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Telecom Markets after the Recovery

News

Statistics

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New Members

We are very pleased to welcome XINHUA Cable Co. Ltd. of China and RAFSANJAN Industrial Complex Islamic Cooperative Company of Iran as Full Members. Xinhua is the 7th member from China and mainly producing power cables. Rafsanjan is the first member company from Iran and telecom cable producer as well as some other industrial products.

Beijing Congress 2002

126 delegates and over 40 spouses from nearly 40 countries met in the 12th Congress in Beijing. Keynote speeches were given on the economic policy reforms in China after accession to WTO and the current situation and prospect of Chinese Wire and Cable Industry. The topics this year mainly focused on the issues that cable industry is facing, i.e." Standardization", "Environmental Issues" and "Industry Structure and Business Models". The detailed report was submitted to those attended and, meanwhile, members can access the reports on the ICF website (www.icf.at) as well. In his address at the General Assembly, President Dr. Kurauchi stressed that, under severe global economic turbulences, it becomes more significant and valuable to attend the congress to exchange views and learn from professional analyses and advise. Vice President Mr. Hauser told the delegates at the closing of Business Session, referring to his experience in the Aluminum industry, that the cable industry need to work on own cost and has to continue restructuring efforts as well as marketing efforts.
The next Congress will be held in Vancouver, October 08–12, 2003.

New President

General Assembly confirmed Mr. Gérard Hauser as new President for a two years period, Dr. Kurauchi as Vice President (Past President) and Mr. Baker Cunningham as Vice President (Future President).

"Energy and Poverty"

"Today 1.6 billion people have no access to electricity", according to the report titled "Energy and Poverty" issued by the International Energy Association (IEA). This awful and shocking news at the same time means that we need to develop more clean and renewable power supply with transmission/distribution cables. Is it rather good news for the cable industry?

Automotive Wire Harness

In the current industrial situation, car industry is one of the most stable and still developing industries. There will be many challenging issues for the industry to develop or improve in the areas of health, safety, security, and efficiency. Wire Harness for automobiles also need to cope with those new technology and development. At the next Congress in Vancouver, we will take up this subject.

Telecom Markets after the Recovery

For many of the larger cable companies, the basic infrastructure markets, both telecom and power, are core businesses. As the buyers of cable in these markets suffer severe financial hardship, so do the companies that supply them. Capital spending budgets are first to see the axe when times get difficult. The telecom sector has been hit particularly hard over the past two years, but it does appear that now the bottom may have been reached. Will the times of rampant capital spending at full pricing for suppliers return, or was the huge investment in infrastructure that took place up to mid-2001 simply a blip in history? In this article we trace the evolution of the telecom crisis and assess what this might tell us about the future prospects for this industry and the companies that supply it.

So, what actually happened in the telecom market? The latter 1990s saw a seemingly endless accelerating growth in telecom traffic, as the rapid penetration of mobile phones was matched by a rise in demand for bandwidth in the fixed telecom infrastructure. There was a widespread assumption in the industry that the demand for telecom services would continue to grow at this pace and, more importantly, that growing traffic would mean a very rapid (though not proportionate) rise in revenues. In the expectation of huge profits in the future, both existing and new telecom service providers rushed to invest in infrastructure, if nothing else, to ensure their share of the expanding market. Capital spending budgets mushroomed, not only in absolute terms, but also in proportion to current revenues.

Unfortunately, most of the spending of the telecom industry was based on debt. The financial community was more than willing to believe in the upbeat financial projections of the telecom companies. In 1999 and the first half of 2000, valuations of telecom companies soared. This was especially true of wireless telecom stocks, which rose in value by more than 60%. In this environment, it was cheap and easy to borrow.

By the end of 2000, the debts of the telecom industry had become enormous. In the United States, AT&T had built up a total debt of US$ 70 billion, WorldCom a debt of US$ 24 billion. On the other side of the Atlantic, in Western Europe, the situation was no better. By year-end 2000, France Telecom had a debt of US$ 62 billion, Deutsche Telecom US$ 60 billion and British Telecom US$ 50 billion. In relation to revenues, some of the alternative carriers and CLECs (competitive local exchange carriers) had an even larger debt burden. During the course of 2000, Europe's telecom operators borrowed a total of US$ 73 billion in bond issues and US$ 149 billion in syndicated loans. Much of the spending of the European operators was for UMTS third generation wireless licences, priced in total at US$ 200 billion.

