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**Global Operations Engineering Services**

# New Business Models - From the Good Old Days to the Current Daze

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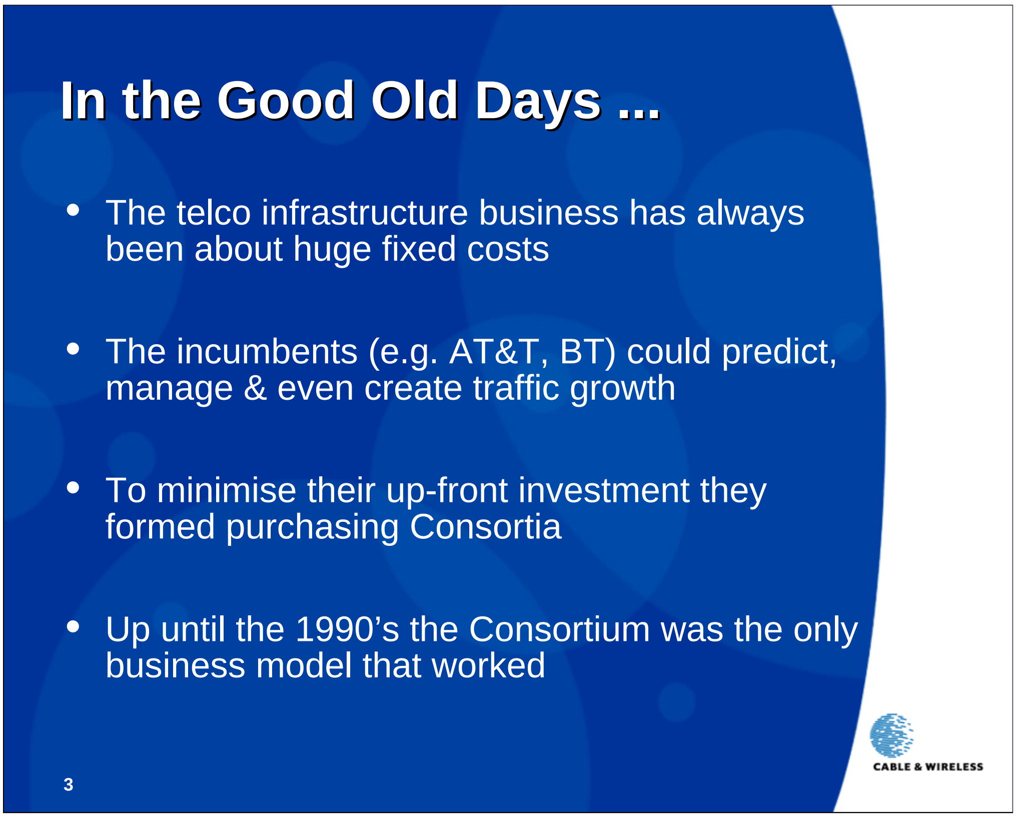
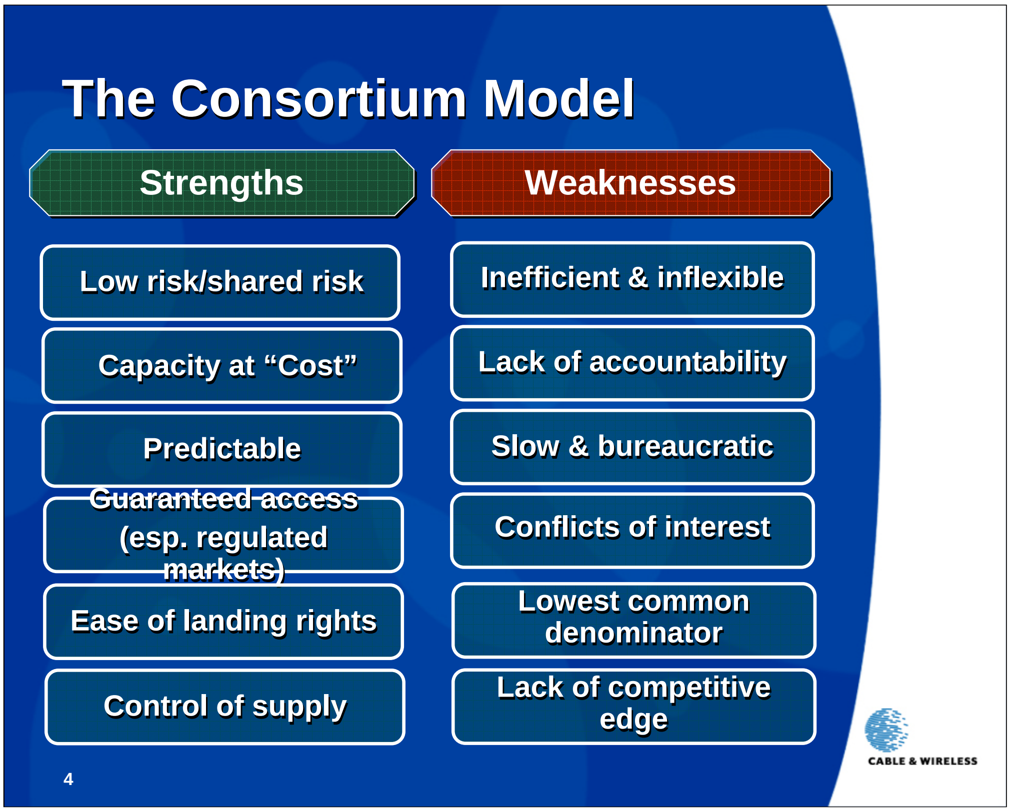



