Focus this month: Revenue Growth; Reducing Churn

Telecom Service Providers Increasing Capital Expenditures

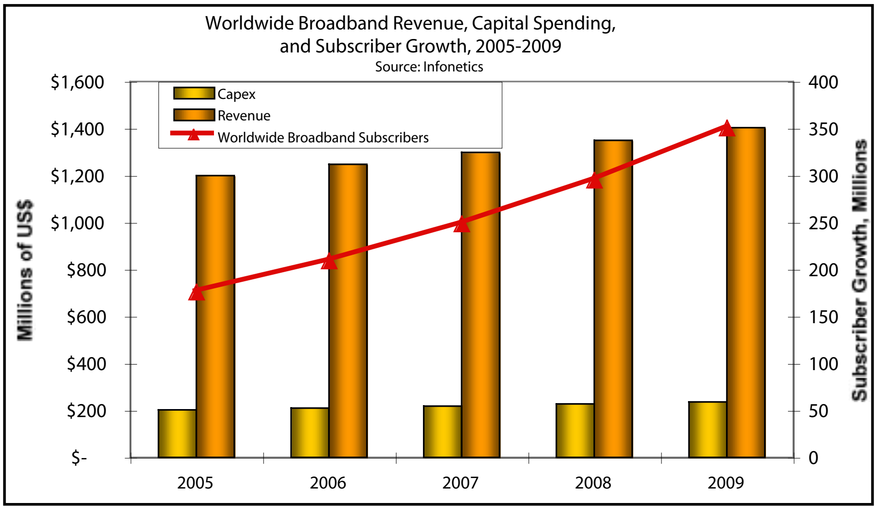
For the third year in a row, telecom service providers worldwide increased their capital expenditures, albeit slightly, and will continue to do so for the next three years, says analyst firm Infonetics Research (www.info.infonetics.com). Lower equipment unit prices hide huge network expansion volume.

Worldwide, service providers' capital expenditures topped $202 billion in 2005, and are expected to increase to over $236 billion in 2009. In that five-year period, service providers will allocate a total of $1.1 trillion to capex.

Consolidation in the telecom industry is increasing economies of scale for the combined entities, and volume production of standards-based equipment, has resulted in considerable capital savings. As a result, overall capex growth has been slowed even though item-to-item, equipment purchases have surged.

Service provider revenue is also expected to grow modestly over the next five years. Between 2005 and 2009, it will rise from $1.2 trillion to $1.4 trillion, at a 4 percent compound annual growth rate.

This slow rate of growth is typical for a commoditized market – the market expands but average revenue per customer declines. Providers' best bet for increasing their revenue is by adding new IP-based services like IPTV, video on demand, video telephony, and fixed-mobile line convergence – all software-intensive services that require only a minimum investment.



Infonetics estimates that telecom service providers worldwide will grow investment in equipment to $1.4 trillion by 2009. Revenue and spending would increase 4 percent annually while the number of subscribers would grow almost 20 percent each year. Thus subscribers would see a sharp cut in prices while bandwidth and service options would increase.

Incumbents' share of worldwide service provider revenue is expected to increase at the expense of the smaller competitors because mergers are reducing price competition and customer churn, according to Infonetics.

Additional report highlights:

- Worldwide broadband subscribers (DSL, cable modem, PON, and Ethernet FTTH subscribers combined) hit 176 million in 2005, and will grow to 350 million by 2009.
- DSL subscribers account for 71 percent of all broadband subscribers, cable for 26 percent, PON for 2 percent and Ethernet FTTH for 1 percent in 2005.
- Asia Pacific accounts for 37 percent of worldwide broadband subscribers, EMEA for 30 percent, North America for 27 percent, and CALA for 5 percent in 2005.
- Worldwide mobile subscribers reached 1.7 billion in 2005, and will grow to 2.9 billion in 2009.

Yankee Group: European Broadband Providers Selling Additional Services

Broadband service providers in Europe are selling more than just broadband access, says the 2006 European Broadband Consumer Survey from the Yankee Group (www.yankeegroup.com). Subscribers are also purchasing value-added content and services as well as home networking equipment. "European broadband consumers' willingness to pay for more than access is reaching a plateau," said Jonathan Doran, Yankee Group Broadband and Media Europe senior analyst.

Two-thirds of broadband consumers purchase multiple services from the same provider, with nearly one-third buying three products. At least one-quarter of broadband consumers now use Internet telephony, while one in 10 has a VoIP handset. As overall bandwidth availability increases and the focus of broadband shifts more toward content and services, advertised access download speeds are losing relevance.

VoIP Grows, Driving Media Gateway and Softswitch Markets

With carrier networks moving towards an all-IP environment, the global market for media gateways and Class 4 and 5 softswitches will jump from $2.7 billion in 2005 to $8.4 billion in 2010, reports In-Stat (www.in-stat.com).

Advantages of media gateways and softswitches include lower costs than traditional equipment and better infrastructure for supporting future services.

The Chinese equipment vendor Huawei garnered the largest market share for media gateway port shipments and Class 4 softswitch licenses in 2005, though more than half of its shipments were to domestic markets.

Nortel has the number one market share for both categories when Huawei's domestic shipments are excluded. In-Stat expects continued market consolidation among equipment vendors.

According to In-Stat, the growth of VoIP is a major driver for the migration of circuit-switch networking to packet-switched, or IP networking, and thus for the growth of the media gateway and softswitch markets.