As the debt burden increased and the take up of new services was less than expected, the financial community became concerned about the value of its telecom investments. The ratings of telecom stocks were adjusted downwards. In Europe, the process started with France Telecom, which was rated downwards from Aa1 to Aa2 in December 1999. Falls by France Telecom and other European incumbents took many of them, including British Telecom and KPN, down to a "B" rating. A "B" rating is taken to indicate a significant possibility of a default on loan repayments, of 10–20% at the top of the range (France Telecom, British Telecom), 30–40% at the bottom end (KPN). In this environment, the valuation of telecom stocks fell dramatically, mobile service providers losing two-thirds of their value in the second half of 2000.

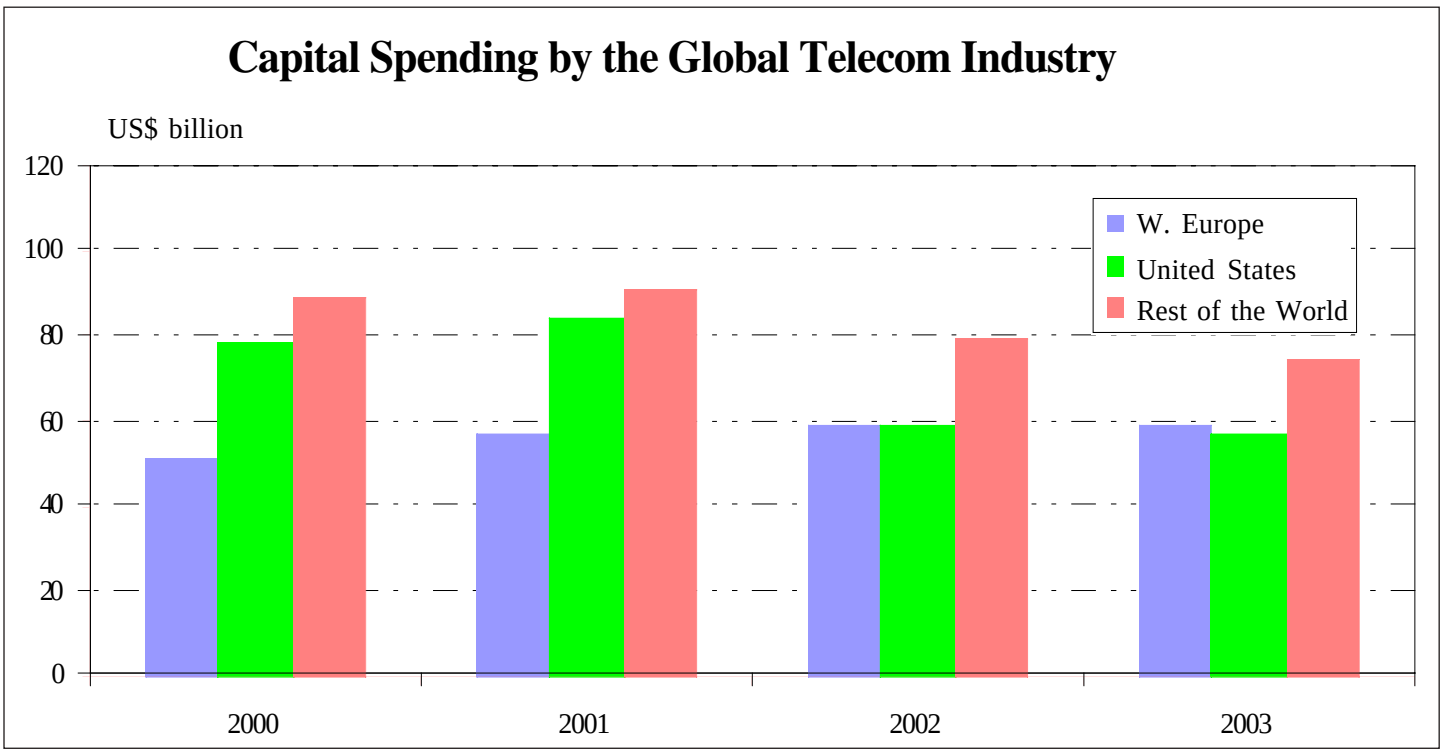
The situation was already bad for the telecom companies when, from early in 2001, macroeconomics turned against them. With a further weakening in demand growth as the economy first of the United States then of Western Europe faltered, the debt

burden of the Telco's became more of a problem. Access to new finance for many companies was effectively barred.