The organisers originally asked me to talk about developments over the past 20 years, but when I looked back, it's really only since 1990 that anything different has happened in terms of ownership models for major submarine systems.

Before that, the incumbents got together and, based on their shared views of traffic forecasts, they could provide as much - or as little - capacity as they wanted.  This lead to a managed market.

The size of the initial investment, coupled with the lack of visibility of demand outside of the incumbents, were formidable barriers to entry for anyone not in this exclusive "Club" - hence the dread title

of "Club systems".




Even though many people talk disparagingly about Club systems, they do have some advantages, and it would be foolish to ignore the reasons why they came about and why, in some markets, they can still be the best solution.

Some of these strengths are self-explanatory, but of particular note going forward is the issue of “guaranteed access”.  Club systems generally - certainly if they land here in the US - have to be open to anyone who wants to - and can afford to - join.  This means they are not anti-competitive, but of course it also means that there are lots of parties involved.  Guaranteed access here however also means that by having a party within the system, the system is guaranteed access to that country.  This is particularly important still in the Asia-Pacific region where regulation is still a barrier in some countries.

Indeed, the strengths of the Club / Consortium model are such that it is still a solution for some good “ole” boys  - TAT 15 !?
We shall deal with some of the weaknesses of this model in more detail later in the presentation, when I share with you some of the Cable & Wireless views on how to move the Market forward.

## From the Good Old Days ...

- 1991 saw the first “Private” cables built
  - PTAT-1 (Private Trans-Atlantic Cable)
  - NPC (North Pacific Cable)
- The mid-1990’s saw further developments
  - FLAG
  - Gemini
- FLAG: funded by a carrier and a collection of banks - now in Chapter 11 - success of this model unclear!

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Cable & Wireless - despite being described by some people who should know better as “old time incumbents” - has a long record of pioneering new structures and new ways of building submarine systems. I guess, given our history which stretches back to the very dawn of the submarine cable era, it’s inevitable that we should be tarred with the “old timer” brush.

But let’s just consider 1991 in context.

As I mentioned earlier, up until then the major trans-oceanic routes were the unchallenged domain of the existing incumbents. In 1991 that all changed with the introduction of the first private cables across both the Atlantic and the Pacific, and Cable & Wireless was a major owner in both of these developments. C&W saw that it was a good time to take the risk - you could also say that, to some extent, we were forced to - and I’m very pleased to be able to stand here now and tell you that both of these systems were commercial successes.

The same is also true of Gemini, another trans-Atlantic system with C&W involvement, although it is not perhaps so clear that FLAG is going to run its course.

