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TOPICS

Business Conditions for Major Domestic and Overseas Telecommunications Business Operators (Fiscal Year 2001 to Fiscal Year 2007)

Introduction

Both domestic and overseas telecommunications business operators have, in recent years, experienced substantial changes in their markets in conjunction with advances in technological innovation. These changes, as represented by the shrinking of the fixed communications market and the expansion in mobile communications telephone market, including mobile telephones, the penetration and developments in broadband services such as ADSL and FTTH (Fiber-to-the-Home), shift to IP in telecommunications networks, and the restructuring of the market through mergers among operators, have had a major impact on the state of business operations by these operators, as seen in financial data. Analyzing these interannual shifts brings to the forefront the state of structural change in this market environment.

MIC's Institute for Information and Communications Policy, having taken the above perspective into consideration, has carried out research concerning interannual shifts in the status of both domestic and overseas major telecommunications business operators, broadcasters and media companies, as well as information and communications equipment manufacturers, between fiscal year 2001 and fiscal year 2007, based on publicly released corporate data (business results), to which it has added other information sources such as newspaper articles to conduct its analysis. From the results of this research survey, the results concerning broadcasters, media companies and information and communications equipment manufacturers will be addressed elsewhere, this paper being devoted to an outline of the status of telecommunications business operators.

Business conditions as addressed in this paper refer to interannual shifts in sales, operating profits and the like between fiscal year 2001 and fiscal year 2007, and in addition to Japan, the survey includes major business operators in the United States, Europe and Asia. In terms of what is meant by "major operators," in Japan these are the top three companies in terms of annual sales and for overseas, they are companies with sales of over \$20 billion a year (where group companies are concerned, consolidated results were considered as a single company performance). As a result, the domestic companies are NTT, KDDI and Softbank, the American companies are AT&T,

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Verizon, and Sprint Nextel, the German company is Deutsche Telekom, the Spanish company is Telefonica, the British companies are British Telecom (BT) and Vodafone, the French company is France Telecom, the Italian company is Telecom Italia, and in Asia, China's China Mobile and China Telecom were included in the survey.

In terms of what constitutes a "fiscal year," this can be different from operator to operator who use different accounting periods, and aside from domestic companies, Vodafone and BT that use a March year end, other operators all use the calendar year as their fiscal year. Consequently, looking at the most recent year which is fiscal year 2007, this can be both April 2007 to March 2008 and January to December 2007, the effects of the financial instability and resulting economic crisis that emanated from the United States recently will not be reflected in these survey results. Please know, superfluous as it may be to state, that any opinions reflected in the text are strictly those of the writers.

Overview of the business conditions of telecommunications business operators

(1) Japan

Whereas the trend in sales has been more or less flat, in terms of operating profit, KDDI and Softbank have been benefiting from the relative good health of the mobile telephone market and have been seeing an upward trend.

(2) The United States

In terms of sales, the trend has been towards a continuing small-scale decrease against the background of the poor performance of the old AT&T, and operating profit margins dropped sharply in fiscal year 2007 with Sprint Nextel's serious deterioration in performance.

(3) Europe

Telefonica and Telecom Italia have been aggressively expanding overseas and have seen ongoing increase in sales and operating profits in recent years.

(4) Asia

Against the background of rapid growth at China Mobile, sales are on a long-term upward trend, with operating profits also on an upward trend. In addition, operating profit margins are being maintained at high levels (See Figs 1, 2, 3).

Furthermore, with regard to the graphs that show trends in sales and operating profits, they attribute a value of 100 to the fiscal year 2006 figures in showing trends. Also, in terms of sales, calculations were made using the exchange rate of the time from the base of yen in Japan, dollars in the United States, Euros in Europe and yuan in Asia (China).

Figure 1: Trends in sales by region (index)

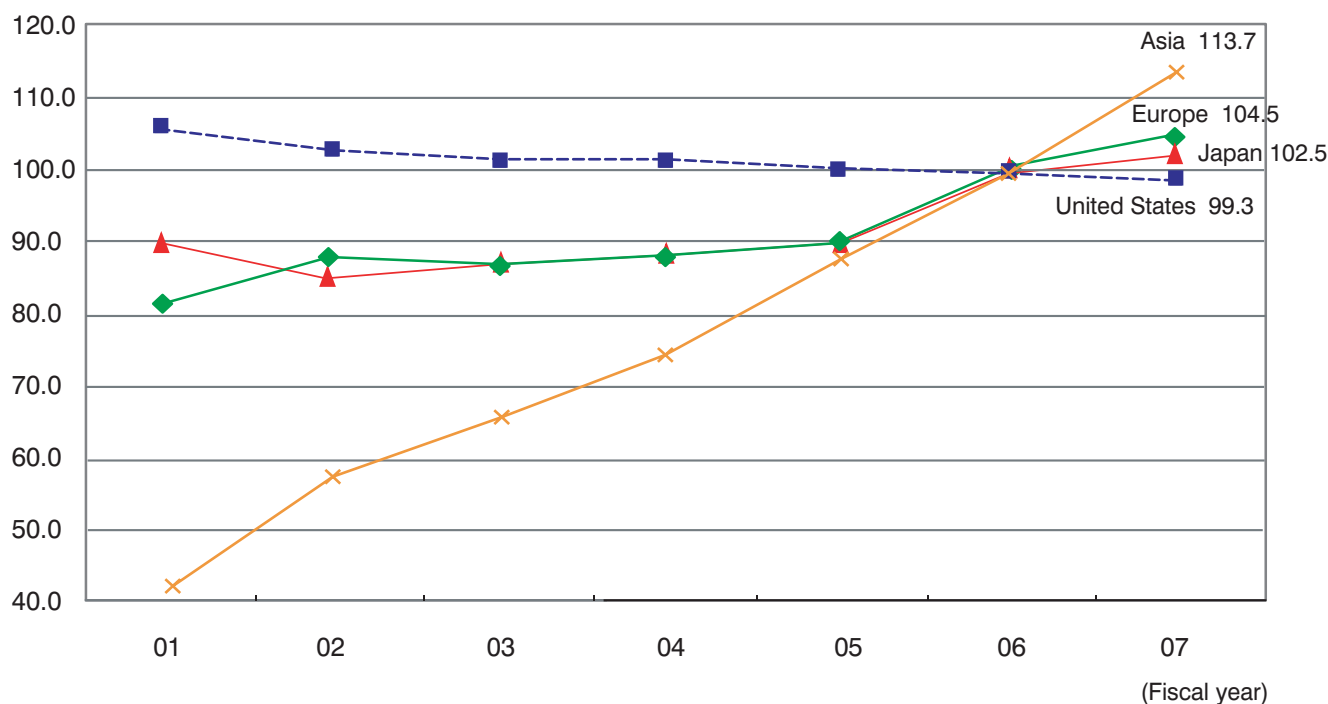


Figure 2: Trends in operating profits by region (index)

