

White paper

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100 more years of Telecommunications: Surviving and succeeding in a dangerous market

Authors: Gabriel Ruhan, Joel Whitman & Stephen Scott

Telecom has been down for so many years we have forgotten what growth was all about. In the years since 2000 we have all experienced difficult business environments, forcing everything from wholesale reorganization and downsizing to bankruptcy after bankruptcy. I'll be willing to bet that there is no one in this room who has not found the past few years to be some of the most difficult years of their careers.

However, since last year, a lot of positive activity has been taking place in Telecommunications and if you consider our corner of the industry - that being cable ships and the services they provide across the globe - at this time there is a great number of positive things going on that are certainly worth mentioning.

By way of example, here are some interesting statistics from TIA 2005 Telecommunications Market Review and InternetNews.com:

- International forecasts project spending on telecommunications goods and services at \$1.1 trillion - showing an 8.7% increase in 2005.
- VOIP, Metro Ethernet and broadband are expected to reach \$17.3 billion this year.
- 3G, Wi-Fi and WiMAX will fuel wireless handset equipment growth, from approximately \$22 billion in 2004 to \$29 billion in 2008.
- International telecommunications spending has growth projected at 10.2% through 2008.

Despite setbacks in recent years, communications markets keep growing and all of this has a positive impact on the subsea networks market.

Before I jump in much further, I realize that many of you in the room may not know much about Global Marine and what has been happening with our business since the industry collapse a few years back. Please bear with a brief description of our business as it may help provide some context for this speech.

Global Marine is a privately held company which is able to track its history back over 150 years. We operate a fleet of installation and maintenance vessels and related assets around the world. We do business in oil & gas and alternative energy however telecommunications is our major industry of focus. In this region we are proud to be part of several strong and successful Joint Ventures with companies such as Singtel, NTT and ChinaTelecom.

A little over a year ago Bridgehouse Marine, a division of London based, Bridgehouse Capital purchased Global Marine from Global Crossing. I joined Global Marine as part of that transaction. Bridgehouse is run by a group of investors and managers who have for many

years acquired, consolidated, integrated and sold businesses across many industries with a good deal of success. In the case of Global Marine we saw an opportunity to return to profitability through a restructuring process and in the past year we have exceeded our own expectations for the business and are proud to say that Global Marine is once again a financially stable company.

By way of an update relating to this transaction, I am delighted to announce today that the final piece of the Global Marine acquisition was completed last week with the purchases of the stock holdings in SBSS.

This \$32 million transaction was concluded after an extensive review process by our partner China Telecom who held the right to veto the transfer as well as a detailed process of regulatory approval by the Chinese authorities.

It can be argued that we, as a team of investors and managers, knew little about the subsea market when we bought Global Marine last year. Admittedly, given the sheer amount of Marine experience in the room, our approach may be a bit too simplistic, but there were a few lessons - both generally and ones specific to the undersea cable market - that we have taken away from this past year. These are lessons you may find useful as you think about your own businesses in 2006.

In the spirit of keeping things simple, I have attempted to group some ideas into three main points – the first:

1. Success means understanding the whole market - not just part of it

In 1999 the subsea network market was awash in orders for business, yet very few stopped to consider in detail the underlying market conditions which were making these orders come our way. For example in the undersea cable business a company like Global Marine scaled up dramatically to deliver against huge and seemingly endless customer demand – a demand it turns out, which was based upon unrealistic market growth targets – when this growth didn't materialize Global Marine was left carrying a huge cost base and onerous contracts – driving a once proud company to the very brink of insolvency. I am sure many of you can tell this same story.

Fast forward to 2005 – We would like to think that boom and bust markets are a thing of the past – but as we all know, the real world requires us to have an understanding of the larger market conditions which surround our business and to build a pragmatic plan to address that market.

To that end, there are a few assumptions regarding our place in the current telecommunications market which I think we can all agree upon, despite the fact that this industry is certain to continue changing shape. In fact, we see an accelerated change over the next 12 to 24 months.

- **First Market Assumption - Modern Telecommunications depends upon submarine fiber cables**

Most consumers and business telecommunication users give little thought to how their networks and phones actually work. The world's current communications traffic, as well as most all of the traffic generated by that growth I mentioned a moment ago, travels between continents via undersea cable. Not satellite, not microwave, not

laser – but cable. This is an industry which will exist as long as we have oceans. Specifically, in relation to the trans-ocean fiber routes it is this reality that allows companies like Global Marine to prosper. We, among others, provide maintenance service for these cable systems which delivers an assurance set against quite strict service levels.

However, that said I am not convinced that we, as an industry, deliver this service in a particularly efficient way. There may be some opportunity for industry-wide improvement in this area which I will return to later in the presentation

- **Second Market Assumption - Regional networking solutions as a part of improving network density and capacity, represent the real fiber installation opportunities today.**

As our industry has matured, cable installation and telecom's infrastructure has become considerably more economical to deliver. Regional Submarine Network development is today within reach of even quite small jurisdictions and economies. A regional desire to participate fully in the world economy by most, if not all, countries is steadily overcoming the lack of network capacity in some parts of the world.