## Early Private Systems

- **PTAT-1**
  - a 50/50 joint venture between C&W and Sprint, wholly funded by the partners
- **NPC**
  - a Joint Venture between C&W, IDC and PTC, again wholly funded by the partners
- **Gemini**
  - a special purpose company created, owned 50/50 by C&W and MCI Worldcom. This was the first system off balance sheet, funded, in part, by debt

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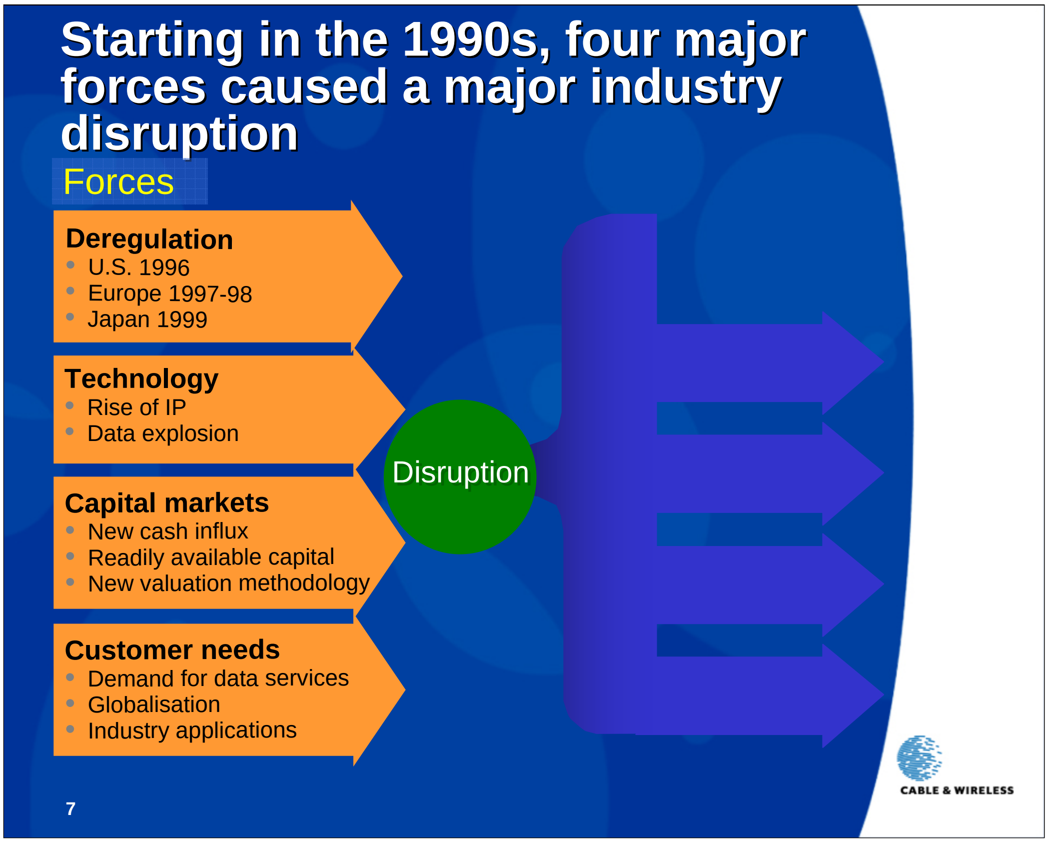
PTAT-1 runs from the UK to the US with landings in Ireland and Bermuda on the way. Although nowadays it is considered old technology, at the time of its introduction it was considered cutting-edge, as was its trans-Pacific equivalent, NPC.

Both PTAT and NPC are still operating, and generating revenues, today. Both of these systems, although nominally “private”, were in fact consortium systems, the only difference being that the consortium was limited to just two or three players. So they were “private” in the regard that they were not open - in terms of ownership - to all comers.

Gemini was another step forward because it was the first system (to our knowledge) to be funded, at least partially, by commercial debt. Gemini is a Bermuda-based company, with its own accounts, run for the benefit of its shareholders. It was able to pay off its debt much earlier than anticipated, which in no small part lead to it being another commercial success story.

