

Review of 2010: Telecoms Bounces Back – a Little

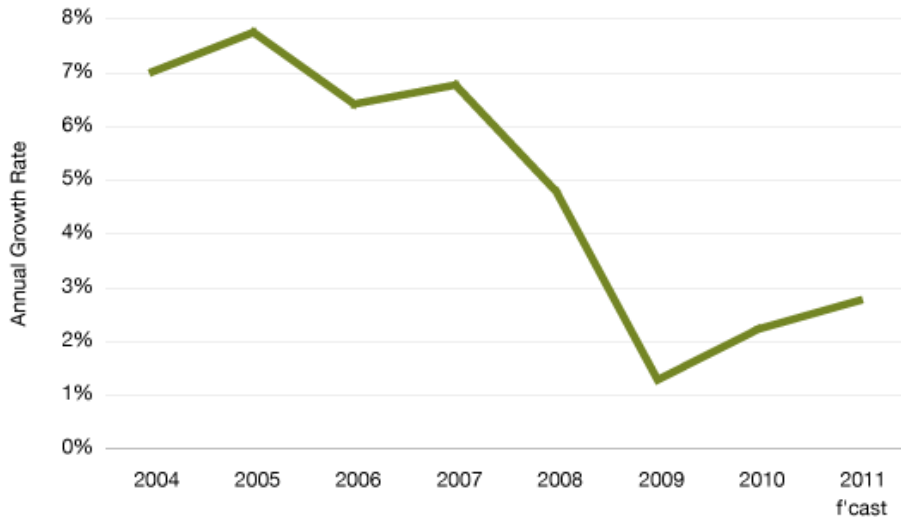
TeleGeography Opinion

Looking back on 2010, TeleGeography sees three themes that dominated the telecoms world: post-recessionary market growth (though ‘post-recessionary’ is a debatable point in many countries); a marked increase in M&A activity; and a boom in smartphones, mobile apps and wireless broadband.

With ARPUs continuing to fall across the board, the robust subscriber growth seen in 2010 did not translate into substantial growth in service provider revenues, although revenue growth rates did bounce back a little from the trough experienced in 2009. Gradual improvement in financial results and business prospects were reflected in higher levels of business development oriented M&A activity, however, with a number of other M&A deals and major internal reorganisations motivated by a need to improve profit margins. Meanwhile the biggest spark in the market was undoubtedly the burgeoning growth of data-oriented mobile applications, evidenced by wider 3G take-up, upgrades to 3G networks, Long Term Evolution (LTE) launches, booming smartphone sales and the iPhone/iPad phenomenon.

Beyond that, the Asia & Pacific region continued to dominate global subscriber additions; the Western European market remained very firmly stuck in the doldrums; VoIP continued its prodigious growth; and cablecos continue to beat up on telcos. Issues vying for the award for ‘most talked about topic with the least discernable progress’ included net neutrality, fibre deployment and stability in the Indian market.

FIGURE 1
Growth of Telecoms Service Revenues, 2004-2011



Notes: Growth rate is calculated based on revenues measured in local currencies.

Source: TeleGeography Research

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Expect more of all of the above in 2011. Keys to the long-term health of the telecoms industry are revenue levels and profit margins for service providers. TeleGeography predicts that the growth rate for telecoms service revenues will nudge up again in 2011, though only by half of a percentage point. Aided by continued industry restructuring and a slightly improved economic climate, profitability should improve also.

4G, in the guise of LTE, might just turn out to be a technology which manages to live up to a fair amount of the surrounding hype. While subscriber numbers will remain very small during 2011 (with 3G and pseudo-4G networks stealing the show), a groundswell of LTE-related activity is rapidly building and the future looks positive.

Data and Analysis

Market Growth

On the market growth front, the good news is that it was not as bad as it might have been. After 2009, when global telecoms revenue growth was at a low of just over 1%, 2010 saw global growth increase by a full percentage point to some 2.2%. That is still a little out of kilter with the long-term growth trend in the market, and TeleGeography predicts some further mild improvement in 2011 – for ‘mild’ read sub-3% annual growth.