Debt service and cost control, rather than expansion, became the order of the day. Some failed in their bid to clean up their balance sheets, and we have seen some major bankruptcies amongst the alternative carriers (although not the incumbents). In July, WorldCom became the biggest ever Chapter 11 filing for protection against creditors in American history. WorldCom's US$ 32 billion debt at the time of filing was twice that of Enron a few months earlier.

Despite the financial difficulty now being experienced by the telecom industry, it is clearly on the road to recovery. Companies have taken the time to clean up their balance sheets, asset sales being the favoured method of doing this. Although this process is far from complete, France Telecom for example is still in debt by US$ 70 billion, debt reduction plans are now well in place and the likelihood of a liquidity crisis minimal for most of the big companies. In Europe, the European Commission is looking at ways of accelerating the recovery by relaxing the onerous conditions of UMTS licences with regard to network sharing, spectrum trading and licence sale.

With the semblance of financial health returning, we may expect to see some improvement in capital spending although, apparently, not yet. Despite the weakening tone to the telecom business in 2000, capital investment remained strong throughout most of 2001 as projects already scheduled were carried forward, especially in the wireless sector. Indeed, capital spending by the global telecom industry actually increased slightly, from US$ 218 billion in 2000 to US$ 232 billion in 2001. The advance was mostly in Western Europe, where there was very high spending by wireless service providers. This spending continues into 2002, where Western Europe is expected to see a slight rise in total investment. In both the United States and Asia Pacific, however, there has been a sharp reduction in capital spending by the telecom industry, despite a strong performance by China, leading to a fall in global investment to US$ 197 billion. For 2003, ana-



lysts expect to see a further drop in capital spending, especially in Asia Pacific, taking the figure down to US$ 191 billion.

Considering the dire state of telecom industry finances, the fall off in capital spending may be seen quite modest. Many equipment suppliers, including cable makers, have seen a much sharper reduction in the volume of their sales. The areas hardest hit by the decline in spending are optical transport and circuit switching. In particular, cable makers have suffered from the collapse in spending by alternative carriers. For fixed line telephony, incumbents now account for around 90% of capital spending globally. While 2001 was a year of decline in consumption, volumes of both fibre optic and copper telecom cable collapsed in 2002. With fibre optic cable consumption this year estimated at 75 mn fibre km, volumes are nearly 25% lower than two years earlier, and the market value is down by over 40%. The fall-off in demand for copper telecom cables has been almost as dramatic.

The capital spending plans of the Telco's for 2003 suggest that this will be a year of stabilisation, but little or no improvement for the cable industry. Longer term, we need to ask some fundamental questions about the structure of telecom investment in years to come. Ultimately, the amount spent on building up telecom infrastructure will depend on the ability of the industry to generate revenues. Despite the massive changes that have taken place, capital spending has remained remarkably stable in relation to revenues, claiming 19–20%.

If revenue is the key to capital investment, then a recent report by Merrill Lynch entitled "What's Up With Telecoms" does not bode well. It suggests that while spending on telecom services rose rapidly as a share of GDP in the past, from 1.2% in 1991 to 3.4% in 2001, there is little potential for any further gain. The report claims that telecom spending by service users is inelastic. The offering of cable telephony, DSL, the adoption and increasing mobile phone penetration may simply result in the cannibalisation of revenues from existing fixed lines rather than any real growth above the underlying improvement in GDP. Talking about the development of broadband services, the report claims that the new product offering reduces the need for "highly profitable" second lines, citing the growing net