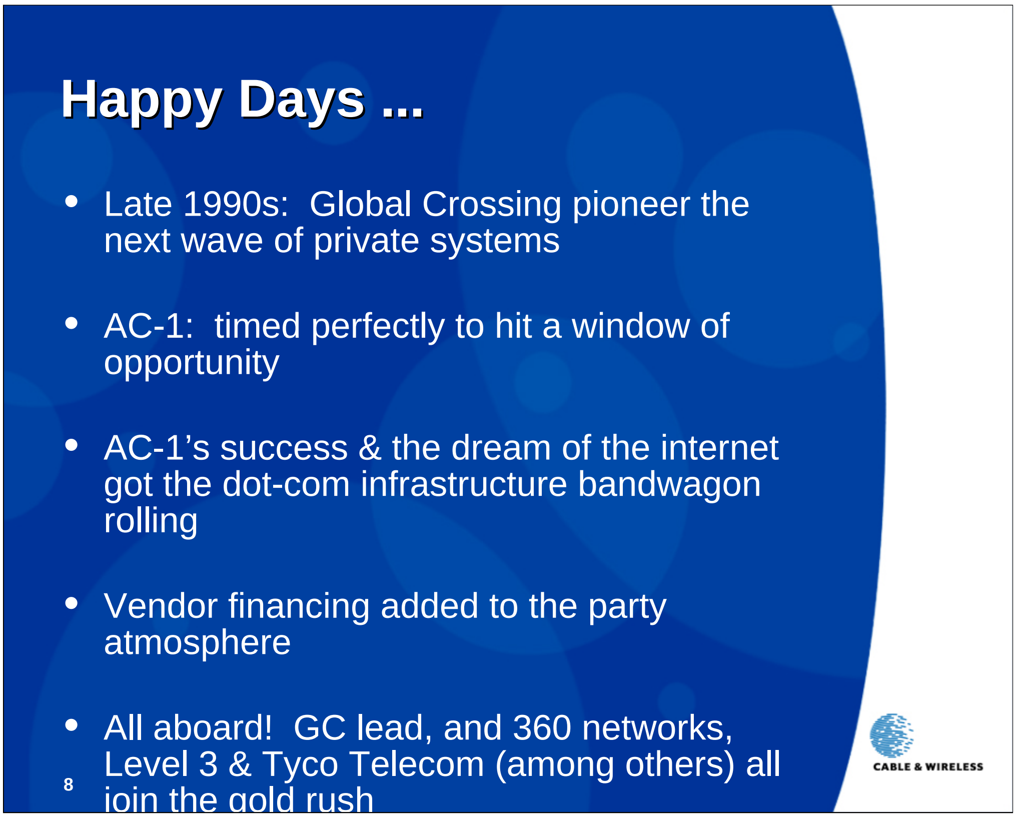
Once again, C&W played a key role in developing this new financial model, which had not been seen before in our industry.




The horizon of the good old days, when the Clubs were impregnable, began to shorten over the course of the 1990's, as we now all know. For some - indeed, many - people, these forces combined to create a window of opportunity that was too enticing to ignore.

De-regulation was opening markets to new entrants and taking away one of the significant barriers that I mentioned earlier.
At the same time, technology was developing at such a rate that previously unheard-of unit costs were now routine, and demand for capacity was exponential.

The capital markets were quick to see this combination of increasing demand and decreasing obstructions and a flood of money became available for all sorts of telecom / dot-com projects.
Now, hindsight is a wonderful thing, but who among us would have spurned the opportunities that this congruence of events seemed to present ? In the mid-1990's, this disruption was a good thing, as we shall see - it promised to lead to a land of milk and honey !