In another report, In-Stat finds that more than 6.3 million consumers selected local VoIP telephony services worldwide in 2005.

However, despite an impressive 62 percent year-over-year subscriber growth rate, VoIP still has little name recognition among consumers.

Rather than technology, factors such as regulatory policy and broadband competition are the primary VoIP market drivers.

There is also a looming battle between traditional service providers delivering (and charging for) voice services and several Internet giants delivering (free) voice as an embedded application.

In-Stat forecasts that by 2009, there will be 55 million VoIP subscribers worldwide, generating over $17 billion in annual revenue.

Municipal Broadband Poses Growing Threat to For-Profit Operators

Incumbent broadband service providers could eventually see their revenues fall by as much as 48 percent due to competition from city-run broadband networks, Pike & Fischer's Broadband Advisory Services (www.broadbandadvisoryservices.com) posits in a new research paper.

The competitive threat from municipal networks is unknown, given that they are only beginning to emerge. But the report presents a model that projects the eventual impact of muni-broadband projects on incumbents' market share and revenue.

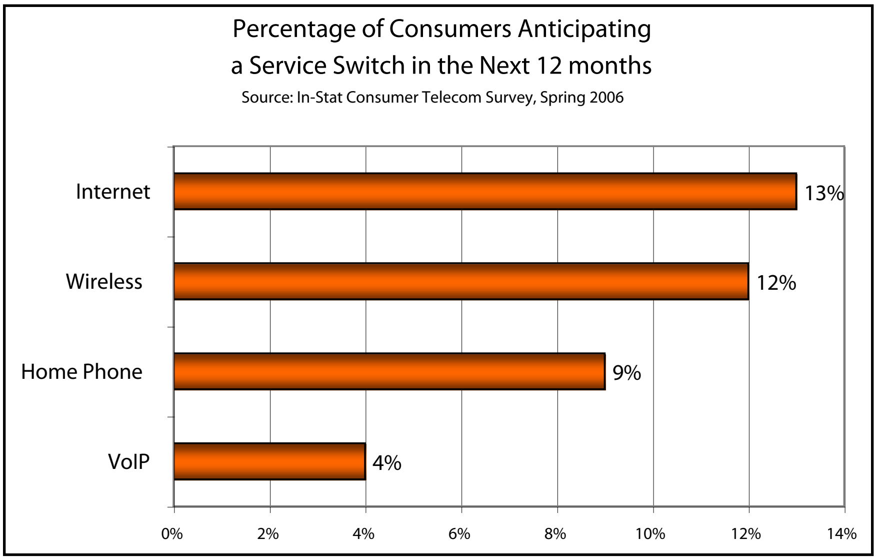
The analysis concludes that muni nets, depending on the broadband technologies used, could grab up to 35 percent of market share for video, fixed voice and high-speed Internet services, and up to 20 percent of the mobile-services market. The competitive impacts will be especially threatening to incumbents to the extent that muni nets can be cost-justified by increased efficiencies, cost savings and other 'internal' or 'social' benefits captured by local governments, schools and other public institutions.

Churn Burn – High Prices for Residential Communication Cause Customer Attrition

Nearly 10 percent of respondents to a new survey indicate plans to switch providers in the next 12 months; for Internet and wireless services, the percentage is even higher. In-Stat finds that, based on a telephone survey of US consumers with 752 respondents (fielded this spring), the majority of respondents are very satisfied with their communications service, whether it be home phone (local and long distance), wireless phone, Voice over IP (VoIP) or Internet. But of these services, responses indicated that anticipated churn (defined as customer attrition or loss) is still high.

High pricing is the primary driver, impacting roughly half of subscribing respondents for each service (except Internet, for which price is important to fewer respondents). In-Stat also finds:

- Relocation is comparatively a more significant churn factor for wireless versus Internet or home phone, as are poor bundling options.
- Quality of service, service offering, and convenience are, comparatively, more significant churn drivers for Internet than wireless or home phone.
- Compared to 2005 results, customer service and quality of service declined in importance, and lack of bundles increased as a churn driver.



According to In-Stat Consumer Telecom Survey results, respondents indicate the highest potential churn would be for the Internet, with 13 percent planning to cancel their service within 12 months. Wireless similarly has 12 percent of respondents planning to change service. Home phone has 9 percent anticipated churn and VoIP, again rather surprisingly given the reported high churn levels, has the lowest anticipated churn among respondents, at just 4 percent.

Churn creates a considerable expense for providers. Providers must continually campaign for new subscribers, not to grow the business, but simply to maintain subscriber levels. In-Stat research does show, however, that programs to increase subscriber "stickiness," such as promoting bundled packages and loyalty reward programs, do appear to have a positive influence in reducing churn.

In a report released early August, Yankee Group estimates residential broadband service providers should see the American market for voice, video, or data service will grow 32 to 35 million households for each of the next three years. In line with the new In-Stat survey (which shows Internet access to have the highest churn)Yankee Group suggests that high-speed data is the key to reducing consumer churn.

Yankee Group said its estimate on the number of new households constituting the annual opportunity market for broadband service providers includes households changing their current providers, households adding new services, and new households attributable to population growth.

Average spending during the subscription lifetime of each of these households will vary between $3,854 and $4,481 in the next 3 years, Yankee Group estimates. This leads Yankee Group to calculate the growth in annual service provider revenue for the U.S. triple-play market as increasing from $137.5 billion this year to $145.3 billion by 2009.