting cash conversion to be strong. Where we've got to now as a business as a kind of run rate, we would like to be continuing to operate at.

Entcho Raykovski ***Crédit Suisse AG, Research Division - Research Analyst***

Okay, great. And maybe just a quick follow-up on CapEx. I think in July last year, you flagged $30 million CapEx spend in relation to future states. Are you able to give us -- for FY '21, are you able to give us what the number is now?

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

For future state this year?

Entcho Raykovski ***Crédit Suisse AG, Research Division - Research Analyst***

Correct.

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Yes. We'll come back. It's solidly below $30 million, it will be between $10 million to $20 million.

Operator

Our next questions come from Ian Martin from New Street Research.

Ian John Martin ***New Street Research LLP - Senior Telecommunications Analyst***

Just a clarification, first of all, on the net leverage ratio, you're talking, I think, about arrangements with the bankers to be 3.25x by December, 3x by June next year. But on Slide 16, you've -- the level is at 2.7. So I wonder how those numbers reconcile?

Secondly, just in terms of capital spending, and so on, one of the areas of potential growth from some of your competitors is fixed wireless. And obviously well advance of Telstra and TPG, Vodafone potential announcements coming up. There's a particular market segment, of course, that's focused on, which you're not necessarily well placed in. But I just wonder, given they're relatively capital constrained and yet they require quite a lot of fiber back haul and front haul, whether there's an opportunity there for Vocus to play in that space in some kind of partnership arrangement?

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Yes. So just on the second point, yes, Ian, there is absolutely -- again, several comment I alluded to the overall market dynamic. I think it is absolutely helpful and something we've been looking at that our competitors are more capital-constrained over the next 2 or 3 years. And we will obviously put away what's wrong, and fiber backhaul is one of the areas we will continue to invest and support. And we are looking at opportunities here, and we've talked about it in the previous 12 months. And I think as people's plans firm up, we would expect to see some progress there.

In terms of net leverage ratios, Nitesh?

Nitesh Naidoo ***Vocus Group Limited - Group CFO***

It's Nitesh. In terms of that clarification, our net leverage ratio at 30 June is 2.7, as you correctly pointed out. The 3.25 comment that I made was more to do with our covenant level. So we are, in summary, comfortably below that at June. And we retained that headroom for another half at 3.25 as a covenant level. And just as a clarification, we expect our net leverage to go down from 2.7x.

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

And as a general rule, we've looked at having that kind of 0.5 head room net leverage after.

Operator

Your next questions come from Kane Hannan from Goldman Sachs.

Kane Hannan ***Goldman Sachs Group, Inc., Research Division - Research Analyst***

Just 3 for me as well. Firstly, just again on the VNS outlook next year. Just interested if you could comment around how much of that 5% revenue growth you had a clear line of sight on in terms of the contracts that you've previously signed ramping up or new contract wins that we know are coming through versus assumptions around further contract wins in what is probably a more competitive market at the moment?

Secondly, just on the retail outlook next year, interested in whether you are assuming consumer revenues return to growth to get within your guidance range? And then around the quantum of legacy earnings you think you have in FY '21 versus at $68 million in FY '20.

And then finally, just a broader capital allocation question, I know you said you will give us an update. But just interested, is there any comments you can make around how you're prioritizing the gearing and reinstating the dividend versus things like potential acquisitions in New Zealand or capital investments?

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Could you just repeat the second question, Kane, just quickly, sorry?

Kane Hannan ***Goldman Sachs Group, Inc., Research Division - Research Analyst***

I think in the presentation, Kevin, you said you were talking about aiming for the consumer revenues to grow in FY '21. So just trying to understand if you assume revenue growth in consumer in your guidance range?

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Yes. So just going through them one at a time, the VNS outlook, plus 5%. Obviously, the nature of the business is we have strong pipelines in enterprise, but also we've got a strong inventory to deliver. So we have, I would say, very good line of sight of our revenues over the coming 6 plus months. And as a business, we are in a significantly enhanced position from 12 months ago in terms of line of sight market opportunities. It's also fair to say that a lot of the discussions we're having in market is now quite firm discussions. We also have a level of confidence on in terms of our numbers for next year.

On the retail outlook, I would breaking through to that positive revenue position is, as much as anything, a key psychological tuning point for our retail business. Is it a critical element around our guidance from next year? No, it is not. Our guidance for next year is not significantly impacted by the revenue performance of our retail business relative to the overall robustness of the business just now.