- **Third Market Assumption - Industry standards and industry collaboration which benefit the customer are worth the investment**

Most of us who went to business school heard the story of how back in the 1800's the Train industry sabotaged itself by refusing to adopt standard track widths. There were so many variations causing unnecessary freight transfer, custom maintenance costs, and engineering confusion that many companies were driven out of business by their own shortsightedness.

In less dramatic fashion, but one of practical importance to our slice of the industry I continue to believe that it is in the best interest of customers that we in the installation and maintenance business seek ways we might collaborate with each other to create agreed upon standards and processes on behalf of customers.

For example, it continues to make sense that there be a single standard universal joint for undersea cable. The cost to customers to maintain custom joints is very high and completely unnecessary. Years ago Global Marine donated its considerable intellectual property and expertise in this area to a consortium of all the major undersea cable installation and maintenance companies created specifically for this purpose. Yet in recent years, in an effort to squeeze revenue out of customers, there has been a significant shift away from this customer centric ideal.

I believe that collaboration, when it makes sense, on behalf of customers, combined with establishing standards in this way, is of benefit to our entire industry by enabling us all to deliver cost efficient installations and maintenance agreements to our customers.

When combining these types of assumptions you begin paint a picture of the place subsea cable plays in the larger market, and in the business plans of your customers. The more aware you are of the larger business trends driving the puts and takes of your business the more you are able to minimize risk and maximize potential opportunity. Simple enough, right?

OK – on to the second main point:

2. Revenue is nice, but profit is better

As a result of the market drop in the past few years Global Marine had to be restructured completely. During that process, there could be no allowance for operational costs which did not drive to ultimate profitability. All of us are faced with deals which may bring a lot of revenue in the door, but when faced with the operational realities of the business have very little chance of ever being profitable. A series of these borderline projects can kill a business very quickly unless, of course, you can depend on a parent company to pay the bills. Otherwise this scenario is best avoided by setting profitability as your business priority rather than less reliable statistics such as market share or revenue.

In the case of submarine cables the choices have been hard, but clear. For example, don't chase bad deals and don't be willing to mortgage the future of the company on a long shot. Sure, customers will always drive a hard bargain, but when you are willing to be driven down to taking a loss on project after project, well you know how that story ends...

Beyond that, insolvent vendors chasing deals only lead to poor quality projects, lawsuits, artificially low prices and potential damage to the ability to deliver quality for the entire industry sector.

A lot of this residual effect is still playing out in our market pointing to trends or actions which we believe will continue to have an impact on market stability and profitability.

An major profitability trend we are continuing to keep an eye on today is that:

- Further consolidation and restructuring continues to be necessary and likely in the cable laying and maintenance market:

In 2004 you may remember that the question was whether Global Marine would survive. Restructuring was painful but necessary for the business. Hopefully since that time we have been able to put those survival questions to rest; Yet, as recently as last week more stories about other possible changes in our industry landscape were published pointing again to further divestment and possible consolidation.

An example action which is important to driving profitability is that:

- Some of our business models need to be updated and diversified

Our current model is a legacy of telecom ownership combined with the recent build out. During the late 90's and early 2000 global network provisioning was at it's peak. Many would argue that a lack of cooperation between the telecommunications companies lead to overcapacity in certain routes when considering subsea, and for that matter, terrestrial fiber. The market has certainly changed, but our business model hasn't. To drive to sustained profitability, a business model needs to reflect current market conditions. Opportunities such as work diversification and asset utilization offset risk and overdependence on one industry or one set of skills.

The continuing consequences following this massive network build out is that cable laying fleets are often still too large and too expensive to operate. The truth is that in 2004 there were 80 vessels around the world involved in the undersea

telecommunications business. In 2005 there are something like 50. Going forward we see that trend continuing.

Again we all know this, but it is sometimes good to remind ourselves that by setting profitability as your primary business priority rather than other statistics such as market share or revenue – the alternatives often become very clear at both an industry and company level – for better or worse – the viability of your business becomes a very stark, and honest, reality.

Now, enough of that grim stuff - on to main point number 3

3. Be flexible and open to change

Change is a constant. It is often those who are unwilling to adapt their business to new and different markets who find themselves with very limited future choices. In our industry this is coming in two distinct ways.

First, the telecommunications markets are continuing radical change. The days of non-competitive telecommunications are being replaced by a mix of customers coming from all directions as a result of corporate consolidation, data networking crossover to telephony, wireless blending with internet and more.

In response, the way we do deals, build new services, think about competitors and push towards sustained profitability with our most important customers must reflect these market shifts. Fall behind, and there is no end of trouble there.