Telecom Spending as a % of GDP

	1991	2001
Australia	2.9	3.9
Austria	1.8	2.4
Belgium	1.4	2.0
Brazil	1.4	4.0
Canada	2.0	2.9
China	0.7	3.6
Denmark	1.8	2.6
France	1.7	2.3
Germany	1.7	2.6
Greece	1.5	4.2
Hong Kong	2.7	4.3
Italy	1.6	3.3
Japan	1.4	2.7
Korea	2.1	4.8
Mexico	1.6	2.2
Netherlands	1.9	3.9
Norway	1.9	2.7
Portugal	2.1	5.2
Singapore	2.7	2.4
Spain	1.8	2.9
Sweden	2.1	3.2
Switzerland	2.2	3.5
Taiwan	2.0	3.0
United Kingdom	2.3	3.8
United States	2.3	2.8
Weighted Average *	1.2	3.4
Average excl China *	1.9	3.1

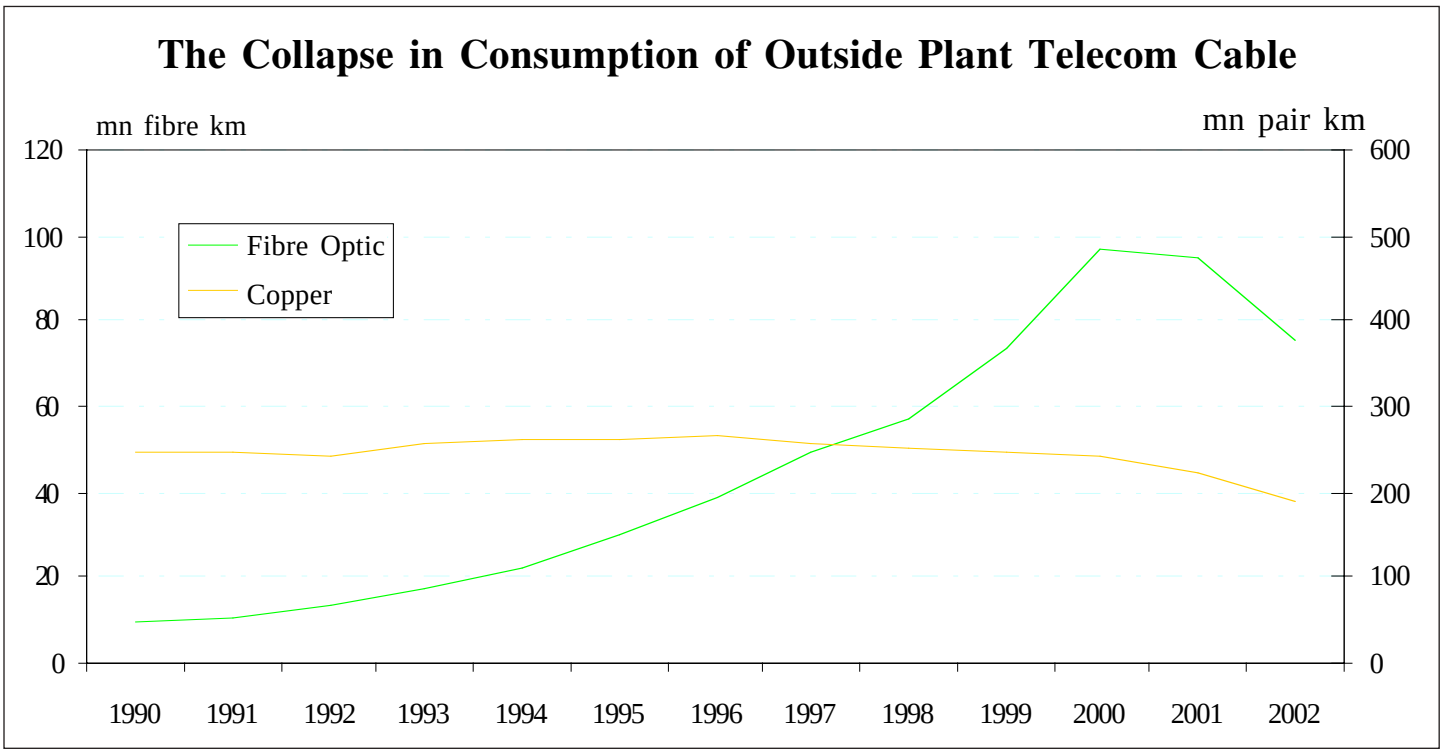
Note: * Weighted by population

loss in access lines in the United States over the past year as proof.