On capital allocation, I will give clarity on that in that February results update, came around in probably sporadic pieces of information. There's a detailed review exercise for us to go -- we can now go through. The world post COVID is different. The market opportunities are different. The opportunities for each of our business are evolving. And we need to think about that calmly, constructively in terms of how we balance up market opportunities, business priorities and the benefit of deleveraging and reintroducing the dividends.

So I think the message today is very simple. We're in a different phase where we have visibility and head space to work those elements through patiently. The time line is pretty much consistent with where my head has been as an executive leading this business, which is enough order immediate work to do. I want to fix it. Let's get to our platform. And that platform is there now, and we can do that work over the coming months.

Kane Hannan ***Goldman Sachs Group, Inc., Research Division - Research Analyst***

I think, Kevin, maybe just on the capital then, just around the New Zealand acquisition comments. Should we think that, that's more bolt-on acquisitions such as the recent one? Or has appetite for mobile or some more transformational acquisitions changed over the last 12 months?

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

You should look at it as bolt-ons. So you should look at it as a rock-solid platform in that marketplace to basically acquire businesses at a manageable scale and leverage the existing capability. But we do recognize that market opportunities may move beyond that in the years ahead, but not over this next 6 months, 12 months.

Operator

Your next questions come from Ian Munro from Ord Minnett.

Ian Munro ***Ord Minnett Limited, Research Division - Senior Research Analyst***

A couple of questions from me, please. Firstly, within the retail segment and specifically the SMB franchise, you've flagged lower investment in FY '21. Can you perhaps elaborate on we're in cycling away from the legacy products and we're still seeing the bottom of this earnings cycle in the first half of FY '22, I think, was the last update on that. And then secondly, can you perhaps comment on the progress lighting up the ASC and how far we are away from generating returns that are accretive to the broader group?

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

So on the second one, I would say on ASC, we are in a position now where we've -- the returns are accretive to the broader group. The revenues in that business are now comfortably north of $20 million. And we see line of sight of improving opportunities going forward.

I'll also say that we haven't chased price down on ASC over the last 12 months as Indigo has launched, and I think that positions us well as we see demand growing in the months ahead.

In terms of lower investment into SMB, we see the small business market in Australia as likely to be materially impacted by events over the last 6 months, and that will contract. It has proven to be a harder market for us to make progress in than we thought over the last 12 months. So whilst we've made very strong progress in our other segments, SMB has been harder. And our view is it will get harder again.

So when we talk about reducing investment, it is in some of those channels, some of those people and resource opportunities. We do recognize that there is product in NBN Ethernet that we need to look at. There's some small enhancements we can make. And we expect margin to erode but stabilize over the next 24 months.

Operator

Your next questions come from Roger Samuel from Jefferies.

Roger Samuel ***Jefferies LLC, Research Division - Equity Analyst***

Okay. I've got 2 questions. First one just to clarify on your guidance for Vocus Network Services. So the underlying EBITDA growth of 8% to 12 %, does that include the impact from AASB 16 just because there's no footnote on that line?

And then second one is just on the progress of the transition from legacy DSL to NBN. How much is left to go in your consumer and also your small business segments? Because at the last result, I think it was around 80% for consumer and around 60% for business.

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

So just in terms of the VNS guidance, no impact from AASB 16. It would obviously be given a percentage increase. And rather than an absolute number, that percentage increase would be the same under AASB 16 or not.

In terms of transition of DSL to NBN, Nitesh?

Nitesh Naidoo ***Vocus Group Limited - Group CFO***

So it will be north -- so it's ahead of the 80%, so it's closer to 90% on the consumer business. And I think on NBN in -- on the Commander business, it's largely voice, which is -- that is the legacy revenues in there. And that's not as relevant from an NBN perspective.

Roger Samuel ***Jefferies LLC, Research Division - Equity Analyst***

So you expect the transition has got another year to go, perhaps?

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Yes. I mean, I think we've introduced some reasonably good transparency on legacy margin and legacy revenue in, I think, Slide 17. I mean the way I think about it is if you look at that revenue margin, if you look at kind of legacy margin reducing 50% to 60% during the course of next 12 months and then reducing 50% the year after that, that's how I broadly think about the shape of the movement. Does that help, Roger?

Operator

Your next questions come from Craig Wong from CLSA.