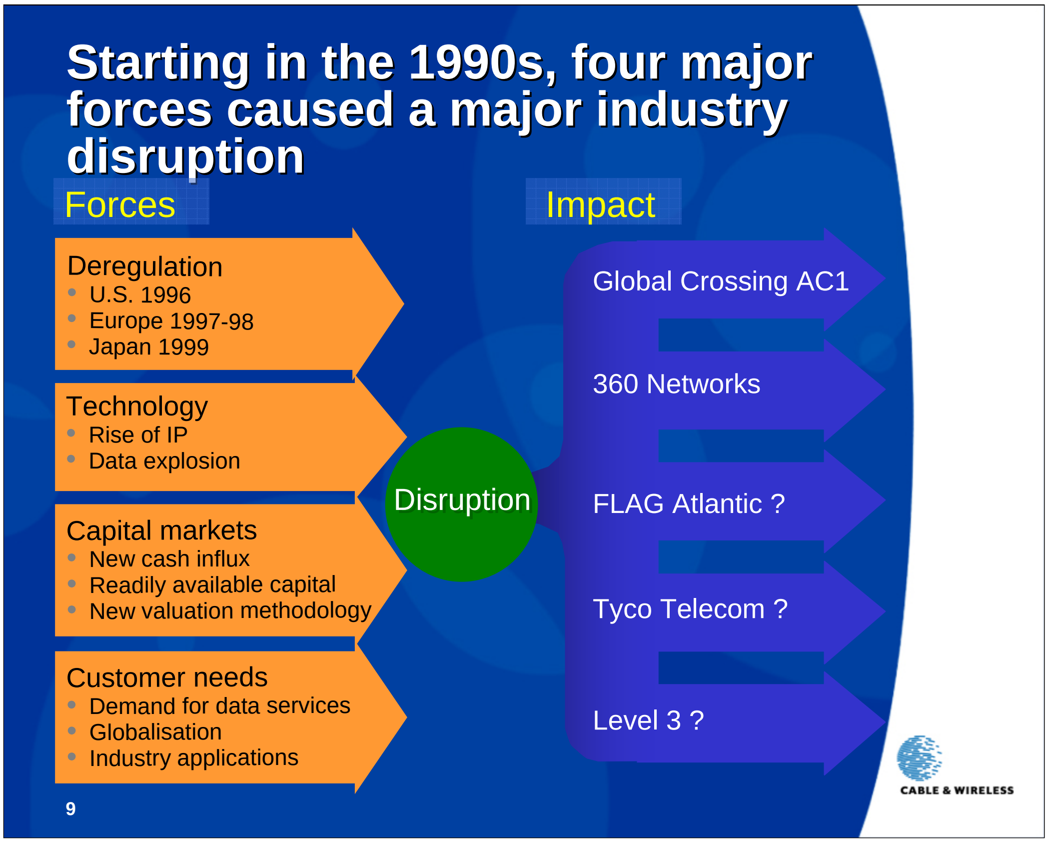



Not only would Cinderella finally get to go to the ball, she would go dressed in the finest Armani outfits, accompanied by a host of hangers-on, and with no concern that midnight would ever strike. The Gold Rush was officially on !

The late 1990's was a time of unbridled optimism for the submarine industry when, even if you were uncertain how long it was going to last, you couldn't afford not to respond.

New cableships rolled off the production line at an unheard-of rate - indeed, some are still coming into service even now !

New systems were announced - some of which I've mentioned here - and wonderful business plans were backed by financiers who all wanted a piece of the action - and who could blame them ? Would any of us have wanted to be the one to be different ? There is a reason why the herd mentality has a name, after all….




So, if we re-visit our slide of the 1990’s, and overlay the Happy Days period, we can see the outcome of this feeding frenzy.

Of course, standing here today, we can also see the real outcome !

## The Current Daze

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- Telco stocks through the floor along with capex forecasts
- Stock markets punishing any sign of expenditure
- Piles of distressed assets literally laying around
- No new systems announced to date - will 2002/2003 be the nadir for the submarine industry ?
- How can we rebuild ?

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And so here we are.  I’m not going to dwell too long on this slide, because we all know we’re in the dumpster.  The question that I do want to address is how do we get out - and when ?

The trough is proving to be deeper than  we expected, even as little as 6 or 12 months ago, and the recovery point seems to be moving further to the right.

Part of this trough extension is undoubtedly due to the continuing uncertainty caused as assets come up for sale but no-one buys them, because more assets will - or may - be coming up for sale in the same area.  This confusion and uncertainty is what I call our “Current Daze”.
As the learned Don Schroeder once said, a quick and brutal blood-letting, although more painful in the short term, would be better than death by a thousand cuts.

But enough of the doom and gloom - let’s try and look forward to brighter days.


- There is absolutely no doubt that rationalisation and consolidation will be at the top of the survivor's agenda.
- But whilst this happens, we need to carefully examine the ingredients of the old and new formula for the development of infrastructure and develop a sustainable model for the future. Before I suggest what this may be, I must point out again that the Telco infrastructure business is about huge fixed costs and scale.

