

COMPETITORS FIGHT AMID DUOPOLY FEAR

by Carol Wilson

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Against the backdrop of expectations that the U.S. telecom market is marching inexorably toward a telco/cable duopoly, some competitive players are showing a willingness to fight amid the growing despair of others. With cable giants growing their voice-over-IP efforts and large telcos pursuing triple-play services and mega-mergers, all competitive hopefuls are feeling the squeeze.

For every Yipes Enterprise Services, which is rising from the ashes of Yipes Communications, there is a host of smaller companies such as Transcom Enhanced Services, which believe they are being driven out of business by large monopolies. Somewhere in the middle are firms such as XO Communications, which within the last week both failed to meet debt covenants and launched a bold service initiative targeting a new market.

For many such players, cutting ties with past impressions is a first big step. Global Crossing is hoping to do just that, making some tough choices that its management believes have the international network operator back on the road to being EBIDTA cash-flow positive by 2006. But even cutbacks may not save smaller ISPs that see falling prices for telco DSL offerings squeezing their already-tight profit margins.

"It's definitely a mixed picture," said Brian Washburn, senior analyst for Current Analysis. "We are seeing some interesting trends. There are some great models for success among CLECs that are very tightly focused on a specific region, such as Cbeyond, and then there are companies with a bigger footprint like McLeod [USA] that are struggling. For the big fiber-owning companies, going into enterprise and retail is a very interesting business model. If they can get a foothold, the margins are much sweeter."

That's Global Crossing's intent, said Anthony Christie, the company's chief marketing officer, and its most recent guidance indicates the company is on track. While revenues declined for the fourth quarter of 2004, that reflected the shift from wholesale voice customers to retail customers, and revenue from the retail business was up 8%. With its December bond offering, Global Crossing's business plan is now fully funded, he added.

"We are seeing significant margin improvement," Christie said. "We have made a conscious decision to lead with the offer, to lead in areas where we think we can win, and that is moving this business toward enterprise customers, specifically those that are global in nature and those consuming IP services."

"Global Crossing has been trying to shift the balance away from wholesale for the last 12 to 18 months, but they haven't executed aggressively enough on that strategy until about six months ago," said Jan Dawson, research director for Ovum.

In October, the firm became more ruthless and stopped investing in low-margin customers, raising prices to discourage that business and looking to sell off some segments, he added.

Global Crossing last week sold its small business group to Matrix Telecom, citing the need to stay focused on enterprise customers. The company is now up against giants, competing against Infonet, now part of BT; Equant, now wholly owned by France Telecom; AT&T, soon to be part of SBC Communications; and MCI, which could wind up part of Verizon.

"This is a scale business, and Global Crossing is arguably at the small end of the market, scalewise," Dawson said. "They have to be able to grow that core business. But I'm feeling much more positive about them."

Yipes is also crossing over into positive territory and emerging from the shadows of Yipes Communications, which built a massive gigabit Ethernet fiber network but couldn't scale its customer base quickly enough. The new Yipes, which acquired the 14,000 route-miles of fiber optics, has been operating for the last two years as an Ethernet service provider, building on the five years of expertise in the market and Ethernet's new popularity, said Keao Caindec, vice president of marketing.

"The Ethernet market is growing 31%, and we are well-positioned in that market," he said. "The guidance in terms of revenue that we are giving is that we expect to be profitable from recurring operations in 2005. We have 500-plus customers, and we are in all the major metros in the U.S. and London."

XO Communications also is trying to emerge from financial troubles but is not moving as quickly as hoped. The company fell \$42 million in revenue short of the earnings requirements of its debt facility in 2004 and admitted in filings to the Securities and Exchange Commission that it does not expect to meet those requirements in 2005.

But the company is not standing still — it has launched JustCom, a brand devoted to very small businesses of eight lines or less — that addresses voice service needs.

"Carriers, by and large, ignore this market niche — nobody is paying attention to the small-business person," said Phillip Brenner, executive director of marketing for XO. "We looked and said we think this is a niche that we have all of the components and the piece parts and the assets to support and particularly when you leverage all the footprint XO has, and its co-location spots."

The company intends to keep the expense of the JustCom offering low by selling a one-size-fits-little-guys product to lower provisioning costs and rely on indirect sales, Brenner said.

"If they can keep their costs down, this is a positive step," said Steve Hilton, director of small and medium business strategies at the Yankee Group. "I think you have to give companies credit that are making new initiatives and moving forward."

Transcom's new initiative capitalized on using VoIP to offer new features that service providers could package with their data offerings. But SBC Communications sued the company in a Missouri court, claiming it owes access charges on a per-use basis — charges that would wipe out Transcom's business plan, said CEO Scott Birdwell. Since then, Birdwell said, SBC has sent letters to Transcom's customers and its suppliers, including AT&T, claiming his company is operating in violation of 2004's FCC ruling that forced AT&T to pay access charges.

"That ruling doesn't apply to us because we change the form and content of every call so we are an enhanced service provider," Birdwell said. His firm has taken the unusual step of declaring bankruptcy specifically to get a bankruptcy court judge to rule on the enhanced services exemption from access fees.

In the meantime, Birdwell believes SBC is trying to drive companies like his out of business, and he has some support.

"There is no question that events in the marketplace support many of the issues identified [by Transcom], and we believe there is a story here that needs to be told," said Steve Braasch, vice president of marketing for PointOne, another VoIP provider under fire from SBC. "Consumers stand to lose all the benefits of the efficiencies created by the technological advances of the communications innovators."

SBC declined to comment, citing the pending legal matter.

Consumer choice is also at risk in the ISP segment, according to small ISP operators. As DSL services, sold by the online arm of incumbent telcos, have gotten cheaper, smaller ISPs have seen their margins squeezed to the breaking point.

“How the hell do I compete with Verizon Online when I am paying \$3 and change less for wholesale service than they are charging for retail services?” asked Larry Summers, general manager of WTS Online of Brownwood, Texas. As smaller ISPs go under, consumers lose the quality of service and IT consulting they provide, he added.

Verizon denies squeezing out smaller ISPs, according to a spokeswoman. She also added that “customers have options — they could use other technologies like WiMAX or Wi-Fi.”

Those options are costly and not always technologically feasible, particularly in rural areas, Summers said. Seeking FCC relief is also not an option — it would cost him a minimum of \$75,000 in legal fees that he can't afford.

The push to a duopoly may continue to crush smaller players, analyst Washburn admitted.

“There's a lot that we still don't know, particularly with the big mergers coming,” he said.

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Transcom Enhanced Services and WTS Online are two smaller service providers taking on large incumbents. Read more about their strategies on our Web site at WWW.TELEPHONYONLINE.COM

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