

"Returning To An Age of Reason"

Alistair Grieve

Chief Executive Officer, Reach

11.07.01

Thank you.

I am grateful to the organizers of this event for their letter to me a few weeks ago, which gave me some guidance for the theme of this speech. Some of you may have received the same letter. It opened by saying that Japan is a "landmine of opportunities". This was probably a simple typing error, or perhaps something was lost in the translation. The writer had, of course, almost certainly meant to say Japan is a "land of opportunities", or maybe that Japan is a "goldmine of opportunities". Landmines are not things normally associated with opportunity. They are generally associated with blowing your leg off. Nasty!

Strangely, this small error may have accidentally hit upon a truth about the state of our industry today, not just in Japan but globally. An industry which many thought was a gold mine has turned into a minefield.

The minefield is, on a daily basis, blowing up those who only recently felt invincible. It is becoming littered with dead and badly wounded companies.

No sector of the global telecoms industry has been immune. The first explosion from the minefield was the one made by the bursting of the Dotcom valuation bubble. The reasons for the irrational escalation in market capitalisations of these companies, and the inevitable consequences, will fascinate future generations in the same way that the Dutch Tulip speculation of 1637, the South Sea Bubble of 1720 and the race to lay railways in the nineteenth century continue to be a source of interest even today.

Had the madness begun and ended with the Dotcom situation, then maybe the world would have been allowed to quietly get back to normal, with the Internet being relegated to its rightful place as an extremely useful and steadily evolving tool, rather than something which would completely and irrevocably change all of life on earth. Some economists and bankers who believed, or told us they believed, that the basic rules of economics had changed forever might have been persuaded to get off their bandwagon, put their brains back in gear, and retire to a life of luxury provided by

their personal fortunes. But it was too late. Others had, by then, jumped on the bandwagon.

Among them were the promoters of 3G. GSM equipment manufacturers were under pressure to find ways of maintaining their high levels of growth into the long term. This requirement was perfectly satisfied by a new wireless data technology which promised to combine mobile growth with internet growth. Governments, bankers and operators were duly persuaded of this wisdom, and we all know the rest: The 3G spectrum auctions in Europe sucked over 100 billion US dollars of financing capacity out of the telecoms industry. 100 billion may not seem like a lot of money compared to the combined market capitalisations of all the European cellular operators at the time, but I do wonder whether the managers of the operators temporarily lost their presence of mind and forgot the difference between market cap and cash. You might wonder equally at the sanity of their external advisers who assured them that not getting a license was certain death for their stock prices. And, we have to wonder at the sanity of those who happily lent the money.

Would they do it now? Would the operators pay so much cash for spectrum? Would they be told by investment bankers and consultants that failure to acquire spectrum was not an option? Would banks happily lend these huge amounts without a much more critical look at business plans and credit ratings? Of course they wouldn't. So why did they do it a year ago? The consequences of this have been severe for many of the European operators, for example KPN and BT, although we have not seen actual bankruptcies among these titans. But the knock-on effect of the removal of so much liquidity from the industry has had worldwide consequences. Telecoms operators, whether they are cellular operators, local access network operators, internet service providers, Dotcoms, or Internet Data Centres - whether in Europe or the Americas or in Asia - are all finding it very hard to raise further funds.

So, while the mightily profitable European cellular operators are still afloat, there is many an Asian startup company in dire financial straits which could justifiably claim that its inability to raise further rounds of financing is, in part at least, a consequence of this folly on the other side of the world, with its ludicrous accompanying cast of "games theorists" who have had their five minutes of fame. Let us hope they spend the rest of their lives in the deep obscurity from whence they came. Asian governments are to be lauded for not being less ready to be seduced by the easy riches of 3G spectrum auctions – or was it that they were just a few months too late?