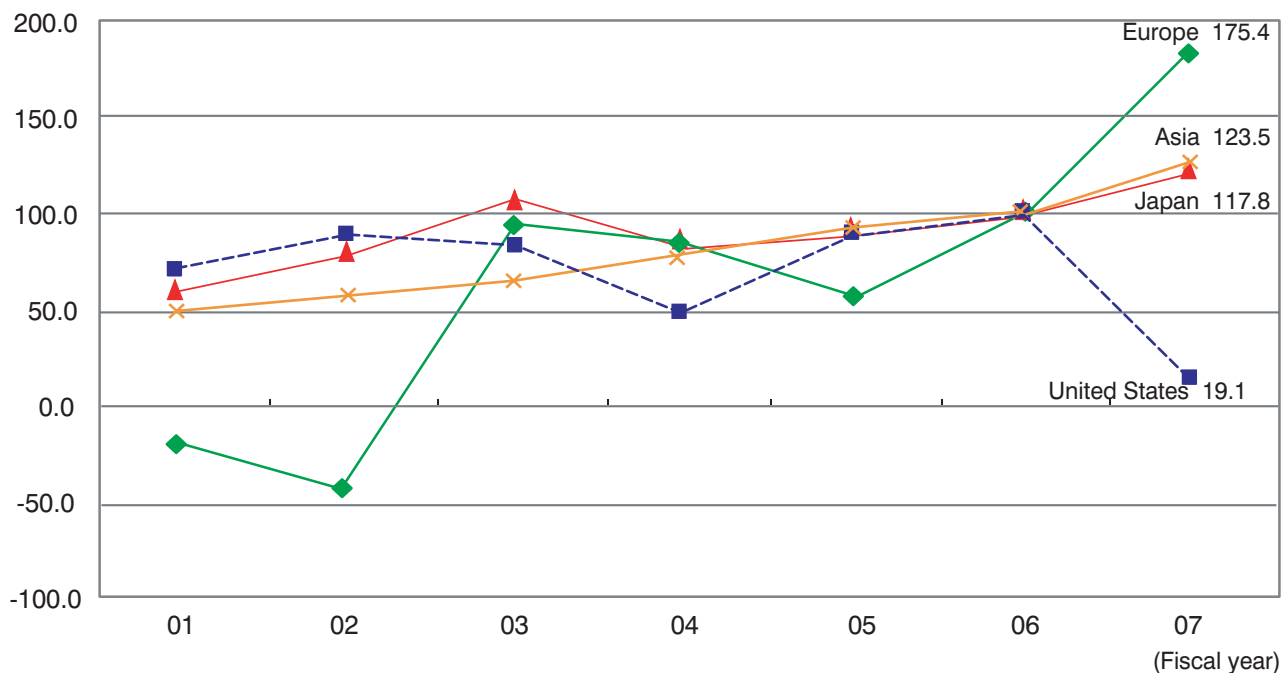
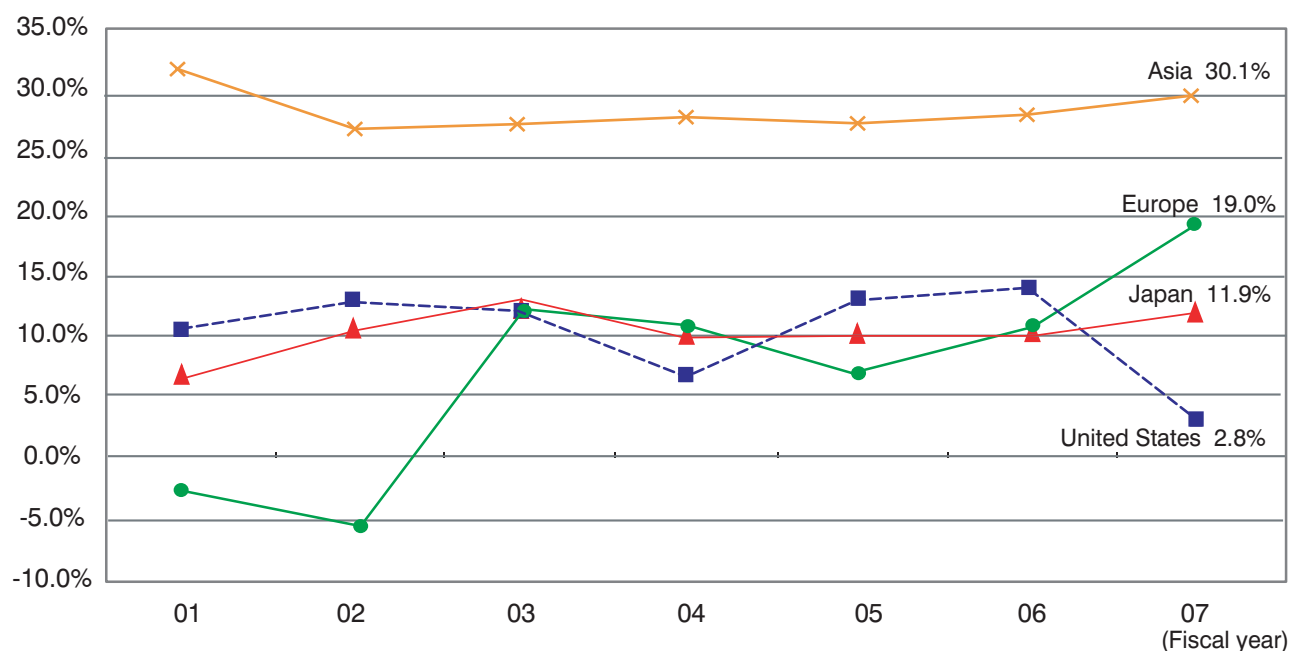