– Carriers have been, and, in my opinion, will always be focussed on the scale, quality and reach of their networks.

– Lowest cost, global infrastructure is a major competitive advantage. But our shareholders must be able to see an acceptable return on capital for their investment.


Return on capital can only have a chance of being realised if:

- There is a well founded business plan which is tested repeatedly by demand scenarios and forward price curves
- There is a project plan which is delivered by an experienced, professional, full time and dedicated management team
- There are clear lines of responsibility between the investors and the management team
- The Board is the directing “mind and will” of the organisation
- The management team is responsible for execution and delivery
- There is a customer / supplier partnership in which risk management is clearly apportioned and understood

In short, like any other business, sound management systems and processes will ensure speed to market and on time delivery within budget and specification

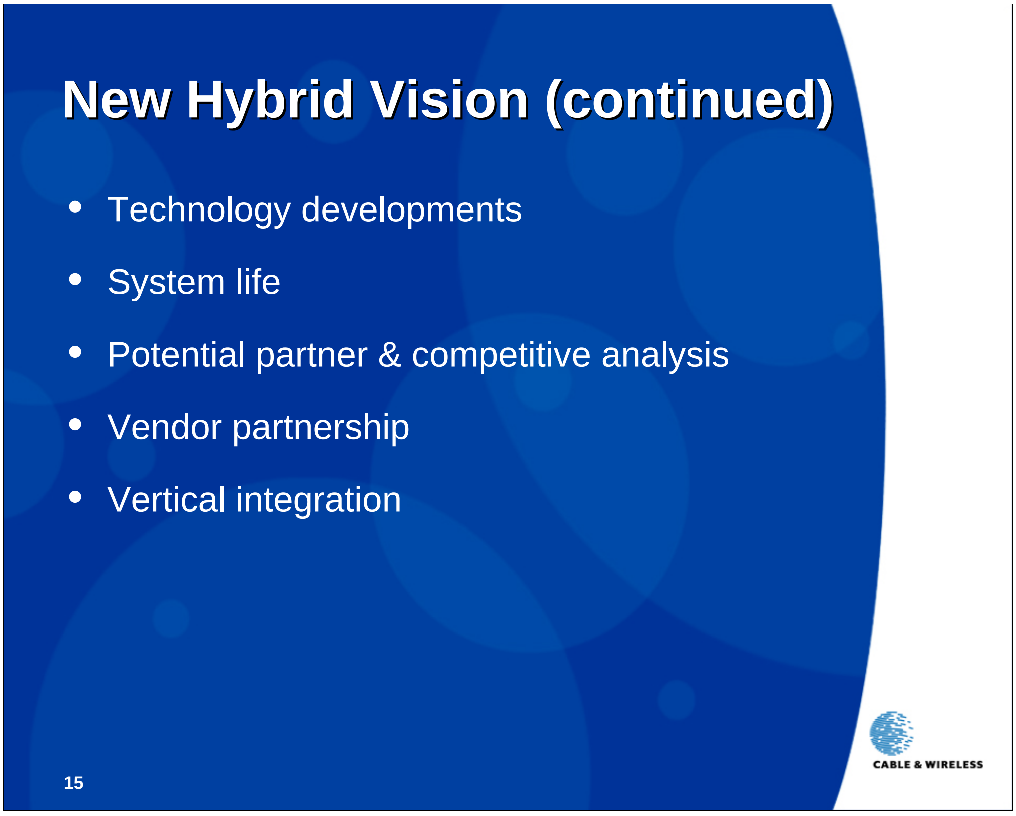

These attributes must be allowed to work within the consortia or special purpose company frameworks (private cable). For too long, we have debated our preference for one or other of these models.

- There is no doubt in my mind that the industry will develop a "third way" of developing and financing new infrastructure builds which will rejuvenate the tired, inefficient, bureaucratic consortium systems, whilst holding in check the excesses of the debt that financed the free for all development of the last few years.
- I have used the word hybrid before which has been attacked in some quarters as impossible to achieve. I agree there is a contention between capacity at lowest cost and rewarding investors who are taking risk.
- But what is fundamentally clear is that any future system will have to achieve carrier underwrite – or capacity presales – if it is to attract equity investors and debt facilities.
- The amount of this underwrite will ebb and flow depending on the general economic cycle, the confidence in the industry and local supply / demand analysis.