Not all agree with the Merrill Lynch analysis. Others claim that the cheaper (and higher bandwidth) access offered by new technology, such as voice-over-the-internet (VoIP) will encourage the development of new services, providing additional revenue streams. More intensive use of the fixed networks should mean increased revenues for network operators, although the increment that may be expected will be small in relation to the increase in bandwidth required. At present, revenue per Tbit/s for voice traffic is around thirty times higher than it is for data traffic; within the next five years the multiple is likely to have risen to one hundred to one (as bandwidth becomes cheaper).

In order to ensure their future revenues, the fixed line operators need to do two things. Firstly, they need to be proactive in creating the traffic to fill their networks. Secondly, they need to have a financial stake in new service offerings, to gain a share in the fastest growing part of the telecom business. This means that the telecom operators need to move away from their exclusive focus on network based services to enter new areas, such as network and data management, providing software and application based services and also business and private content. This is a real challenge, but one that network operators appear to be willing to take on. If they do take on the challenge, then the larger fixed line operators have a lot going for them. Their existing access to a huge customer base and the likelihood that the demand for greater flexibility by customers will ultimately lead to a return to switched rather than open line services are both in their favour.

So, for the longer term we should not be too pessimistic about the prospects for network telecom cable. Global telecom revenues should increase at least at the pace of GDP, probably considerably faster. The buyers of the cable, the network operators, should be able to ensure their slice of revenue growth, and have the funds to invest. They will also need to invest. Despite the claims that there is already quite enough cable to support bandwidth requirements for some time to come, bandwidth de-



mand growth (running at around 90% p.a.) will almost inevitably show up deficiencies in the existing networks fairly quickly as, thankfully, cable has not always been laid in the right place at the right time.

News in Brief

(provided by Metalica Ltd. UK)

Furukawa Realigns in Optical Fibre: The intention of temporarily reducing optical fibre capacity by around 50% from its current 30 million fkm by March 2003 has been announced by **Furukawa Electric.** The cuts, with the loss of 1.020 jobs, will be mainly at the former Lucent, now **OFS,** plant at Norcross, Georgia in the United States. The Norcross facility will be retooled to make mass-market products, when another US facility will refocus on LANs cable and the company's unit in Denmark on speciality fibres.

Corning Cuts Go Deeper: Despite the announcement of 4,400 job losses for 2002 in July, **Corning Inc.** said in October that further cuts of 2,200 were necessary, based on third quarter losses of US$ 260 million. Amongst the jobs to go are 500 at Concord and 200 at Hickory, South Carolina. In order to avert a short term liquidity crisis, Corning has recently sold one of its most valuable assets, its profitable television lens division, for US$ 850 million.

Alcatel Cuts US Jobs: in the light of a US$ 1.33 billion loss in the third quarter, Alcatel has announced a further 1,000 job cuts in the United States. Amongst the first round of cuts were 200 positions at the Plano headquarters and 97 at the company's Claremont optical fibre facility.

Andrew Corp. Cuts Back: The leading producer of coaxial cable for mobile phone systems, **Andrew Corp.,** is to carry out a major restructuring of its business, with a net loss of 800 jobs. Discontinued business will mean the closure of four facilities in the United States, while a further four US facilities together with plants in Germany, Russia, England and New Zealand will also be closed, with the main part of the business being transferred to new sites on the US/Mexico border. In total 1,200 jobs will be lost and 400 added.

Phelps Dodge Announces Temporary Closures in the United States: By year-end **Phelps Dodge** is to close its Laurenburg winding wire plant, shifting production to El Paso and Fort Wayne. Phelps Dodge will also close its West Caldwell high performance wires plant, shifting some production to Inman. The plants are expected to reopen once market conditions improve.