At Global Marine a good example of this type of flexibility has been the success with our Partners here in Asia. Throughout the world we are a direct sales business however here in Asia we often work through our Joint Venture partners ChinaTelecom, Singtel and NTT. These important relationships were started long before Bridgehouse arrived on the scene, but it was very easy to see that this type of partnering model was the preferred way of doing business here in this vast and complex region, and we believe will continue to be an important path to success.

The second way we see industry change coming is in our need to create higher levels of asset utilization. It will not surprise anyone that customers are always interested in finding ways to decrease their wet maintenance costs, that said, a close look at standard contracts yield some interesting potential tradeoffs.

As mentioned a bit earlier, current cable maintenance business models are a product of the boom years and it is common for a contract to require a maintenance vessel be ready, within one day, to leave port for the repair site. The actual time it takes to complete a repair is less stringently defined with consideration given for poor weather, etc. The urgency of those first 24 hours cost customers a significant amount of money.

Now of course the repair must be made as quickly as possible, hence the 24 hour contract provision. Yet, by requiring that cable ships be immediately available for any emergency, carriers are adding a significant cost to the operation of their networks. This often means the vessel spends a large percentage of its time waiting in port - unutilized.

With a bit of cooperation between Telecommunications companies in much the same way they currently arrange network peering - or absent that, an alternative network design -

traffic could be re-routed, eliminating any disruption of service in the event of almost every cable problem. Therefore, with adequate planning, and no service disruptions, mobilization on day 2 or even 3 would yield considerable cost savings for carriers.

In the end, carriers, and customers in general, are much happier when they are dealing with healthy, viable vendors and cable ship operators have healthier businesses when they improve asset utilization and diversify their services. If they are able to offer a customer good alternatives, they keep them happy, keep their services current, keep prices at market levels with a resulting opportunity to increase asset utilization and diversification.

That diversification makes them available for all manner of marine work outside of telecommunications. Things such as oil & gas, renewable energy, power, survey, inspections and various defense contract work are all available – only if the assets are in a position to pick up the contracts.

Okay, let me begin to tie this together.

Subsea cables have been around a long time, and although the beginning of the new century looks a lot different than anything we have seen before, all indications are that our industry will be around for the foreseeable future.

Over the past few years, we have all come a long way as this industry returns to some type of stability. To summarize, perhaps the key things to keep in mind are as follows:

1. Success means understanding the whole market not just your part of it:

Key points which help to illustrate this idea are that:

- Submarine cables are fundamental to telecom as a whole
- Regional networks are the future
- Investing in industry standards - great for customers & helps us all

2. Revenue is nice, but profit is better:

- The drive towards profitability is going to push further consolidation in our industry
- Some of our business models need to be updated and diversified to align with market expectations

3. Be Flexible and willing to change:

- The telecoms industry is continuing radical change & this is being reflected in our own segment
- Flexible service options can lead to satisfied customers and improved utilization of assets

With a strategic understanding of your market, end to end, a demand for profitable operations and a willingness to be flexible and open to change your business can survive the most ridiculous market enthusiasm to be one of the few left standing once everyone has come back to earth.

Since the beginning of civilization, any civilization – people have devised method after method for improving their ability to communicate with each other. Innovations which allow communications in new and interesting ways are going to keep coming.

The last word on undersea cables?

The internet bubble burst was not a sign of internet failure – it was a direct result of bandwidth supply outstripping demand – today there are any number of new network communication tools just getting a foothold. These new tools are slowly, but steadily, filling that available bandwidth. Our subsea part of this industry will continue to play an ongoing and crucial role in their evolution. When they are filled to capacity, we will be happy to lay more cable, just as we have been for over a century and as we expect to be doing a century from now.

Additional information:

About Global Marine

Global Marine (a wholly owned subsidiary of Bridgehouse Marine) has been in business for well over a century and continues to be the pre-eminent provider of submarine cable installation and maintenance services in the world. Since the installation of the first telegraph cables in the 1850s, it has been essential for system owners to produce detailed cable maps to plot the location of a cable on the seabed, keep it maintained, and ensure that information is regularly updated.

Global Marine has remained at the forefront of cable installation and maintenance ever since. Operating with the world's most advanced fleet of cable ships and subsea vehicles, it is a market leader in marine cable installation and maintenance for telecommunications, as well as scientific research, oil, gas, utilities and the renewable energy sector.

It has installed more undersea fibre optic cables than any other operator. More than 50% of the world's buried fibre optic cables have been installed by Global Marine Systems and, between 30 and 40% of all subsea cables repairs and maintenance are undertaken by the company. It continues to develop sophisticated tools and techniques to plan, install and maintain cables in order to improve the resilience of its customers' systems. With a highly experienced and knowledgeable workforce operating cutting edge systems, it ensures its customers receive the most innovative and forward-looking solutions for their specific needs.

Global Marine is at the forefront of data record management and continually develops new technology to meet the needs of the submarine cable industry. Its developments in state of the art geographical information systems and computer mapping technology play a vital part in the drive for greater system security.