Carriers on the Move

Slower but steadier - and not dead.

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The telecommunications service provider industry is, apparently, still not an attractive target for investors. Is their gloominess justified? Some carriers at least are extending their reach and winning customers. This would have been seen in previous years as a good sign. Today, investors seem to have lost confidence in their ability to pick the winners.

Telecommunications carriers worldwide are in trouble, with Energis, Worldcom, Global Crossing, Versatel, Winstar and many more experiencing well-publicized financial problems. Most of the big incumbents (RBOCs and PTTs) are cutting back on capital expenditure and reducing headcount. In the US, more than 50 CLECs have filed for bankruptcy. There are fewer than 70 facilities-based US CLECs in operation today, down from more than 300 just two years ago.

Investors remain gloomy. This is understandable, when this industry has disappointed many investors in the last couple of years. But before the melt-down, service providers also made heaps of money for many investors. (This included service provider insiders who sold at the top of the market, and helped in their own small way to accelerate the downturn.)

Is the continuing reluctance to invest in service providers justified?

Clearly service providers themselves think not. They point to indications that the industry is alive, and not too unwell. For example, here are some recent announcements selected almost at random.

Established companies extend their reach:

- Telseon announces 2200 new buildings in six cities on their Gig-E fiber network.
- Swedish Telia extends their Viper IP network deeper into Central and Eastern Europe.
- BT is launching the UK's first public access Wireless LAN with 4,000 'hotspots'.
- NTT DoCoMo partners with wireless operators worldwide - AT&T, Bouyges Telecom, KPN Mobile, E-Plus - to extend I-Mode to new markets.
- At the same time European wireless operators (while still holding back on 3G deployment) push ahead with GPRS.

Companies seize consolidation opportunities:

- Energis pulls back to focus on the UK market, but demonstrates its confidence by increasing its stake in MetroHoldings a company that has build metro fiber rings in five major UK cities.

- Spanish mobile operator Telefónica Móviles moves to buy 65% of Pegaso in Mexico.
- BT Wholesale announced a deal to buy the network of national UK telecoms company Redstone, allowing Redstone to focus on its retail business.

Competition is not dead:

- According to the Association for Local Telecommunications Services (ALTS) market share gained by the US CLECs continued to grow in 2001, from 9.0% to 10.7%, measured as a share of local revenue.
- A new entrant in the UK market: Argos, an established retail chain, has decided to enter the telecoms business as a cut-price reseller.

And companies are still spending on networks, while end-user demand continues to grow:

- BellSouth completes its build out of DSL capability across 136 North Carolina central offices seven months ahead of schedule.
- In the US, the FCC released statistics that showed in the first half of 2001 there was a 36% increase in high-speed access subscribers. There are now over 10 million high speed lines in the US.
- IDC predicts that the Middle East and North Africa region market for data communications services market will grow to $1.4bn (E1.57bn) by 2006 from $743.6m (E836m) this year, following dramatic increases in investment over the past two years.
- Jazztel reported 77% growth in revenues in 2001, EBITDA on track for quarterly break-even in the second half of 2002.
- Several US companies reported significant quarter on quarter growth – Allegiance, Alltel, CenturyTel, Commonwealth, ITXC and more.
- Sometime early in 2002, the number of mobile phones overtook the number of fixed lines – there are now over a billion of each. The number of Internet users exceeded the half-billion milestone. The market for telecom services worldwide was over $1 trillion. (ITU estimates.)

This is not an industry that is withering on the vine.

For more than forty years, the global annual telecom user growth rate was between 5% and 7%. Then in the early nineties the rate of growth started to increase, reaching a record level of around 25% by 1999. Although the rate of growth has fallen, growth has not stopped.

We all know (and write) that the explosion in investment during the past few years was anomalous. But no-one yet can tell just how freaky that period will prove to be once the next decade's figures are compiled. But it is reasonable to guess that growth will likely exceed the 5% rate that we had become used to ever since 1950, while not hitting the heights of the late nineties. And even at that modest rate, the reported bandwidth glut will not last for long.

In other words, we are back to this being a good, sound business to invest in, not an arena for getting rich fast with little effort. And this makes sense. This is an infrastructure business in which the total capital investments are huge compared with the annual revenues. But the revenues go on, year after year.

Earlier we asked, is the continuing reluctance to invest in service providers justified?

The answer is still yes – for the type of investor who in the past made (or lost) money simply by investing in randomly selected service providers. Today, wise investments require a deeper understanding of what is going on inside a company. Because not all service providers are born equal, and there is more attrition to come.

For investors who understand the operational, financial and management characteristics that will lead to long-term success, and are prepared to be patient, then of course there will be service provider investments that will pay off. The market for telecommunications services is not going to go away, and the right sort of customer-oriented, operationally lean company should be able to filter out some of that $1 trillion per year in the form of profits.

The trick will be to choose the right companies, and this is not so easy when all make the same claims of excellence, and when it's not easy to see into the operational machinery. And we have also learned that an executive team that applies determination and imagination to squandering investors' money can bring down even a basically sound company.

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