Pirelli to Make Cuts Worldwide: At the time of its third quarter results announcement, **Pirelli** unveiled plans to close six plants, three telecom cable and three energy cable facilities, with the loss of 2,400 jobs. Although the plants were not named, it was stated that nearly all of the lay-offs would be outside Italy. A few days later, the closure of two energy cable facilities in the United Kingdom were announced, with the loss of 445 jobs. The company is closing its Erith, Kent power cable operation (250 jobs) and also it is mothballing one of its premises near Southampton, Hampshire (185 jobs).

Other Cuts in Europe: The Swedish cable workforce of **Ericsson** is to be cut by 195, with the loss of 140 of the 550 positions at Hudiksvall and 55 of the 140 working at Sundbyberg. Ericsson's 300 workers at the Falun cableworks, also in Sweden, are unaffected by the downsizing. **NKT Cables** of Denmark has announced the loss of 145 jobs, of which 70 are at its Cologne unit in Germany and 75 in Austria. Dutch cable maker **TKF** is to lose 60 staff at Lochem and Haaksbergen, following the 140 losses announced earlier this year. In Northern Ireland, **Getty Connections Ltd.,** a wire and cable and cable assembly subsidiary of the US-based **Marmon Group,** is to close its plant in Carrickfergus, Co. Antrim with the loss of 135 jobs. Getty has remaining facilities based in the England and in Asia.

Consolidation at CDT: The telecom/data cable company **Cable Design Technologies** (CDT) has announced the consolidation of four of its operating units into other CDT operations, with the loss of 8% of its workforce. The units concerned include **NEK** in Sweden, and **NorLAN** in Canada making network cable products and **Red Hawk** in the United States, making specialist data cable products.

Belden Acquisition in Canada: Belden Inc. has agreed to purchase the assets of **Cable Design Technologies'** subsidiary **NORCOM** for US$ 8.1 million. NORCOM, a manufacturer of copper telecom cable, recorded sales of US$ 50 million during the past year and employs 300 people.

Developments at Nexans: Cable group **Nexans** plans to axe 1,000 jobs this year, following the 1,500 that it axed in 2001. The restructuring cost is scheduled at Euro 120 million and will be a factor behind an anticipated loss of Euro 75 million this year. On a more positive note, at the time of its jobs loss announcement Nexans also unveiled its intention of expanding through acquisition in Asia, made possible by the company's low debt gearing. Soon after, the company announced an agreement in principle was reached for the acquisition of a controlling stake in **Kukdong Electric Wires Co.** Xuedong, a major producer of marine cables, recorded sales of US$ 100 million in 2001; it employs 240 staff. Nexans will operate Kukdong alongside its existing Korean subsidiary, Nexans Korea.

Data Cable Subsidiary at Leoni: The auto harness and drawn wire company **Leoni AG** has created a new subsidiary called **Leoni High Speed Cables GmbH** in Friesoythe, Germany for the manufacture of high-speed copper data cables. Production should commence by the end of 2002.

Changes at Tele-Fonika Kable: Following the bankruptcy filing of its former major shareholder **Elektrim** and recent rationalisations (including the intended closure of its Ozarow cable plant, employing 600, and the relocation of business to Bydgoszcz and Szczecin-Zalomie.) Polish cable maker **Tele-Fonika Kable** (TFK) plans to invest PLN21 million in order to raise power cable capacity, with the creation of 100 jobs. TFK also plans to build a new cable plant in the Ukraine, scheduled to become operational during 2003. In a new company realignment, TFK and its parent **Tele-Fonika KFK** are to merge and the listing of TFK on the Warsaw bourse withdrawn.

Developments in the Former Soviet Union: As well as TFK's Ukraine plant, the commissioning of another new facility has been announced for Tajikistan. The **Regarkabel** plant employs 180 people and makes 400 tpm of cable. Other developments in the FSU include a planned consolidation of **Irkutskabel** and **Kirskabel** into a single unit by parent Siberian-Urals **Aluminium Company** (SUAL). In Uzbekistan, cable maker Uzkabel has secured US$ 8.3 million in investment funding from the UK-based **East Asian Development Corporation** (EADC). The EADC will gain a 51% stake in the company as part of the deal...