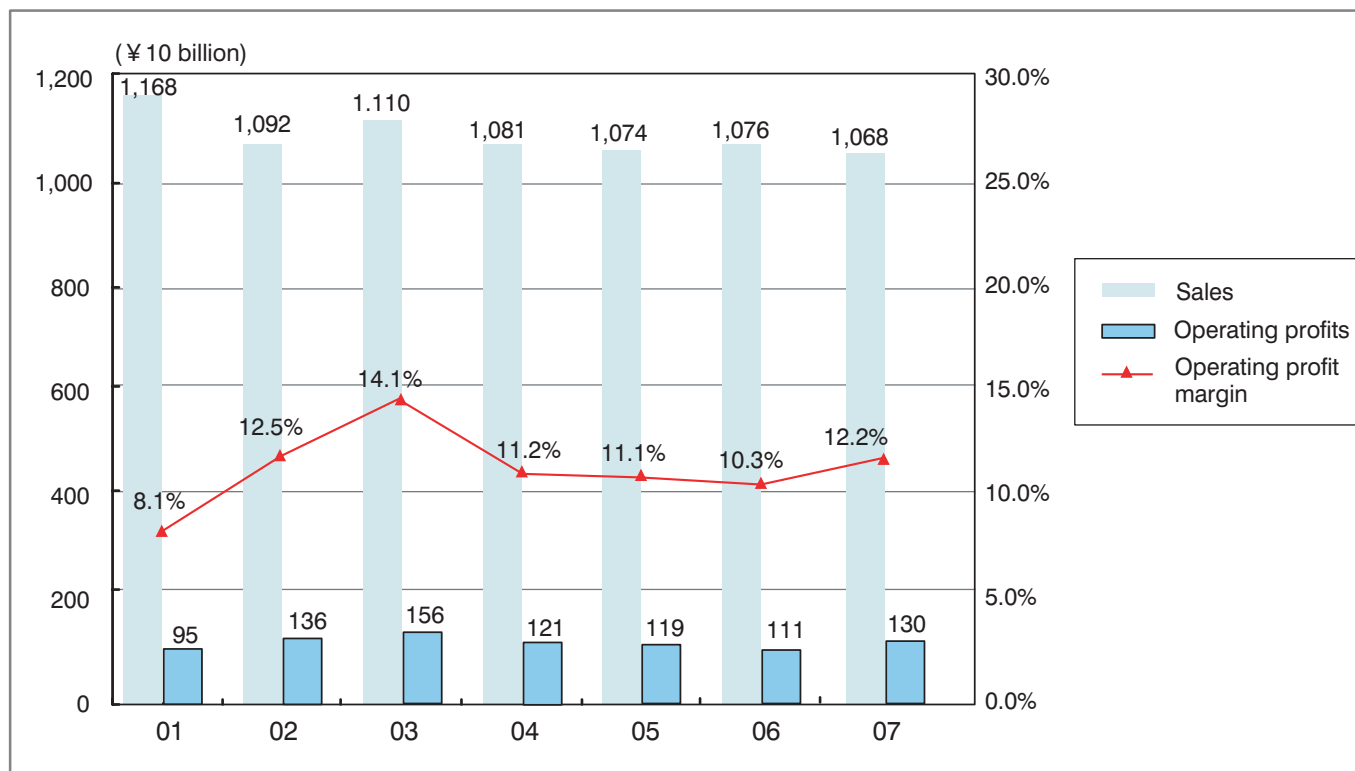
Figure 3: Trends in operating profit margins by region



Business conditions for telecommunications business operators in Japan

With regard to the NTT Group which accounts for over 60% of domestic sales among Japan's major telecommunications business operators, sales are on a downward trend against a background of a slow fixed communications business, with voice communications related sales dropping at a faster rate than the increase in revenue from IP-based services, but operating profits turned positive in fiscal year 2007. The increase in operating profits was in the major part due to extraordinary profits that came from a reduction in retirement contribution liabilities related to the interim portion of interim redemptions of pension funds, but even if this extraordinary element is disregarded, operating profits increased, which means that the result of cost reductions is being seen. Furthermore, with regard to fiscal years 2005 and 2006, in addition to lower sales in fixed communications, the mobile telephone business was also in a slump, leading to a slump in operating profits (Figure 4).

Figure 4: Business conditions at the NTT Group



With regard to the KDDI Group, there is a continuing trend towards a slight increase in sales but this has probably mainly been sustained by the mobile telephone business, and conditions are not necessarily good when one looks at the fixed communications business. In fact, the structure is such that the red ink from the fixed communications business, caused by the effects of the spread of FTTH is being covered by the mobile telephone business. Furthermore, in fiscal year 2007, the company's mobile telephone business maintained its good health through an increase in subscriber numbers, making a major contribution to the increase in sales and operating profits (Figure 5).

With regard to the Softbank Group, the last few years have seen continuing increases in sales and profits. The background to this includes the fact that sales increased approximately 2.3 fold following the acquisition in fiscal year 2006 of Vodafone's mobile telephone business, and that in 2007, in addition to the mobile telephone business, the Internet-related business always shifted to positive figures, resulting in current conditions of seeing the highest figures for both sales and operating profits since the company was founded (Figure 6).

Furthermore, as opposed to the flat trend seen in recent years in terms of growth in mobile telephone subscriber numbers for NTT (NTT DoCoMo), KDDI and Softbank have both been increasing their subscriber numbers, and seeing increases in both sales and profits. However, the outlook after 2008 is that all three companies will see a drop in subscriber number growth, and that revisions in rate packages will see a noticeable drop in demand for mobile terminals, adding a lot of caution to what is an unclear picture concerning the business environment.