In 2010 Africa was the highest growth region, a fact that was helped by it being both the smallest and the least developed market. Telecoms service revenues in Africa grew by a fraction under 10% in 2010. Asia & Pacific was again the region with the largest telecoms service revenues and it also grew by over 4%, almost double the global average.

Subscriber growth rates were once again robust in 2010 (generally speaking they were little affected by the recession), with double-digit growth in broadband and wireless, almost 40% growth in 3G subscriber numbers and 35% growth in IPTV households. 2010 saw the addition of almost 640 million net new wireless subscribers to reach a global total of 5.3 billion; while broadband subscribers increased by 55 million to reach some 530 million.

FIGURE 2
Wireless and Broadband Subscriber Growth by Region, 2010

Region	Wireless		Broadband	
	Subscribers (m)	Annual Growth	Subscribers (m)	Annual Growth
Africa	536	19%	6	30%
Asia & Pacific	2,583	20%	213	13%
Eastern Europe	458	4%	36	17%
Latin America	562	10%	41	19%
Middle East	286	11%	15	16%
U.S. & Canada	317	6%	97	8%
Western Europe	524	1%	120	7%
Grand Total	5,267	14%	528	12%

Notes: Subscriber figures are forecast year-end 2010 numbers based on Q3 2010 actuals.

Source: TeleGeography Research

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The improvement in revenue growth rate was enabled by a slow-down in the erosion of ARPU levels. As recessionary pressures eased and service providers struggled to reduce their dependence on price as a competitive differentiator, the trends in ARPU started to look a little rosier. Producing meaningful statistics by aggregating and averaging ARPUs across multiple countries and regions is a tricky proposition; nonetheless, on a global basis TeleGeography calculates that wireless ARPUs fell by around 8% in 2010 compared with a 12% reduction in 2009.

Mergers and Acquisitions

2010 saw a distinct uptick in the level of M&A activity, with no less than nine of the top twelve service providers involved in multi-billion dollar deals. Major telecoms deals that closed in 2010 had an aggregate value of almost USD100 billion. The nature of the biggest deals ranged from acquisition, through consolidation and merger to asset disposals. The main driving forces behind the activities were:

- Bulking up of international operations to drive revenue growth – e.g. Bharti, Telefonica
- Increased scale to improve competitive strength and financials – e.g. America Movil, Telefonica, KDDI, T-Mobile UK & Orange UK, Vimpelcom & Kyivstar
- Divesting non-strategic assets or minority holdings to sharpen corporate focus – e.g. Verizon, Vodafone

FIGURE 3
Examples of Major M&A Activity, 2010

Main Country/ Region	Details	Status 12/31/ 10	Value (USD billion)
Japan	KDDI secures 31% stake in J:COM from Liberty Global	Closed	4.0
Africa	Bharti acquires Zain's operations in 15 African countries	Closed	10.7
Latin America	America Movil absorbs Telmex and Telmex Internacional	Closed	2.1
Brazil	Telefonica acquires Portugal Telecom's 50% stake in Vivo	Closed	9.8
China	Vodafone sells its minority stake in China Mobile	Closed	6.5
Switzerland	TDC sells Sunrise to CVC Capital Partners	Closed	3.3
Japan	Vodafone sells its minority stake in Softbank Corp	Closed	4.8
Russia, Ukraine	Russia's Vimpelcom and Ukraine's Kyivstar merge	Closed	22.0
United Kingdom	France Telecom and Deutsche Telekom deconsolidate and merge UK operations	Closed	–
United States	Verizon sells fixed line assets in 14 states to Frontier Communications	Closed	8.6
Brazil	Embratel acquires remaining shares of cableco Net Servicos	Closed	2.6
Germany	Telefonica acquires Telecom Italia's broadband unit HanseNet	Closed	1.3
United States	Windstream acquires NuVox, Iowa Telecom Services, Q-Comm	Closed	2.5
Greece	Wind Hellas taken over by group of creditors	Closed	–
UK, Global	Cable & Wireless completes demerger	Closed	–
United States	CenturyLink and Qwest to merge	Pending	10.6
Brazil	Portugal Telecom agrees to buy 22% stake in Telemar Norte Leste (Oi)	Pending	4.8
Middle East, Africa	Etisalat bids for 46% stake in Zain	Pending	10.5
Russia, Italy, Africa	Vimpelcom and Weather Investments (Orascom & Wind) agree to merge	Pending	7.0
Denmark	Private equity owners of TDC announce IPO plans	Pending	2.9
Ukraine	Government to sell 93% stake in Ukrtelecom	Pending	1.3
Russia	MTS to merge with Comstar	Pending	1.0
Russia	Reorganisation of Svyazinvest, Rostelecom and seven regional operators	Pending	–

