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Commander Market Brief
Adrian Coote – Managing Director

What prompted Commander to undertake a review of operations?

Perhaps this is best answered by detailing the recent history. Commander acquired RSL COM in late March this year. This gave Commander access to a national switched network which presented the opportunity for Commander to have carriage of its existing customers' telecommunications traffic. The purchase was a critical element in being able to execute Commander's strategy and resulted in a new relationship, with Telstra wholesale replacing the pre existing relationship with Telstra retail.

During August our Chairman, Ms Elizabeth Nosworthy was appointed and two new Directors, Mr Rob Topfer and Mr Peter O'Connell joined the board. Continuity was assured by Mr Neil Mc Dermott and Mr Terry Winters remaining on the board.

The new board requested management ascertain the current expectations of the market with regard to the financial performance of the group. Our analysis identified that the market has knowledge of Commander's long term opportunity but had not factored in the full cost of transition from a retail to a wholesale relationship with Telstra. The market was informed on the 26 September that an operational review was to be completed to provide a more detailed review on the prospects of the company.

In the intervening four weeks the operational review has been completed and based on this, we are confident of providing appropriate guidance to the market.

In summary while myself and the majority of the board have been in the position for a little over a month, we have made a thorough review, and identified those areas requiring concentration of our resources. Fundamentally, Commander's strategy is sound and its platform for executing that strategy is second to none. While a first half clean out is often expected of new management, in this case the fundamentals for strong growth are there and all we need to do is to focus on the basics required to deliver the strategy.

Having completed your operational review are you generally happy with what you found?

Having been in the industry since the start of deregulation, I knew that Commander had an exceptional name in the SME market. As a brand, Commander stands for quality and service and we will continue to maintain its standing.

Note: The questions in this market brief have been posed by Commander to provide a context for the brief

The little known factor I have discovered, was the quality of the people at Commander. We believe Commander has the largest and best qualified telecommunications team servicing the SME and corporate market in Australia. That is a powerful selling proposition for our customers.

I have been delighted by how far Commander has progressed in delivering its 360º campaign. Commander really does have the capacity to provide the full suite of voice and data telecommunications hardware and transport services that are required by SME's.

There are 220,000 SME's in Australia. Of those, Commander has had a relationship with more than 135,000, providing hardware and/or services. With a strong brand, good people and a 360º offering, Commander is in a position to offer unmatchable service to the SME market.

What we have found is that while the strategy is well developed and is the right fit for the company and its target market, there are some basic business processes that have been neglected and need focus. The review clearly identifies a need to get back to sound practices such as Sales and Service productivity metrics, KPI setting and measurement of performance against the agreed KPI's. Management action to ensure that Commander staff share and believe in our vision and a common purpose flows throughout the team has been a priority. We have already restructured the Sales group to reflect the set of disciplines necessary for the Commander sales engine to deliver on required outcomes. The restructure has been well accepted and has created a different mood. A culture is emerging which celebrates success and values being on a winning team. We are working on a plan to enhance the service unit performance as a business profit centre in its own right.

What is the strategy Commander will adopt in approaching the SME market?

Commander will be a more solutions focused telecommunications business. It will offer the full range of telecommunications hardware and connectivity services that SME's require and will support that on an ongoing basis.

Historically, Commander supplied telecommunications hardware to its SME customers and had an experienced field service team, which installed and maintained that equipment. The hardware sold by Commander includes not only the 3 to 10 line key systems sold to SOHO and SME's, it also includes large enterprise solutions, sold to government and large corporate customers. Our Data division provides professional grade servers and PC systems, support services such as fast restoration and web hosting and has recently achieved Microsoft LAR and Cisco Wireless accreditation status. Commander is also the provider of advanced voice and video conferencing systems.

So you see multiple lines of revenue- new hardware sales, new services bundled with new hardware, new services sold to the existing customer base managed services, and field service and maintenance. Which is the most important?

No one line is more important than any other.

New systems sales produce a revenue opportunity and this is a primary focus for the Commander Group. Those systems also provide the pull through to annuity style income of telecommunications services, and service and maintenance. In an infrastructure based telecommunications business, the cost of acquisition of customer and rate of churn are two critical elements determining profitability. The revenue opportunity associated with a hardware sale reduces the cost of acquisition of that customer for the telecommunications services side of Commander's business. Similarly, as most hardware is rented, the sale of telecommunications services as part of a bundle effectively eliminates churn during the rental period.