Craig Wong-Pan ***CLSA Limited, Research Division - Research Analyst***

Just 2 questions for me, one on D&A. Could you provide any comments around what you expect for FY '21? And then just the cost in infrastructure and operations, that seems to be a little bit lower than what you were previously expecting for FY '21? I'm just wondering if your target out to FY '23 is still intact or if you might be running at a lower run rate than that?

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Yes. So I'll take the second one. So no change in targets to FY '23. The -- I mean, I know Ellie and her team have done a really, really strong job on cost this year. But that's more of an acceleration of reduction rather than -- same as any different aspiration. I think a reduction of $30 million over 3 or 4 years is a massive step forward in terms of the cost base. So those targets remain in place.

Nitesh Naidoo ***Vocus Group Limited - Group CFO***

On D&A, Craig, so there's 2 components there. So amortization reduces very, very significantly in the coming years as we unwind some of the previous acquisitions from the original acquisition of M2. So amortization comes down very significantly.

Depreciation grows low single digits and more so because we continue to invest in CapEx and we're maintaining our capital investment in next year.

Craig Wong-Pan ***CLSA Limited, Research Division - Research Analyst***

Could you provide any sort of comments around how much amortization comes down from M2?

Nitesh Naidoo ***Vocus Group Limited - Group CFO***

It's around $30 million. So it's (inaudible).

Operator

Your next questions come from Brian Han from Morningstar.

Brian Han ***Morningstar Inc., Research Division - Senior Equity Analyst***

Kevin, my apologies for having another go at this, but on a post AASB 16 basis, what was the network services EBITDA in F '20?

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

It's a $15 million improvement. So if -- so what would that be year? If FY '20 was -- what was it, $222 million, $223 million and then $15 million higher.

Nitesh Naidoo ***Vocus Group Limited - Group CFO***

Right. Okay. The reason why Kevin answered the question, so this is Nitesh, Brian, is that this year, we've obviously shown the impact of AASB 16 in an underlying view, so we've excluded it. Next year, there's no necessary reason to do so because it's in the reported result for 20, and it's in the report -- and it's in our guidance for FY '21. So Kevin's point which is that 8% to 12% guidance from VNS is the same on both because AASB 16 is at similar levels for FY '20 on a reported basis and for FY '21. Hopefully, that helps.

Brian Han ***Morningstar Inc., Research Division - Senior Equity Analyst***

Right. But for VNS specifically, AASB impact would be, did you say, $12 million?

Nitesh Naidoo ***Vocus Group Limited - Group CFO***

$15 million.

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Yes, $15 million.

Brian Han ***Morningstar Inc., Research Division - Senior Equity Analyst***

Okay. And also second question, perhaps for Andrew, can you please provide some color as to what further refinements you have made in terms of your target markets and as you say where you can win, whether in terms of the customer segment or your vertical market?

Andrew Wildblood ***Vocus Group Limited - Chief Executive of Enterprise & Government***

Yes, sure. So we've done a number of changes in the last year, which has been the investments we made. First of all, we rolled out a new sales methodology, which has sharpened what we pursue and what we don't pursue, and that's return great dividends in terms of pipeline growth and win rates. So that's just a sort of underlying enabler.

Secondly, we continue to really do well in customers that sit probably in the 1,000- to 2,000-seat type organization, where they're probably spending about, in our terms, $50,000 to $100,000 a month on network services. And these are typically where the 2 incumbents have deprioritized or they're sort of lowered down in their order of customer and they're just not getting the service. And so in the last 6 months, we've had a series of very good wins at regular pace in that scale or size of deal.

We've then started to segment and organize ourselves this year better around market opportunities in industry. Mining oil and gas has been good to us. Gas and oil is slightly problematic now because of the drop in gas prices, so some big projects are slightly delayed. But certainly, in mining, we've been doing very well over the last 12 months, and the pipeline is growing very strongly for this financial year in terms of organizations looking to go to full automation and, therefore, requiring dedicated fiber services. Many of them have got old fiber networks that need replacing. So we're building a really strong pipeline with the top miners and Tier 2 miners, and that's geographically all over the country, including some interesting projects offshore as well.

And then in healthcare, as an example, we have had some really brilliant wins in the last 6 months, and that's really where organizations have realized that they need to transform their own network. Their clients are changing and the needs of digitization is changing. And COVID has accelerated that. And so we've had some very strong wins in aged care, health care, radiology and imaging type services where networks are critical to transformation.

And then financial services, we continue to do well in financial services.