Figure 5: Business conditions at the KDDI Group

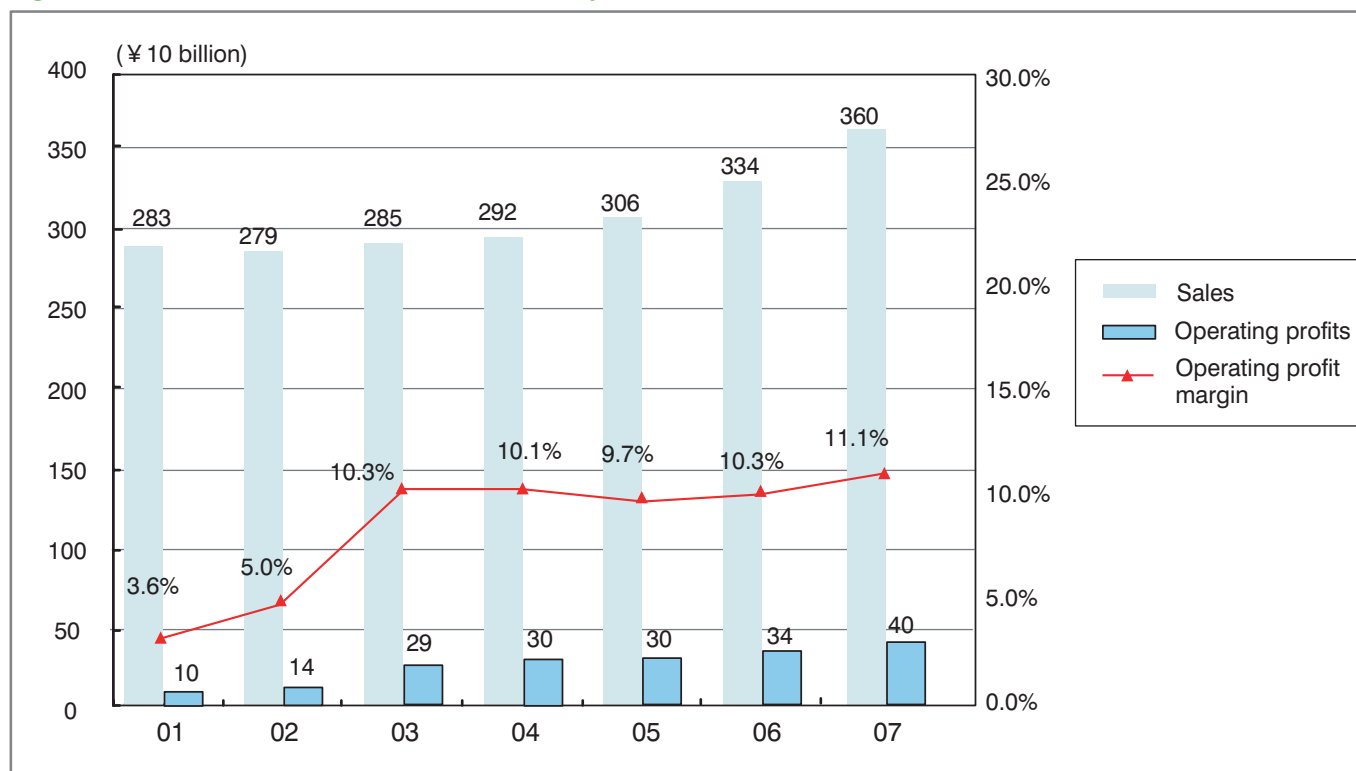
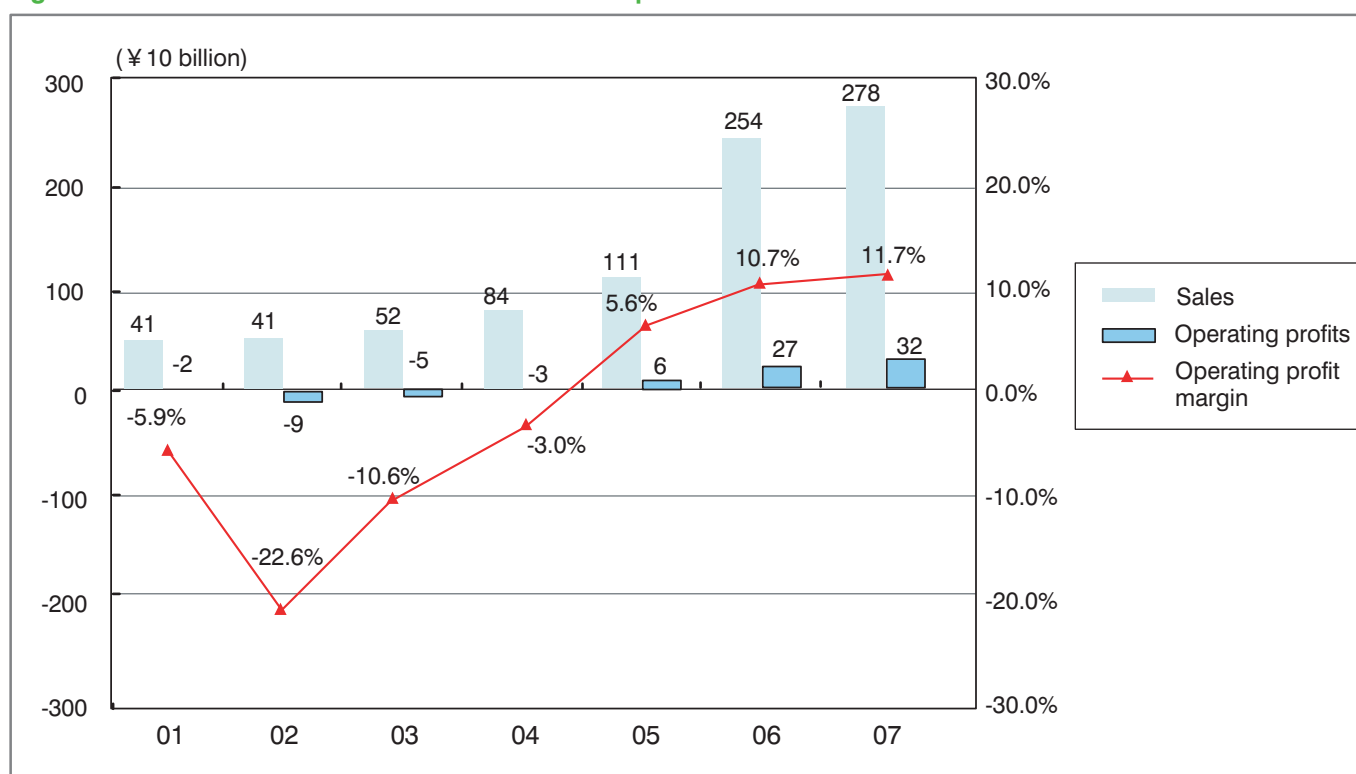