So the major carriers are fundamental to new infrastructure – which is common sense, actually. But I'm afraid some of the new capacity wholesalers lost sight of this logic as they rushed over the cliff.


So what is the formula for a new hybrid system ?

- Firstly, it is a start-up business and should be managed in this way.
- It needs **seed capital** to fund the visionary and **business planning** stage. The sources of the seed money are numerous but it is fundamental to the new venture to have major carrier commitment, or at the very least, enthusiasm.
- Carriers, funnily enough, spend a great deal of time and money doing supply/demand analysis, predicting price curves and evaluating **build, buy and lease** decisions.
- The venture needs to project **whole life costs**. Too often, ongoing system maintenance is a critical element of the viability of the eventual competitiveness of the offering and too often not enough attention is paid to detail and cost saving. Broad assumptions such as x % of capital cost are slotted into the financial model – or worse still – cost plus y % admin are assumed without taking account of what might be a more suitable cost base in these days of network meshing.
- **Size of system** – as the manufacturers search for greater and greater transmission rates, fibre and wavelength capability and the unit cost per wavelength tumbles, let us all remember that this equation only works from a competitive stand point if it is possible to fill the system.



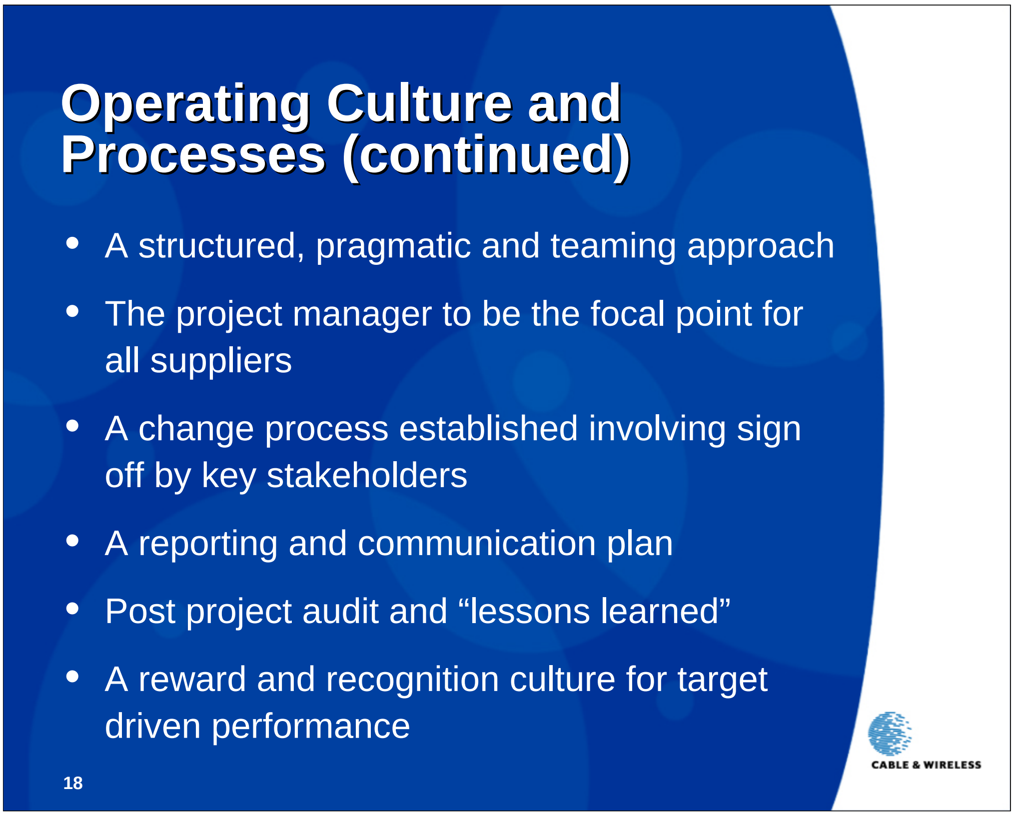

- The most difficult decision to be made will be when the next technology development will be in the market and whether this will be commercially attractive enough to inspire a rush of new investment to cut short the life of this current vision.
- Too many companies have a system earning revenues over 15-20 years. It is now apparent that the early fibre cables will be in operation for 10-12 years max and that cables such as Gemini will be lucky to reach 10 years – Gemini is full. The decision about its life expectancy will depend upon the competitiveness of its maintenance costs.
- Potential partner and competitive analysis. This research is often overlooked and had the wholesalers and debt providers been more vigilant in this area in the late 90's, we would not be nursing the hangover we have today ! Firstly, the partners – who is likely to benefit from the introduction of this new system and who is likely to give commitment (in the form of either pre-sales, in a binding or non-binding form, or equity or a combination of both). Running in parallel with this exercise is of course the competitive analysis on the likelihood of others – either carriers, or wholesalers developing a capability in the near to medium future on the same route, or another route which will effectively be able to compete on a city to city basis.
- Of course in this analysis is also vendor support and partnership. We have seen vendors make some "strange" decisions during the boom which I am sure they have regretted and these decisions could have been made differently had the vendor been more involved in the business planning stage of the venture, when the very basics of what made the plan viable – supply, demand, price declines, carrier support would have been visible to the vendor who was apparently hooked on the promise of a hefty future contract.
- I am convinced that the vendor has an important role in the future infrastructure development beyond straightforward manufacturing. I do not believe it is as a vertically integrated carriers carrier – but that is an argument for another time.


