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## Spacetalk’s valuable tweak

Sometimes a seemingly modest tweak to strategy can have profound implications for a company. Spacetalk (SPA.ASX) is one such company. For some time Spacetalk has been prioritising SaaS revenue over its product sales revenue, but a recent development by the new management could lead to a material change in the group’s financials and value.

Spacetalk sells Australia’s leading kids smartwatch, targeting 8–12-year-old children. It has a range of features which are exciting for the kids and gives reassurance to their parents. The Company makes money through the sale of the watch and subsequent monthly revenue from its app, which manages the features. The watch requires connectivity to a mobile network and historically its customers arranged this separately, but in November last year Spacetalk became an MVNO (Mobile Virtual Network Operator). That is to say, it resells usage on Telstra’s mobile network.

Consequently, Spacetalk’s watch business now has three earnings streams: the gross margin on the hardware sale; the margin on its app revenue; and, the margin on the price it charges customers for connectivity, versus the wholesale cost of buying network access from Telstra.

The problem for Spacetalk has been that once a kid goes to high school, they don’t want a kid’s watch, they want a phone. So, the lifetime value of their customers has been short. For a parent, the safety features incorporated in Spacetalk’s service are also diminished by simply moving to a smartphone – which is the role that Life360 (360.ASX) is filling.

The tweak that Spacetalk’s new management has made is that the when the kid changes to its first mobile phone, the SIM card from the watch can transfer into the new device, with Spacetalk’s device agnostic ‘Family App’ facilitating the transition. This is an attractive feature, both because of the convenience of not having to change mobile providers, but also from a safety perspective, as kids typically travel further to attend high school, so anxious parents are likely to find this appealing.

The mobile industry is highly competitive. In Australia, Subscriber Acquisition Costs (SAC) for a mobile user are estimated by the ACCC to be ~\$140 each. This is a key cost to mobile companies, and they have a short timeframe to generate a return on this investment as consumers are fickle.

Spacetalk has two material and unique advantages in the MVNO market:

1. It has zero SAC, in fact it makes a profit on new subscribers through the sale of the watch. If this customer can be transferred into a phone subscriber, then this would be reason to reconsider the value of its subscriber base.
2. It can appeal to very young users. The majority of parents (88%) are not providing their kids with a smartphone before high school, so Spacetalk can attract customers before traditional telcos target them. This is much akin to CBA’s ‘Dollarmite’ program, which was used to attract junior customers for c.90 years.

The value of an MVNO subscriber can be revealed by M&A activity. Although not a perfect illustration, as acquirers may also ascribe value to other elements, such as brand, it does show that the intangible value of subscriber bases is genuine.

| Acquirer    | Target MVNO             | Cost per subscriber | Date |
|-------------|-------------------------|---------------------|------|
| Optus       | Virgin Mobile Australia | \$729               | 2016 |
| TPG Telecom | Lebara Mobile Australia | \$500               | 2020 |
| Optus       | Amaysim Australia       | \$210               | 2022 |
| Amaysim     | OVO Mobile              | \$205               | 2020 |
| Average     |                         | \$411               |      |

Spacetalk only has 16,300 mobile subscribers currently, yet all have been acquired in the past 12 months. By making the service transferable to a smartphone Spacetalk is extending the customer lifetime value making the customer base considerably more valuable.

The opportunity is that Spacetalk has over 42,000 active users, which equates to a 39% take-up rate of Spacetalk’s own MVNO product so far, with the rest buying a SIM from an alternative provider.

Spacetalk only launched its MVNO product last year, and more recently its SIM has been included in the same box as the watch, and this has lifted the proportion of users taking its mobile offering. Moreover, in its new low-cost *Loop* phone (due to be released shortly) the SIM will be in the watch itself and locked to the service.

We would expect that, over time, it is likely that ~90% of its active customers will use Spacetalk’s MVNO connectivity. If the Company can achieve this transition, even at the lower end of M&A pricing, the current subscriber base would be worth ~\$8.0m, which equates to the market cap of the Company.

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