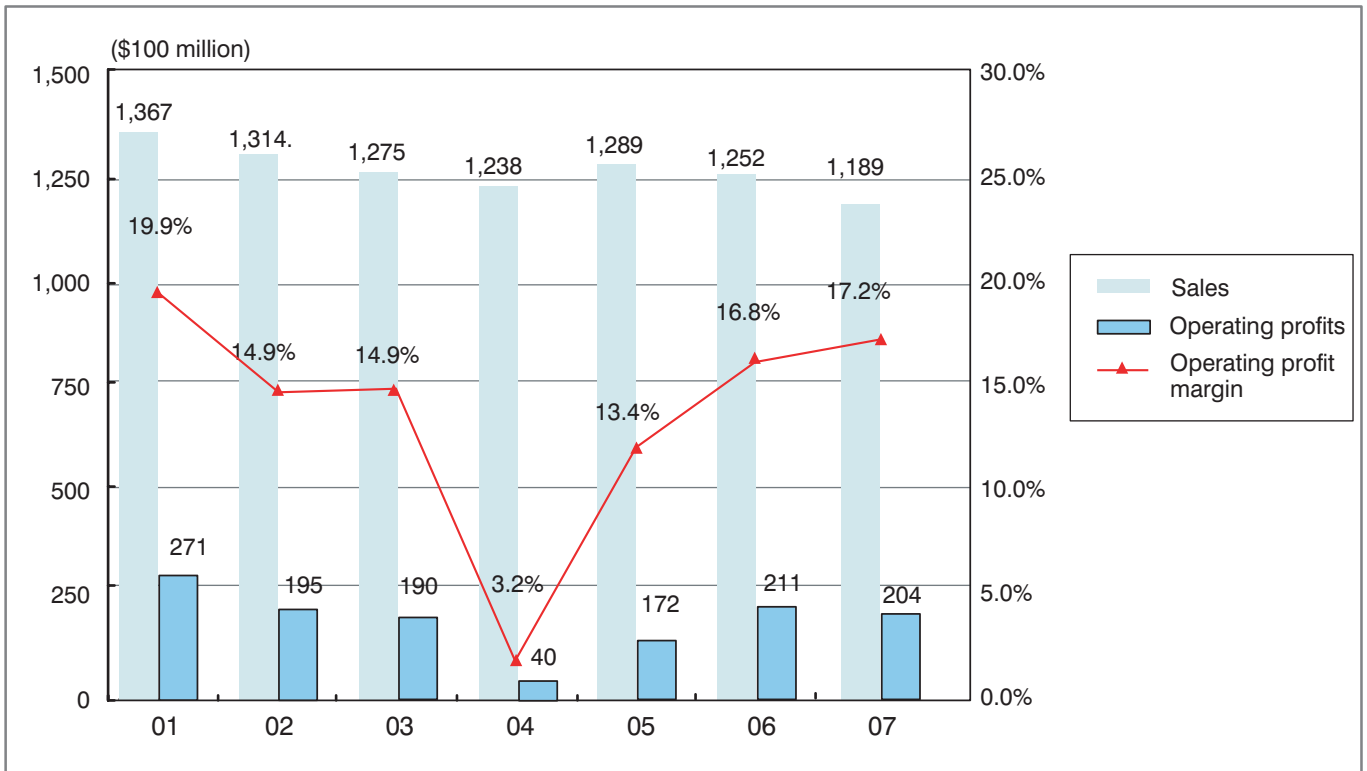
Figure 6: Business conditions at the Softbank Group



Business conditions for telecommunications business operators in the United States