**Raising Finance**

- Equity, debt, vendor financing and carrier commitment are all elements of potential finance available to the start-up.
- In the early years, the development of private cables systems such as Gemini and Southern Cross saw considerable equity participation by their sponsors, the carrier shareholders. Certainly it is true to say today that most indebted carriers, and even those such as C&W with healthy balance sheets, will not be keen to take equity risk in network infrastructure.
- This does not mean that they will not continue to purchase capacity, nor that they will be unable to give a pre-commitment to system development.
- This, however, does mean that there is a role for new infrastructure equity participants or an extended role for the system manufacturers. But the manufacturer is also a nervous risk taker after the recent events. I am however, convinced that the manufacturer will take a far more positive supporting position if the carriers underwrite for the business plan is substantial.
- In other words, if the major carriers are prepared to take for example, 50-75% of initial capacity in a system, it is possible that, with a dedicated sales team working with the system, vendor financing attached to a margin share agreement for at risk capacity can be achieved
- BUT none of the risk takers, or debt providers will be able to support a system unless governance and management can be articulated in such a way that will ensure the execution of the business plan, including the ongoing operation and maintenance of the system.


This management structure must be supported by clearly defined processes to deliver a “can do” culture.  Critical elements are:

- The project roadmap and timeline:
- Measurable and targeted objectives allocated
- Critical paths, activities identified and monitored
- Risks identified, understood, allocated and managed
- Contingency plans prepared.  Resource limits and plan
- Authority limits for financial and technical commitments
- Budgetary control and financial reporting systems




- A structured, pragmatic and teaming approach led by the project manager with all suppliers
- The Project Manager to be the focal point for all suppliers
- A change process established involving sign off by key stakeholders
- A reporting and communication plan
- Post project audit and “lessons learned”
- A reward and recognition culture for target driven performance

This is by no means an exhaustive list but I want to draw out a few real issues which any new start up should concentrate on. I am in danger of transgressing into a lecture on project management - which is not what I’m here to do. So to draw to a close - let me summarise.

# Summary

- It's likely to be a long hangover!
- Capital and debt financing will be in short supply
- Rationalisation and consolidation of companies and assets will be a priority
- Demand is still healthy
- New systems will be developed
- Early carrier involvement essential
- Potential for investor, carrier and manufacturer partnership

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Just for the sake of clarity, when we talk about a return to an orderly market, we don’t mean a return to the days of the incumbent that I talked about at the start of my presentation.  Tom Soja, I can give you some notes if you’re here, so that there’s no more confusion in your mind.

What we mean is that business plans need to be realistic before they get funding, that systems need to be meeting a real need rather than a pipe dream, and that the demand and supply sides need to be in balance.  I hope that’s cleared up what C&W means by an orderly market, and that concludes my presentation.
Thank you

# Any Questions?

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