The average Commander key system customer currently consumes approximately $7,500 pa of primarily voice related telecommunications services. With the acquisition of a telecommunications network, Commander now has the capacity to provide those services to its customers rather than referring them elsewhere.

Commander has the opportunity to bundle telecommunications services with new hardware sales, thereby offering a complete telecommunications solution to its customers. In addition to the bundled product, Commander now has the opportunity to offer telecommunications services as a stand-alone product to its existing customer base.

What makes you think that the bundle will be an attractive proposition to customers?

The bundling between hardware and telecommunications services has already been successfully launched and sold by some of our competitors.

Recognising the need to catch up, Commander elected to go one step further and acquire RSL so that it had its own network allowing us to buy capacity from the lowest cost provider in the market and deploy the most effective bundle. That flexibility will provide Commander with additional margin from its bundled offering.

Telecommunications are mission critical to SME's. They, like most of us, are time constrained. Therefore, a one-stop shop for hardware and services across voice and data, which is supported by a second to none field service capability, will be a compelling bundled suite.

Do you have the sales team that can sell the bundled product?

Selling the bundle will require us to re-educate and re-orientate our sales teams. It will be important to include the field service staff as part of that sales initiative. Over time we may well move to an indirect dealer model in the smaller key system bundle to match customers expectations while positioning our direct sales force toward the more customised sophisticated higher end product. We have already begun to refocus our sales and marketing effort but it will take at least six months for the results to be seen in terms of consequential increased bundled product sales.

The company has spent nearly $2m in the first quarter on brand advertising in an effort to increase sales. Unfortunately, while increasing the general brand profile, this advertising did very little to increase sales. Going forward, therefore, our strategy is to put the right bundled product together and have our sales and marketing team sell directly to SME's rather than relying on brand advertising.

Of the 220,000 SME's in the market, 135,000 are known to Commander and the remainder are easily identified. Selling to those customers with the right bundle will produce more effective results and be more cost effective than general advertising.

Do you have the sales team that can sell stand-alone and bundled telecommunications services into the existing customer base?

Again, direct marketing is the key as these people are already our customers.

Commander has been using the existing Network telesales group to test the new offering to the existing customer base. The first test groups were not an optimised sample but the results were very encouraging and with the expansion of the telesales group we are anticipating a success rate in excess of 800 new telecommunications services customers each month.

We believe our level of confidence is justified based on current progress. Not only will the group be aggressively selling these services but our field service force has great potential to introduce existing customers to Commander's expanded product and services while making their routine service and courtesy calls. The latter initiative will also enhance the productivity of our direct sales force.

If you do achieve all your goals this financial year, your annualised run rate telecommunications revenue could be an additional 30% to the Network's existing traffic streams. Will the existing Network infrastructure cope with this increase or will additional capital expenditure be required?

Commander's network comprises intelligent switches in the major capital cities and points of presence in significant regional centres. Those switches and other points of presence are linked by pipes leased from infrastructure players such as Telstra and Optus, That network utilises mainly Ericsson equipment.

Commander's wholesale relationship with Telstra allows Commander to service its customers with its own network or on the Telstra network. As a result, Commander is able to optimise the use of capital necessary to expand its network to take on that additional traffic.

The capital expenditure necessary to take on an addition 30% traffic growth is approximately $2-3m. In addition, Commander may need to lease extra links to expand its trunk capacity. However, with the current level of overcapacity in the transmission market, those links are relatively inexpensive.

So did your review reveal any financial problems?

As a result of the termination of the Telstra retail association, Commander has lost a number of recurring revenue lines:

- Telstra commissions
- maintenance and rental contract income
- sales leads resulting in lower sales order intake

Interest income under finance lease will continue to decline during 2004 due to the lower number of self funded rental contracts.

Additionally, Commander has incurred a number of one off costs that will impact the 2004 year:

- Advertising spend
- Executive payments

Transitional issues have also affected first quarter sales performance with KTS equipment revenues down 25% on the same period last year.

This revenue will be more than replaced by telecommunications services sales as already outlined. We expect the telecommunications service revenue to ramp-up over 2004. While the first half will be dragged down by the lack of replacement revenue, the second half will show a dramatic improvement.

Did your review reveal any structural problems?

The strategy is a sound one and Commander has an excellent platform from which to implement its business plan. However, the risk remains one of execution.