And finally, in government, we've had a very strong year in government in, particularly in federal and state. And in federal, we've got some pretty exciting pipeline opportunities which are getting close to closing, which are material for us. So that investment that we've made in our secure networks and the amount of cleared people we've got lends itself to be relevant into certain parts of federal government in Canberra.

So much more sharper and, consequently, it's meant we've deprioritized in other areas where, historically, we would have wasted time pursuing, and now we just don't go there. And that's meaning our win rates are better. Our pipeline is growing, and we're getting a much clearer value profit market.

And I think the other thing we've not really mentioned through this has been the brand. We've done a brand launch -- relaunch. We did that in February. And the brand is now really resonating with organizations who simply had enough of poor service elsewhere and want a better experience.

Brian Han ***Morningstar Inc., Research Division - Senior Equity Analyst***

And then just the top players...

Andrew Wildblood ***Vocus Group Limited - Chief Executive of Enterprise & Government***

Yes. So I should say, as well, in the wholesale and OTT, there, we're the top players. The explosion of bandwidth requirements is phenomenal. And COVID has really helped us in that in terms of high-capacity over-the-top applications required, which has been really powerful for us as people come in on the ASC cable and need to transit across Australia to the hyper data centers.

You might have seen a report that was written. We're one of the most connected data center providers in Oceania. That was an independent report, 144 data centers connected. Why is that important? Well, through this environment, everyone's required internet and it's usually met at a data center where they're moving towards cloud. And this digitization movement means that we're well positioned to capitalize on it.

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

I think we've got time for one more question.

Operator

Your next questions come from Andrew Levy from Macquarie.

Andrew Levy ***Macquarie Research - Analyst***

Just 2 questions. The first one was -- I think I heard it properly the comment earlier that sort of Vocus Network Services, the competition has maybe eased off to some extent or there's more of a focus on retention at the moment. So I just wanted to check if I heard that right, and whether you think that's a structural shift in terms of trying to protect returns and margins or more COVID-related and you see it reversing?

And the second one was just on the outlook commentary. Could you just clarify again if lumpy sales fall into recurring or nonrecurring? If there are lumpy network sales and if there's anything out of the ordinary we need to think about for FY '21? I think you made a reference to FY '19, there was some ASC sales that fell in but...

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Yes. So I made a comment earlier but just a general competitive environment. And again, I'll repeat our view that I've had for a while but I think is now shaping which is that there is significant competition in the mobile market. There is a significant push for capital investment in mobile infrastructure. There's also a squeeze on financials for big players in the marketplace. That means some level of prioritization of capital. And that is a good environment for us to operate in.

So I think you've seen it very clearly with Telstra's results, a reduction in capital spend or a prioritization of capital spend to other areas. I think, generally, the markets we are in are more favorable just now. I think that it is good to be investing in fiber infrastructure for our core markets rather than competing head-to-head in mobile.

So that general macro dynamic, I think will play out over the next 2 or 3 years. That does not suggest that we don't have big competitors that we're up against. But we are seeing very clearly that the market environment for us feels positive just now.

On the lumpiness of spend, we've split out large infrastructure projects as a definition and in these financial statements. And that really, if you go back, included Coral Sea Cable over the last couple of years. And we're basically guiding towards no comparable builds this year but flagging the fact that we have significant capability and pipeline of opportunity that we're working on that may be relevant to years beyond 2021.

Andrew Levy ***Macquarie Research - Analyst***

Okay. And if you do capacity deals on ASC, you recognize that revenue over time, is that right? You might have the cash upfront but just on the...

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

That is spread over 15-year terms in terms of our use, et cetera.

Nitesh Naidoo ***Vocus Group Limited - Group CFO***

To clarify, in large infrastructure revenues, it's just the Coral Sea Cable for FY '20.

Andrew Wildblood ***Vocus Group Limited - Chief Executive of Enterprise & Government***

Yes, one-off projects.

Kevin Steven Russell ***Vocus Group Limited - Group MD, CEO & Director***

Okay. So I think we'll wind down at that point. If I can just make some final remarks.

I do hope this update has been helpful. As I say that I think the shape of the different businesses is becoming clearer. We are very pleased with the progress we've made in the last 12 months. We're pleased with the results that are, frankly, more importantly, I'm very positive about the turnaround progress made and the platform we've got going into next year. I'm, frankly, focused now on the opportunities ahead of us and not so much just the execution risk on turnaround.

I do want to wish everyone the best in uncertain times. And I just -- look after yourselves, and I look forward to sharing more in the weeks and months ahead. So thank you very much for joining today.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may all disconnect.