Madeco's Failed Equity Issue: A US$ 90 million equity issue by Chilean-based wire and cable and fabricated products company **Madeco** appears to have collapsed, with the share subscription level falling below that agreed as a condition of the capital increase. Madeco, with cable and fabricated products interests in Chile, Peru, Argentina and Brazil, had recently put a new management structure in place, following a major restructuring of company business through the course of 2002.

Alpine Consolidates its Stake in Superior Telecom: The **Alpine Group** has signed a Letter of Intent regarding its plan to increase its stake in leading US wire and cable producer **Superior Telecom** from 49% to 100% for US$ 85 million in cash plus assumed liabilities. The change in structure is intended to increase the financial flexibility of Superior and follows a recent renegotiation of its revolving credit facilities

Lucent Disposes of Stake in CommScope: Lucent Technologies has sold the 10.2 million shares that it acquired in coaxial and fibre optic cable producer

CommScope at the time of its sale of optical fibre and fibre optic cable facilities to **Furukawa Electric** and CommScope in November 2001. CommScope itself repurchased 2.54 million shares for US$13.2 million, with the majority going to its fibre optic partner Furukawa Electric. The share purchase has increased Furukawa's stake in CommScope to 13%.

Transfer of Business Units by Mitsubishi Cable: In order to reduce personnel and facility costs, **Mitsubishi Cable Industries** is to relocate three business units. Output of optical fibre and telecom cable will be moved to Itami in western Japan and building wire output will be moved to Ryosei Industry Corp. in Kumagai, north of Tokyo. Sales operations will be concentrated in Tokyo.

SEI to Expand its Auto harness Business: Sumitomo Electric (SEI) is to invest Yen 60 billion (US$ 60 million) in its automotive wire harness business over the next three years. Of this total, Yen 15 billion will be directed to SEI's Asian factories in Thailand, China and Vietnam. An equal amount will be spent in North and Central America, with staff in Mexico being doubled to 4,000. A total of Yen 10 billion will be spent in Europe to double capacity in Romania, Poland and Slovakia, while the remaining Yen 20 billion will be spent on Japanese operations. The investments should raise the SEI wire harness capacity by 50% and is intended to increase its global share of the business from 11% to 15%. Despite the investments in Japan, the ratio of imports into the domestic market is to be increased from 34% to 50%. Meanwhile, SEI is drastically reducing its capital spending on fibre optics, where it is reported that investment is to fall by two-thirds to Yen 85 billion in the next financial year.

Auto harness Expansion in the Philippines: Auto harness producer **Yazaki-Torres** is investing US$ 30 million to double output over the next five years; its current capacity is 75,000 harnesses per month. Yazaki-Torres has recently opened a US$ 5 million satellite factory in Batangas, boosting capacity by 29%.

Corning Finalises Acquisition of Lucent Fibre Optic Interests in China: As agreed in July 2001, **Corning** has acquired **Lucent Technologies'** joint venture interest in Lucent Technologies Shanghai Fiber Optic Co. Ltd. and Lucent Technologies Beijing Fiber Optic Cable Co. Ltd. Corning will pay Lucent of US$ 225 million, including US$ 50 million of Lucent common stock. A further US$ 25 million will be paid if certain conditions are met.

LG Winding Wire Plant in China: Korea's **LG Cable** is to set up a winding wire factory in Tianjin. Initial capacity is slated at 8,000tpy, with further expansion to 12,000 tpy planned. Output should commence by end-2001.

Samsung Fibre Optic Cable Plant in China: Another Korean company, **Samsung,** plans to set up a fibre optic cable plant in Hainan province, China. This is part of a package of four investments by Samsung planned in China, at a total cost of US$ 500 million. The intention is to raise Samsung's revenue from Chinese operations from US$ 7.5 billion this year to US$ 10 billion in 2003.

Copper Wire rod Plants in China: Copper producer **Jiangxi Copper** has commenced construction of a 150,000 tpy wire rod line, due for completion end-2003, and has announced its intention to engage in further downstream projects in order to offset copper price risk. **Dowa Mining** of Japan has also announced its intention to build a continuous cast wire rod line in China, near Shanghai.

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