So much for 3G and its consequences. Network infrastructure providers are another major element of the industry to be badly affected as a knock-on effect of the hubris and nemesis of the Dotcom sector. The reasons are many. Firstly, the forecasts of endless exponential demand growth for bandwidth that were being made a couple of years ago have turned sour, as the new customers of the infrastructuralists - the internet companies - failed to generate as much traffic as had been hoped. Those same companies are now also facing financial difficulties, and cannot afford to pay for the bandwidth. Secondly, broadband local access has been much slower to take off in every country, with the possible exception of Korea. Thirdly, I believe many

business plans did not take sufficient account of the number of competitors who emerged around the same time. Fourthly, and putting it simply, there was just too much money available to be borrowed, which stimulated an excessive number of competing infrastructure projects and a pace of growth in supply which far outstripped demand. And finally, technology; the advent of Dense Wavelength Division Multiplexing has multiplied capacity a hundred-fold. I note that a couple of weeks ago Bell Labs researchers announced they can now push the capacity of a single fibre up to 100 terabits per second. A great achievement. But I do wonder how much use that will be in the medium term given that in North America only about 5 per cent of the potential total capacity of current networks is actually lit, and of the lit capacity, probably only about half of it is in use. We may have to wait a number of years before these technology developments can be usefully exploited.

Telecoms companies have run up colossal debts. Their market values have collapsed and many have filed for bankruptcy. Since 1990, 47 public telecoms companies have gone bankrupt. What makes that figure astounding is that more than *half* of the 47 filed for bankruptcy in the past year. In the same period hundreds of private companies also folded. Wall Street analysts put the total US industry debt level at about 600 billion US dollars. About 20 percent of that debt is thought to be troubled. International ratings agency Standard and Poors reports that in 1990, 92 per cent of all telecoms companies globally enjoyed investment grade ratings. Today, only 17 per cent enjoy such a rating. Twenty per cent of all global bond defaults this year have been in the telecoms sector. It's highly likely that over the next year or two that figure will grow considerably.

The exuberance which resulted in the overbuild of fibre infrastructure has been matched in the Internet Data Centre sector. Here again, supply greatly exceeds short-to-medium term forecast demand. Again, predictably, we witness the now familiar story of companies which took on high levels of debt to build data centers, failed to attract business, and are now unable to survive. It is very surprising that, given the general acceptance that the sector is massively over-built, companies are still pouring money into new construction! Maybe the best business to have been in recently is making computer flooring, UPS systems, and bashing sheet metal to make equipment racks!

But unfortunately, even if they did this, the manufacturers have not escaped from the carnage. In this sector, too, profit warnings, massive write-offs and staff layoffs have recently been industry norms. Nortel, Lucent, Ericsson, Marconi, in fact, just about all the big names in the industry have had serious problems. Across the entire technology and telecoms sector almost 237 thousand jobs have been shed since January, most of those from the manufacturing sector.

It seems that all is gloom and doom. But while it is certainly true that growth has not matched the levels which were being forecast two years ago, we can take heart that our industry is still growing at a rate which would make most other industries extremely envious. We will continue to be faced with another period of uncertainty, but the next 12 months will also be a time of consolidation. Some companies will not

survive and there will be a flight by customers to stability and quality which will make life even more difficult for the recent entrants, and will give some relief to well-established carriers, especially incumbents. A new equilibrium may be achieved in markets such as IDD telephone service.

There will be more good news as we look forward to the eventual success of broadband local access networks. It has been rather depressing that in spite of our high hopes for the replacement of dial-up internet with ADSL and cable modem high-speed access, we have not yet seen satisfactory growth in this service. There have been some exceptions, such as Korea, Hong Kong and Singapore, where broadband local access penetration is about 18, 10, and 9 per cent of households connected respectively, but in most other markets –the larger markets - it has undoubtedly been slow. The US, Japan and European countries have to date achieved per-capita penetration levels of only between 1 and 3 per cent. In former times international capacity was the bottleneck – its scarcity and high cost led to expensive international communications. Suddenly, however, with the advent of very high-capacity cables, the bottleneck has been reversed. It is now in the local network. This will be rectified but it is taking time. We look forward to Japan leading the way with the development of economic fibre to the home systems, opening up the possibility of true broadband communications for everyone, not just businesses.