Source: TeleGeography research

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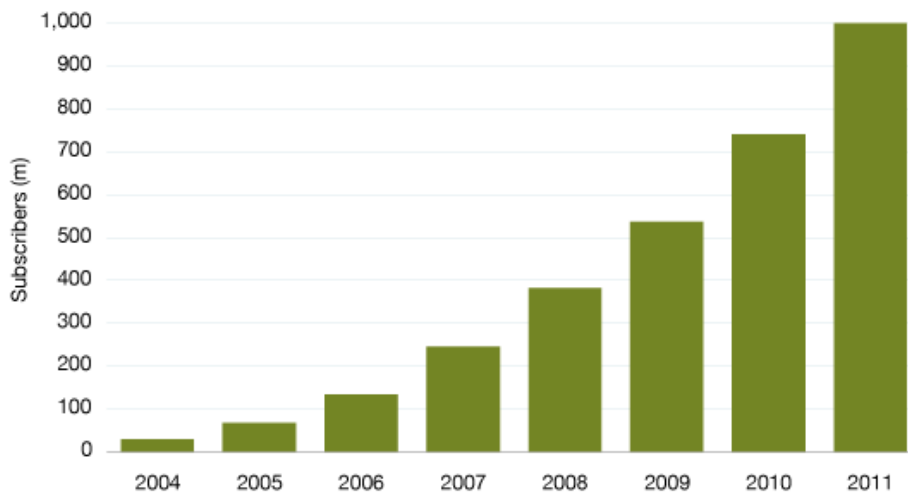
While some of these deals had the effect of reducing reported revenue, in aggregate M&A activity helped to boost quarterly revenue of the top 30 service providers to around 3% above the levels seen a year previously. TeleGeography believes that the pace of M&A activity is likely to increase in 2011. At the outset of the year there were already some USD60 billion worth of deals at various stages of planning or closure, some of the larger ones involving Etisalat, Qwest, Vimpelcom and Portugal Telecom.

Wireless Broadband

A key feature of the global market in 2010 was the proliferation of smartphones, mobile apps and mobile data. As Android phone sales took off, Apple just went from strength to strength. It virtually doubled its already impressive iPhone-related revenues and at the end of 2010 it passed the USD10 billion per quarter mark. Thanks in no small part to Apple, wireless service providers have become increasingly reliant on data and non-voice apps to drive their own revenue streams. AT&T, for example, now derives 35% of its wireless service revenues from

data; the respective figure for Vodafone in its European operations is 31%. On the 3G front, despite a very late start in India and a relatively slow start in China, subscribers globally reached some 750 million at the end of 2010, having grown by over 200 million during the year. TeleGeography forecasts 3G subscriber growth of well over 30% during 2011, with the two billion subscriber milestone to be passed in mid-2014.

FIGURE 4
3G Subscriber Growth, 2004-2011



Notes: 2010 figure is a forecast based on Q3 2010 actuals.

Source: TeleGeography Research

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Meanwhile, with bandwidth-hungry phones and applications taking off, service providers looked to meet the demand and ease traffic constraints by launching 4G networks. By the end of 2010 there were 17 live LTE networks in commercial operation, including flagship launches in leading countries such as the United States, Japan and Germany. TeleGeography expects to see some 60 live LTE networks in place by the end of 2011, which will include major launches in Russia, Italy, South Korea and Spain. However, with 3G growth remaining strong (helped in part by HSPA+ capabilities that improve available bandwidth) TeleGeography is not expecting a precipitous take-off in LTE subscriber numbers; it will be 2013 before LTE accounts for 1% of all wireless subscribers globally.

