



# Wall Street Reconsiders Telecom - And So Should Congress

By Steven S. Ross ■ *Editor-in-Chief*

Investor interest in telecommunications revived somewhat in 2006. The S&P telecommunications index was up a whopping 33 percent – more than double the rise of the entire index. The AMEX telecom index recovered after a low last spring. And Verizon rose steadily all year. While it closed below its pre-FiOS high of around 40, it was up to its early-2004 levels.

The rise was steady and strong all year, and had little to do with the Christmas Season gifts bestowed by the FCC with regard to video franchise reform and net neutrality – although it rose further after the start of the new year.

Does this mean that Wall Street has discovered the virtues of investing in fiber to the home? We think not. Thus, it is time – past time – for a national telecom policy.

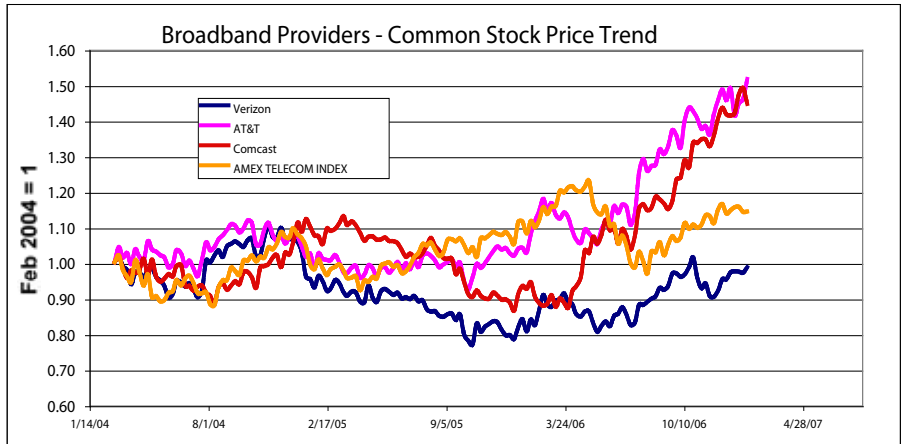
Over the past five years, telecom stocks have lagged so far behind the broader market that an uptick was due sooner or later. And AT&T and Comcast, which are improving their networks but not generally doing FTTH overbuilds, performed even better. What's more, the investment community talks more about mobile services than about fixed broadband – not entirely realizing that mobility is based on fiber backhaul and that high-bandwidth mobility is more easily implemented if there is fiber everywhere.

But it may mean that investors are less hostile to the whole idea of broadband in general and fiber in particular. For that to happen, investors had to start believing that the stocks had bottomed out, and have no place to go but up despite telecom's huge capital expenditures.

The success of AT&T and Verizon to get customers to sign on to the highest tiers of their video and broadband Internet services is one reason. Lower future operating costs with fiber compared to copper are another.

## Independent Telcos Contribute to Growth

But we could not help but notice that the



gathering strength extends to smaller telcos. As we detail in this issue, the smaller telcos are going for fiber – and particularly fiber to the home – in a big way. Investors in smaller companies are concerned that the companies keep up to stay in business, so the cost of fiber is sometimes seen as a plus. Their success is reflected, for instance, in the steady rise of the AMEX telecom index. It doesn't match the rise of generally larger-cap S&P stocks, but it has done well.

This is despite the fact that smaller telcos are not merely cherry-picking upscale greenfields. In fact, many greenfields are being picked off by an entirely new class of fiber-only providers exemplified by Zoomy Communications and Connexion Technologies. For non-RBOC telcos, only a third of the new builds over the past five years have been greenfields.

Almost all of the non-RBOC telco builds over the past five years involve video – an entirely new business for most telcos. In fact, 20 years ago, they would have been barred under federal regulation from even offering video without special FCC exemption.

Highlighting fiber's low operating costs, about a third of the FTTH builds have been to upgrade old copper plant. Fiber's ease in service adds an extra margin when they go to the bank to say they want to spend money on plant to get into an unfamiliar business, and

that this is a much better bet than simply repairing or replacing old copper.

The last third of the builds have been in direct competition with other providers, proving again that fiber competes well with coax. Verizon has been saying that for years of course. But Verizon has deep enough pockets to offer the latest in bells and whistles – a classy interface, video on demand, local weather and so forth. The smaller telcos are, more often than not, doing video much like the cable companies have been doing it. The promise of a slightly lower price, perhaps, or much greater reliability, has been enough to make subscribers switch from cable.

It is little wonder, then, that Verizon is exceeding its customer growth expectations? We might add that AT&T is as well.

The lesson is plain: FTTH is a good bet for telcos and their customers – and increasingly, for investors – even without help from the regulators. But again a solid, rational, and well-considered national broadband policy will make it all happen much faster. **BBP**

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