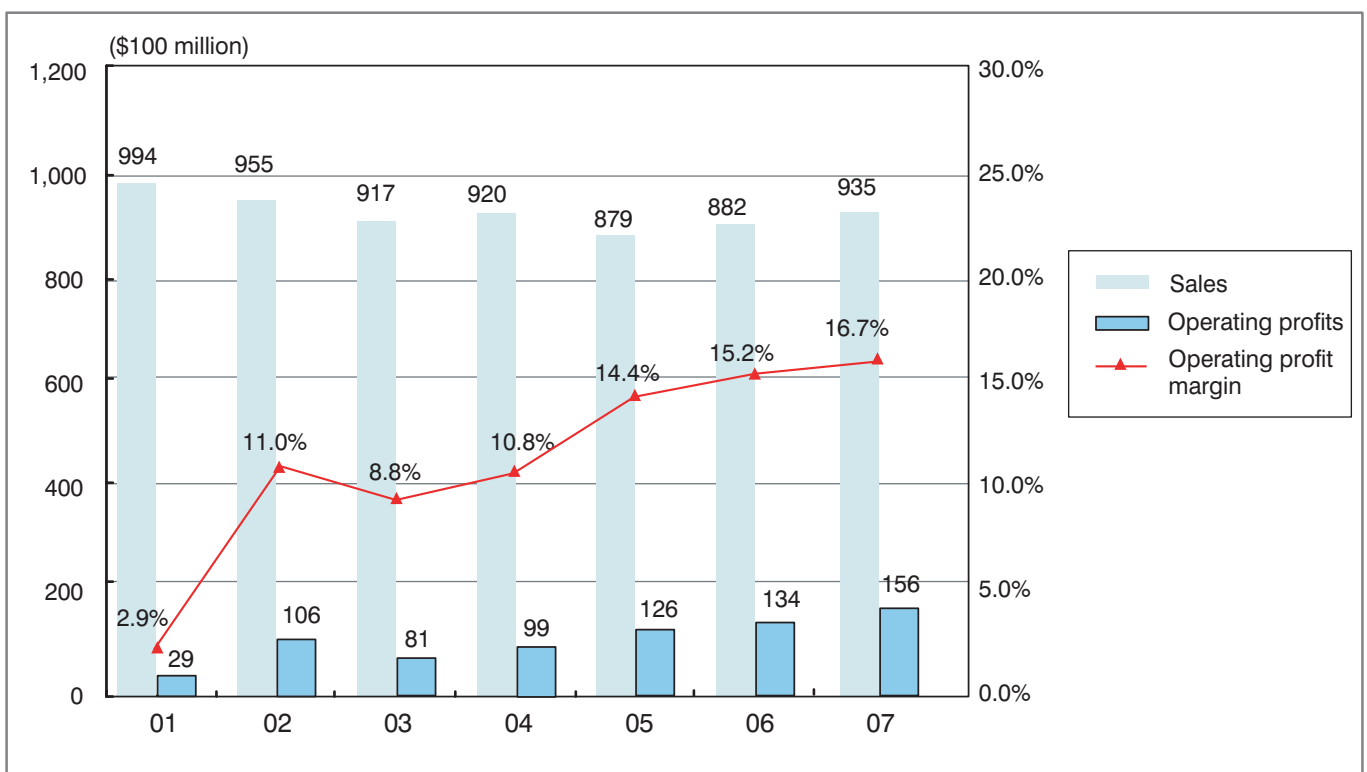
With regard to the AT&T Group, performance was depressed until fiscal year 2004 due to the poor performance of the old AT&T, but since the 2005 (November 2005) merger with the old SBC, performance has gradually recovered against a background of good demand in the long-distance, DSL, and mobile telephone businesses. Furthermore, the broadband business in the United States, which is represented by DSL, has the characteristic of having seen aggressive advances from CATV business operators in recent years, and as of July 2008, the AT&T Group and Comcast, the largest CATV operator, were competing for broadband subscribers (Figure 7).

Figure 7: Business conditions at the AT&T Group



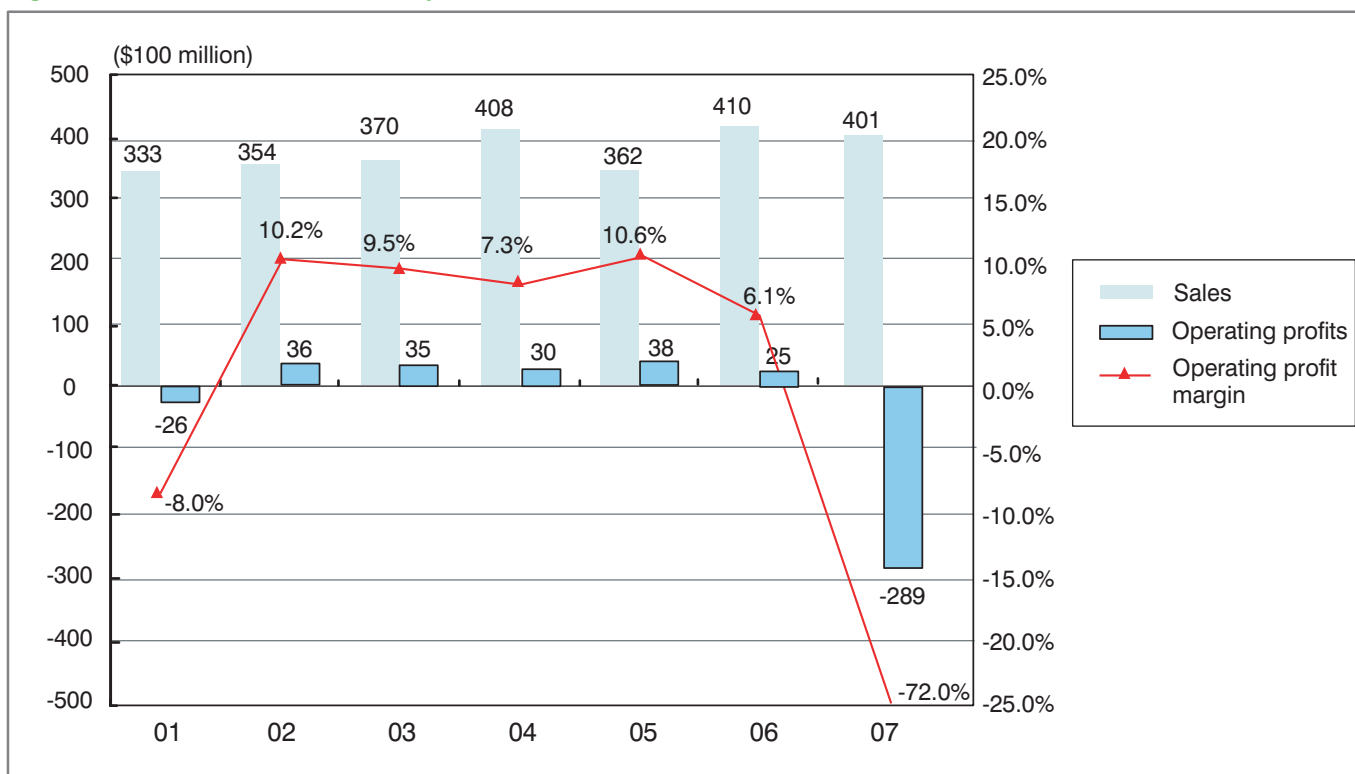
With regard to the Verizon Group, the company has sustained growth in operating profits by covering decreases in its fixed telephone business with its mobile telephone business, and with its broadband division doing well recently, has also seen an upward trend in sales. It saw its worst performance in operating profits and operating profit margins in fiscal year 2001 but the reason for this was the poor performance of the old MCI (WorldCom at the time). Furthermore, looking at the recent market for mobile telephones in the United States, it appears to be approaching saturation with a penetration rate of over 80%, and it is necessary to keep in mind that the focus of the strategy of the major business operators is in the process of shifting from acquiring new subscribers to stealing existing subscribers from one another (Figure 8).