The other side of the 4G story is WiMAX – its subscriber base more than doubled in 2010 to reach eleven million. However, despite TeleGeography forecasting that this figure will treble in the next five years, the numbers will remain small relative to mainstream cellular technologies. While WiMAX can be used for mobile applications, in most instances it is being used to support fixed or nomadic applications, which severely limits potential subscriber numbers.

There was one development in 2010 which was not so good for consumers. In the world of burgeoning mobile apps, wireless operators figured out that all-you-can-eat mobile data packages did not make good commercial sense. Caps on data usage with extra fees for

exceeding limits are becoming the new norm. AT&T, chastened by its iPhone experience, scrapped its old data plans for new customers in mid-2010.

One final note on wireless broadband – the wireless industry shot itself in the foot by proving itself totally incapable of setting and policing standard definitions. 2010 ended in an unseemly rush by some operators to label their wireless broadband service offerings as ‘4G’, irrespective of whether or not they met previously agreed technical standards. Instead of effectively policing the issue, the ITU wimped out. The results are erroneous marketing material and consumer confusion. This does not help the industry.

Other Key Events (or Non-Events)

Outside of the above three areas, other notable aspects of 2010 included:

- **The continued rise of the Asia & Pacific region** – remarkable subscriber growth was again experienced in India and China. In aggregate these two countries alone added well over 300 million wireless subscribers during the year. With quarterly revenues of USD19 billion, China Mobile is now firmly established as the world’s sixth largest service provider and it’s closing in on its two nearest rivals. Big subscriber additions were also seen in Indonesia, Vietnam, Bangladesh and many other countries in the region
- **Western Europe continued to struggle** – it is the most highly developed market with the lowest growth rates, and for the second successive year it experienced a reduction in telecoms service revenues. Looking ahead over the next five years, the region will be flat in terms of revenue generation, resulting in an aggressive dog-eat-dog market for its local operators
- **India can not seem to get it right** – despite hugely attractive subscriber growth numbers, India remains a chaotic market in which it is enormously difficult to build a profitable business. Politics are a huge barrier to progress; there are too many wireless competitors but consolidation is virtually impossible; and the licensing regime is slow and illogical. The market is now mired in a probe over licence award irregularities
- **The decline of wireline subscribers** – 2010 saw a 5% reduction in global PSTN lines that was only partially offset by an increase in telco and cableco VoIP subscribers. Wireline subscriber numbers will continue to fall
- **The use of computer-based VoIP services continued to skyrocket** – Skype’s international traffic grew by some 80% to reach 102 billion minutes in 2010. According to TeleGeography data, aggregate international call volumes for all traditional global carriers was only four times that achieved by Skype
- **Last-mile fibre deployments continued at a glacial pace** – despite well over 20 years of intense discussion and debate over the use of fibre in local networks, LAN/FTTx still accounts for only 12% of global broadband subscriber numbers. This number will change only slowly over the coming years
- **Interminable debates about net neutrality continued** – while many impartial observers either lost the plot or lost interest, there was at least some movement. Chile became the first country to guarantee net neutrality, while in the U.S. the FCC finally approved a set of net neutrality rules. Thanks to political interests and strong lobbyists, expect to see a deathly slow process over the coming years that will result in anodyne rules and regulations
- **Cablecos continued to eat into the wireline market at the expense of telcos** – globally cablecos now have some 95 million broadband internet subscribers and 63 million voice subscribers. Despite the fall in global wireline subscribers, cablecos continue to grow their voice customers by some 13% per year
- **Telcos struck back at cablecos via IPTV service offerings** – at the end of 2010 telcos had a tally of 44 million IPTV subscribers. However, as their IPTV ARPUs are much

lower than the broadband and voice ARPUs achieved by the cablecos, telcos continue to lose substantial revenue to their cable TV rivals

- **Increase in intra-company mergers of fixed and mobile units** – enabled by fixed-mobile convergence, companies are seeking to cut costs and employee levels. There were many examples including leading operators in Austria, Brazil, Colombia and South Korea

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