



SubOptic -2007

Enabling Global Communications

Towards a Profitable Supply Industry

“Don Quixote”

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The State of the Supply Industry

- The supply Industry is not profitable today
- The market level in 2006 was at the average level for the foreseeable future
- The industry is not viable if it is not profitable at the average market level



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Response to Losses

- Cost cutting.
 - Can and does lead to loss of quality
BP/Texas – Computers - Cables

Volume growth

Has to be at competitors expense

Price increases

But how when suppliers are cutting each others throats?



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Our World is not what it was

- 20 years ago the average market was about 25-30,000km route length a year
- There were 6 system suppliers for repeatered systems
- The industry was profitable at that level
- So what has changed?



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Agents of Change

- Takeovers
 - STC
- Divestitures
 - AT&T-SSI, KDDI
- Customer Base
 - Community of interest between suppliers and major customers no longer applies
 - Centre of gravity of purchasing power has moved to Asia



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The Future

- Price increases are inevitable – but what will be the mechanism by which this will happen?
- 8 possible scenarios



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The Way Ahead - 1

- A continuing war of attrition which goes on until the last man standing wins and becomes a monopoly supplier



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The Way Ahead - 2

- A pre-emptive strike by one or more Carrier(s) who buys an existing business to ensure his in-house supply source



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The Way Ahead - 3

- In a boom period, one supplier holds out for higher prices and when existing capacity is full, wins contract(s) on delivery
- (This assumes capacity has reduced considerably from current levels)



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The Way Ahead - 4

- One supplier becomes so dominant that it can afford to raise prices and the rest follow



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The Way Ahead - 5

- Quality failures reduce the supply base. Excessive cost cutting results in supplier quality problems which destroy the supplier (KDDI?)



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The Way Ahead - 6

- Consortium bidding on transoceanic systems has to lead to agreements on bid price which could spill over into the general market price levels



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The Way Ahead - 7

- The existence of the upgrade market has in one sense lowered the barrier to entry. (Azea, Xtera). But it also segments the market and makes the supply and installation of (repeated) submerged plant a specialist segment



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The Way Ahead - 8

- The segmentation of the market leads to the creation of one or two specialist houses who do all the work relating to the submerged plant. System houses subcontract all the work relating to the submerged plant to it/them. The market will not support more than two



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Which Way?

- The structure of the industry is currently not stable.
- How will AlcatelLucent's management view ASN?
- Tyco's submarine business looks anomalous
- OCC and GMSL were bought by private equity



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Which Way?

- The industry has its future in its own hands – but for how long?



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