Figure 8: Business conditions at the Verizon Group



With regard to Sprint Nextel, operating profits have been on a downward trend in recent years and fiscal year 2007 showed a major decline in profits due to a depressed mobile telephone business, increased investment costs for WiMAX, and increases in M&A costs. The company's mobile communications business has maintained good performance in data communications related sales but the reduction in income from mobile telephone units due to the worsening of price competition in recent years has resulted in a drop in sales. The company is said to have a relatively high proportion of users from low-income levels, so that its mobile telephone services are said to be more easily influenced by business conditions than those of its competitors. It is expected that results for fiscal year 2008 will see a considerable deterioration in mobile telephone sales. Furthermore, it is likely that the losses in fiscal year 2001 were the results of expenses spent on restructuring the old Nextel's business (Figure 9).

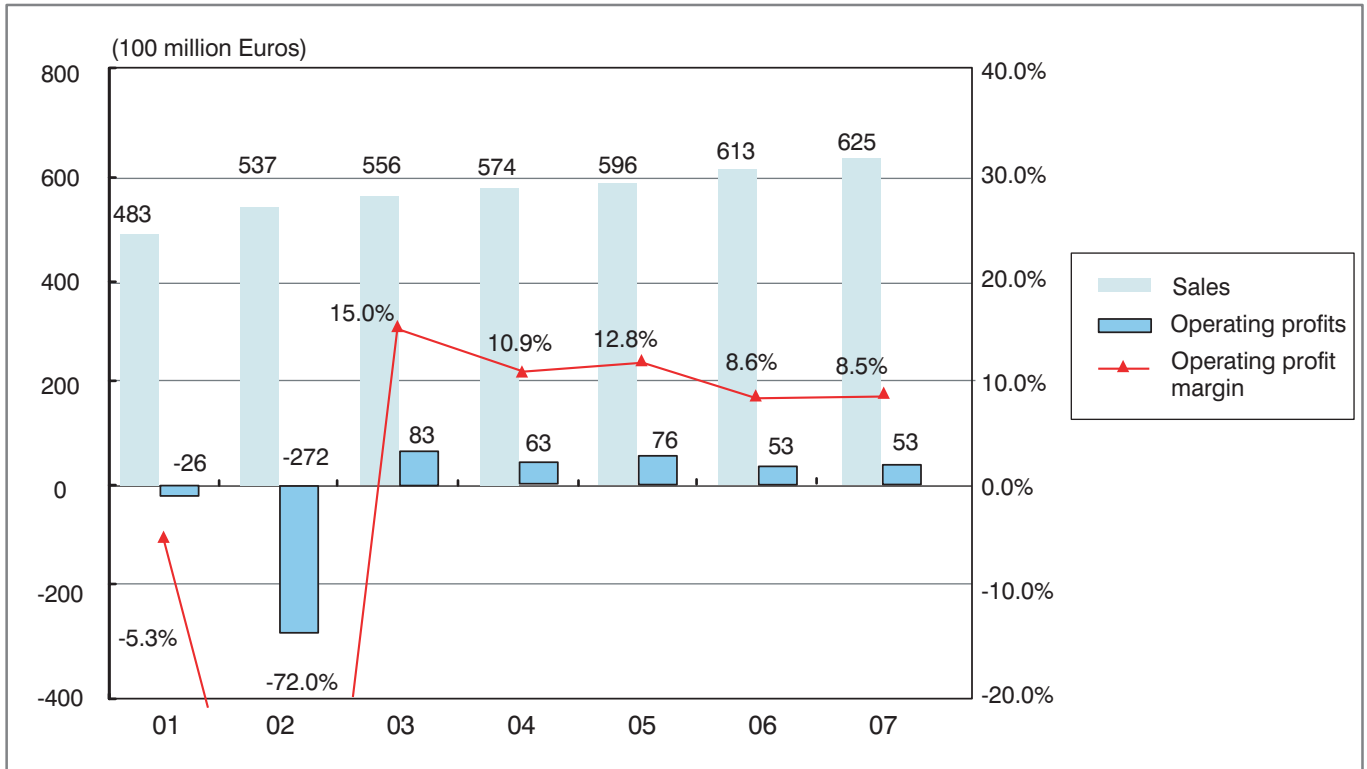
Figure 9: Business conditions at Sprint Nextel