Commander had a work force focused on hardware sales and service. The sales force has now been re-directed towards the sale of the bundled product and the sales of telecommunications services to the existing customer base. The time taken to re-focus the team has resulted in a delay to the desired outcome by 6 to 9 months.

All of the ingredients necessary for successful execution of the strategy are in place right now. It is a matter of harnessing and focusing the expertise on delivery of a first class product. Even since taking over I can see the excitement in the company as people realise the opportunity that we have in front of us.

So how do you see the financial position of the company in 2003/2004?

In the absence of any acquisitions or restructuring costs we expect that the costs and losses referred to above will result in a net loss of up to $2.5m for the first half of 2004. That is unfortunate but it reflects the current structure and productivity.

However, we expect a significant turn around in the second half of 2004 as a result of the telecommunications services sales we have made and will make during 2004. Unlike hardware sales revenue, telecommunication services sales produce ongoing monthly revenue that grows progressively with the addition of each new customer.

While we don't expect to return a 2004 bottom line that is an improvement on last year, we do expect the results for the last quarter of 2004, on an annualised basis, will be materially better than last year. The very nature of recurring telecommunication services revenue is such that if our expectations of the last quarter's results were applied to the 2005 period, we anticipate that 2005 will be a material improvement on 2003.

In the absence of acquisitions or fundamental restructure, we see the financial metrics of Commander for 2004 falling out as follows:

June 30, 2004	1st Half	2nd Half	Last Quarter annualised
Revenue $m	230	270-285	600 - 630
EBITDA $m	6	16-18	40 - 49

In the absence of acquisitions or capital reconstructions the balance sheet should not change in any significant way.

If you execute your strategy well, won't your revenue growth cap out in 3-5 years ?

Certainly in voice services we are limited by the size of the total SME market and it is true that the potential for extraordinary growth through our own customer base is limited to 3-5 years. It is also true that if we are only able to capture 50% of the over $1bn of predominantly fixed wire voice telecommunications services currently consumed by our target customer base, we will still have a substantial company, albeit with some limits on future growth. However our revenue growth potential does not depend solely on fixed wire voice revenue. Our customer base will, increasingly, consume telecommunications services other than fixed wire voice.

As part of wholesale arrangements, Commander will be able to introduce mobile telecommunications services to its customers. Commander believes that in the SME environment, mobile connectivity will become an increasingly important part of the bundled product. SME employees tend to require mobility as part of their communications mix.

Perhaps of even greater interest is Commander's potential as a provider of data telecommunications services to its SME customer base. Commander also clearly recognises that broadband data will be a major growth engine for at least the next 10 years. I think it has become a truism in our industry that while the market for new technologies takes twice as long to develop as you expect, it grows to be twice as big as you expect.

Although you are conservative in that you are not relying on data services to drive short term growth, will there be a need for major capital expenditure over the period to position Commander for growth in the next 3-10 year period?

Commander is well positioned in that it already has a significant customer base in its data business. Although the main focus of its data business is hardware sales and support, there is a major opportunity for the conversion of existing customers and bundled sales to new customers of Commander's data telecommunications services.

It is the fact that the current Commander network is capable of running both data and voice services.

Commander will not expand its capacity ahead of its customer's requirements. Capital expenditure at Commander will be programmed to respond "just in time" to increased demand rather than in anticipation of increased demand.

Are there other revenue opportunities or risks that you foresee in the medium term?

Commander's field service force is both a risk and an opportunity.

If hardware sales remained at the current level per month, the field services group is greatly under utilised. While we can take up some of that underutilisation by redirecting the field service force to sales enhancing functions, in the medium term, we will need to increase sales if we are to offset the associated fixed costs.

However, the field service force provides a significant opportunity as well. It is a team well recognised for the depth of knowledge, training and prompt customer response.

Also, the field service force can be used to install, maintain and support other non-telecommunications hardware, which has telecommunications as a part of its bundle. Examples are EFTPOS and ATM hardware and other applications on transaction networks.

Finally, has your review left you excited about the opportunities in Commander?

I think Commander is uniquely positioned to become the leading supplier of telecommunications hardware and services to the SME market. Right now it has all of the main ingredients to achieve that.

Commander has an unrivalled brand in the SME market, a low cost scaleable intelligent integrated telecommunications network, the largest SME customer base and highly skilled people. These are the principal elements required to deliver the strategy. The execution risk lies in the motivation of our Commander people. I have no doubt that we will rise to meet that challenge.

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