We at Reach see these broadband local access networks of the future as vitally important feeder systems for our international broadband network.

Reach's objective is to take its experience in managing a wide range of assets and creating a range of services for our wholesale customers to offer to their retail customer bases. Our objective is to work with the full range of wholesale customers, from ISPs, Mobile Carriers, Challengers, Incumbents and other global carriers. We see little long-term wealth generation in selling slabs of capacity. Although I'm not saying we won't do this, it will be purely a component of a wide-ranging product and service portfolio. With a major industry shakeout happening, it is almost impossible to replicate in the data world the same level of bilateral relationships that are still strongly evident in today's voice world. Bilateral frame and ATM have been unsuccessful and, in highly competitive markets, traditional IPLs are also being replaced by end to end services. In the retail telecommunication markets, customer ownership on a global basis is the Holy Grail, and we have many players with varied success rates. Generally, and in desperation, those carriers have turned half-heartedly to wholesale – whilst at the same time competing fiercely with those same carriers for the same customers.

What then is Reach's approach to this changing market? Reach is planning to have a wide portfolio of services, from our traditional voice services through to IP Virtual Private Networks. In terms of our product and service objective, it is fairly straightforward and simple. Firstly, we are focused on providing end-to-end managed service with service level agreements and rebates for non-performance across our services. In fact we are planning to offer customers a range of service packages that will meet their needs from a price and quality perspective. Secondly, in order to

achieve this objective of managed end-to-end services, we will continue to team up with like-minded wholesale carriers and work closely with them for seamless service delivery and quality. Unlike some of our competitors, we will build a global network on a “door” to “door” basis, using our expertise in network management, customer care, operations, and partners to deliver these services.

Let me take a minute to provide a quick overview of our services. Reach is a full international service carrier offering business enablement services, from Carrier Hotel facilities, managed routers, high quality IP connectivity to the global internet, Frame and ATM services, broadcast and satellite services, dial access, and an increasing range of IP Value Added Services, such as Global Roaming Exchange - when the much anticipated if not somewhat disappointing mobile data services begin to add real value to mobile users. Shortly, we will announce our technology partner for what we expect to be a major future service for Reach - a network based IP VPN service providing a range of quality-of-service options. We are also excited by the expansion of broadband content in the region and we are looking for the day when the USA is not necessarily the center for international content.

Fortunately for Reach, unlike some of our competitors we have the right kinds of legacy assets, and in the case of our IP backbone we will be going to a single global AS number providing the perfect springboard for future global services. While we acknowledge interprovider VPN services are still a challenge, we are confident that our partnering approach, combined with our strength in Asia, and ability to provide high quality managed end-to-end services, is key to the success of a new age data wholesaler.

So, while we will be stepping around the landmines, we won't be missing the opportunities. We are cautiously evaluating the risks, especially in the Japan market. It has been difficult for foreign companies to make an impression on this market over the past 20 years. The situation has indeed inexorably changed, but for better or worse depends on your point of view. Personally, I find this country an enormously exciting place to be. Japan can learn from the mistakes already made, and get it right. This country made a false start in the race to get fibre to the home in the mid 1990s because economics got in the way. The economic problems of the 90s are now being resolved. I firmly believe that Japan will become a global leader in fibre to the home because the key to doing that is to drive costs down. This country has a unique capacity to get the costs of terminal equipment low, and there-in lies all sorts of opportunities for Japanese manufacturers, not only in domestic markets, but overseas as well. Reach is primarily an Asian carrier and we are committed to Japan as Asia's largest market. We are here to make friends, to meet new customers, and to investigate potential business opportunities with like-minded carriers. Reach is cashed up, we have good revenue flow, we have customers, we have experienced staff, and we have measured, achievable ambitions.

Our corporate mantra is “Under-Promise and Over-Deliver”; our Vision, to be one of the top global connectivity providers, leveraging a strong Asia-Pacific presence.

Thank you.