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The Economy is on all of our minds these days.

See Dave Dunphy's article in the next FiberSystems Europe print edition of November: written in August, before the crash when many financial analysts and the U.S. government were still predicting a potential upswing in the economy for 2009, it discusses why the economy was not that stable at that time despite apparently positive GDP figures, why governments sometimes perceive an incentive to not admit impending recessions and can therefore delay taking action until it is too late, and what a slowdown would potentially mean for telecoms.

Now it is no longer "potential," and in hindsight *we were not pessimistic enough*. We still do not know the full impact of the downturn, because this situation is a new scenario involving a strange mix of bad and good:

- 1) The astounding greed of banking institutions, and their willingness to take imprudent risks
- 2) The seeming incompetence and apparent lack of oversight by a number of regulatory bodies in the U.S. and Europe
- 3) The unprecedented international cooperation of world governments in addressing this problem.

Bail outs of errant financial institutions will undoubtedly have a negative effect on the economy in future periods. In justifying the bail-out, the U.S. government has explained that once housing prices return, the stake they have invested will be repaid. That assumes, of course, that housing prices are going to return to their former levels within a reasonably short timeframe. And that may not be a fair assumption in some of the markets where housing prices were driven more by

speculation and people “over-buying” relative to their housing needs as a form of investment. This practice, coupled with the over-building of sizable luxury housing that resulted, may have long-term implications. There will be far fewer people to afford in the short-term that can qualify for these homes during a credit crunch. And even in the long-term, as interest rates return to more historic levels there is likely to be a glut at the high end of the housing market as there will be a smaller percentage of buyers that will be able to afford the interest payments. Where housing is more likely to rebound quickly is in more moderate homes, particularly given how little attention the building of sensible housing has been getting from real estate developers and home builders over the past five years.

The impact on telecom

The impact will definitely be negative to a degree dependant on how effective the cooperative international efforts to prevent a worsening of the financial crisis prove to be, because that is going to influence both consumer and business spending.

We think that a potential worldwide depression was only narrowly avoided, and that this welcome newfound global cooperation on financial market intervention will significantly reduce the impact of the recession which will be the result. But there will be no free lunch here. The price of saving ourselves from the full potential depth of a market crash that could have spun out of control is going to have to be repaid, and doing so is going to result in national debt and taxation that will extend the length of that recession. We decreased the magnitude of the downcycle, but in doing so will extend its period.

A subset of the predictions of the impact of the economy we have shared with our clients over the past few weeks:

- **Expect consolidation to hasten.** The 5+ years of painful consolidation that remained last quarter will be shortened to 2 to 3 years now, thanks to the tightening of the capital markets and impact of the recession on consumer,

business, and therefore carrier spending. Expect things to get very rough for a major player at the end of Q1 2010.

- **The same players will fall, only more quickly.** Transforming major corporations is never quick, and never easy. But occasionally we've seen it done (IBM is a great example). The sad thing is that the downturn means some of the vendors with the fewest resources may have less time to try and turn things around now due to the impact of the economy.
- **Buyers will be few.** This is a bad time to try and seek the merger of a company with the intention of preserving the staff. And for that matter, the market for piece parts of companies is likely to be stronger than the market for whole companies or divisions during a downturn. Few players will have the depth of resources and interest in expending the kind of reorganization costs that a merger can impose in this environment.
- **Bargains (and non bargains) in M&A will become available in the next couple of years.** Some bargain piece parts of former competitors may come up for sale in 2H 2010 and 2011...though by then some of those for sale will have been resource constrained for so long that development activity may not leave much of value to buy at that point. There will be more opportunity in transforming weak competitors' customer networks in this timeframe than for good mergers.
- **If your business plan depends on the sale of \$600+ smartphones, it is time to rethink it.** 2009 is the year during which the availability of new smartphones like the iPhone 3G, Blackberry Bold, NSN and others were going to start making mobile Internet browsing and GPS usage a more pleasant (and marketable) experience. But in this kind of economy, the price of those devices (even bundled in service contracts) is going to be a barrier to a fast ramp up - to a great extent with consumers, and to a significant though perhaps lesser extent with business.
- **Opportunity is far from dead.** Data storage requirements will continue to escalate, use of the Internet is now a staple of everyday life and may even grow during a recession, and there may be far more compelling reasons for the Enterprise to migrate to Ethernet services now than ever.

- **But some opportunities will die, and others will be less healthy than they might have been.** If it is an established and necessary part of a consumer's lifestyle or an Enterprise's strategic plans to optimize their use of IT, that's a good sign. If you're selling new applications that are highly entertainment focused and have existing competitive alternatives available, that's not a good sign. Mobile TV is not likely to fare well in this kind of environment.

Questions / comments /

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