Business conditions for telecommunications business operators in Europe

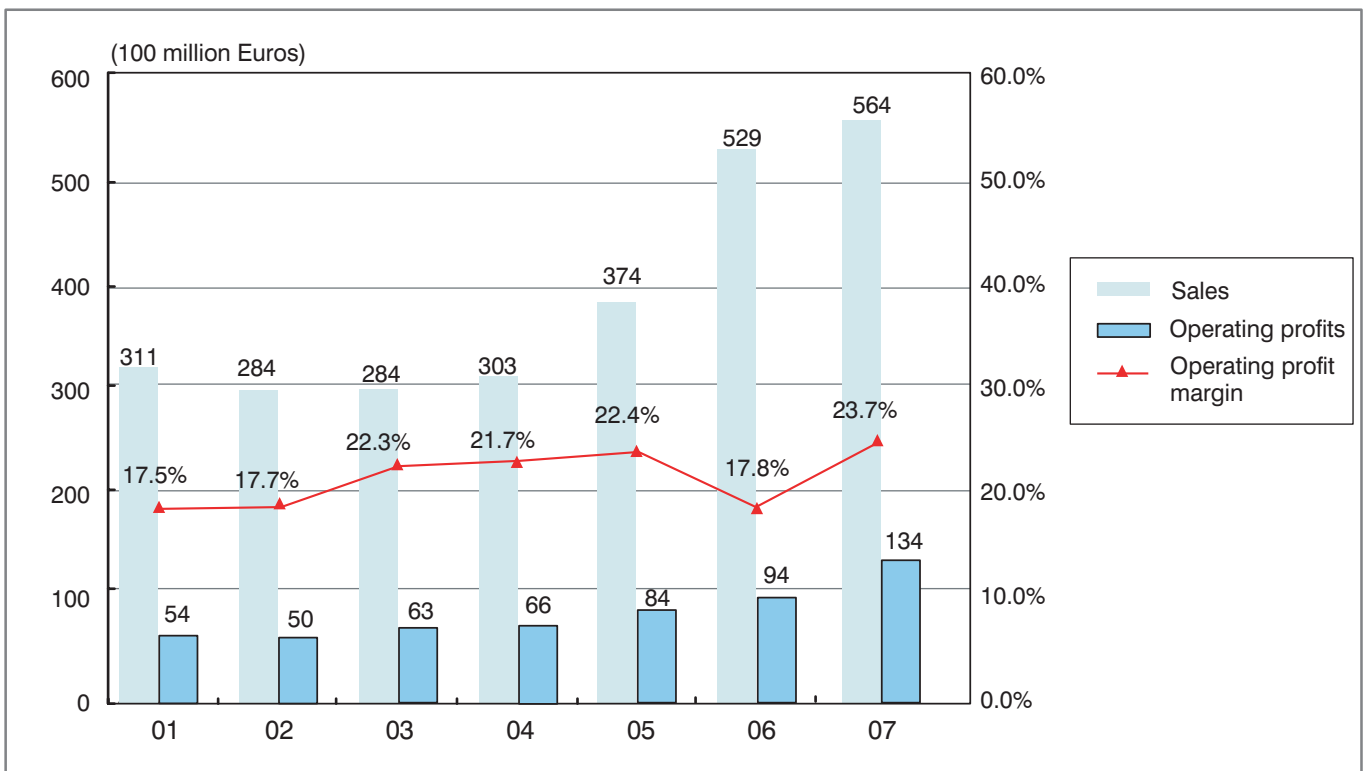
With regard to Deutsche Telekom, there has been steady growth in sales in recent years due to good performance in the mobile telephone business and the ISP business, but poor performance in the fixed communications business and the broadband business has led to a slump in operating profit margins. The company had liabilities of approximately 67 billion Euros in the past due to the purchase of 3G licenses and the like, but as a result of implementing a financial restructuring plan starting in fiscal year 2002, it returned to profitability in fiscal year 2003 and has been able to sustain steady sales since then (Figure 10).

Figure 10: Business conditions at Deutsche Telekom



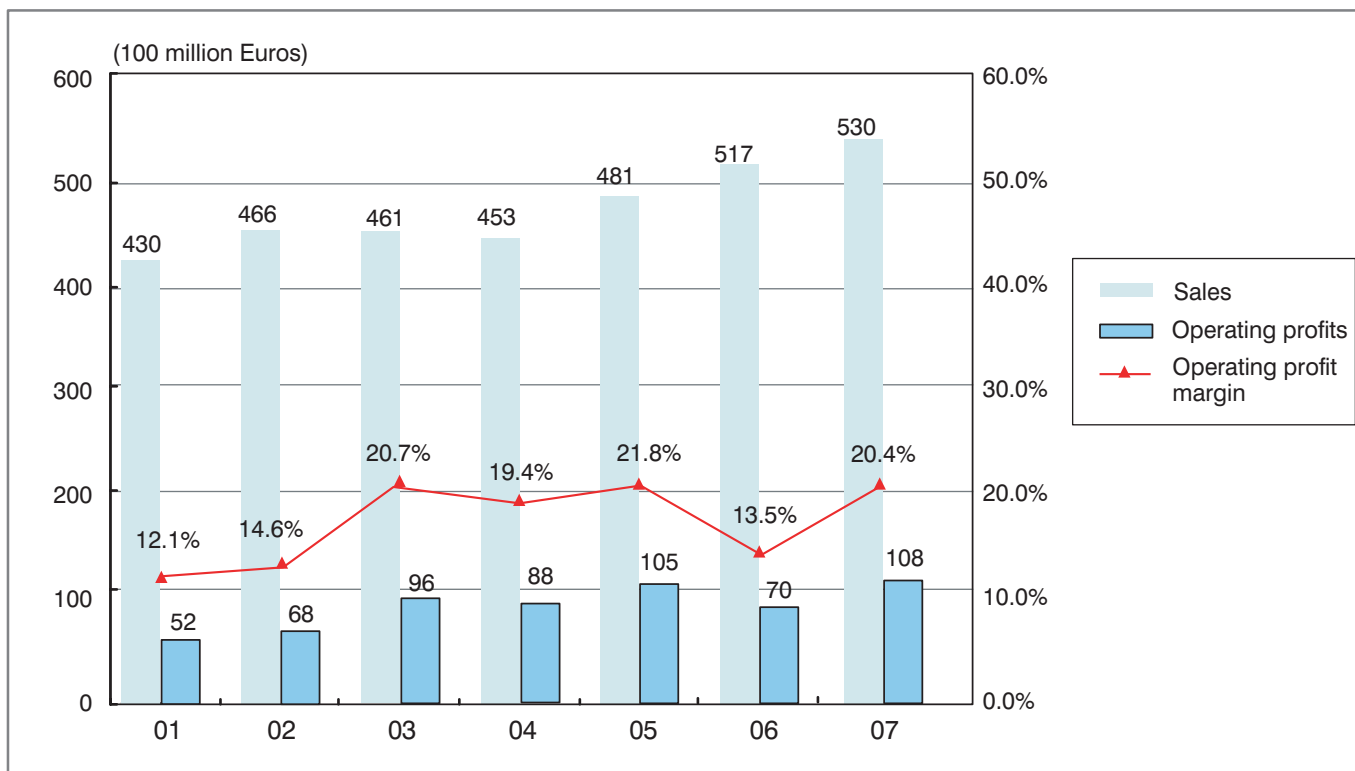
With regard to Telefonica, the company has been boosting its performance through aggressive corporate purchases, mainly in the Latin American region with, in particular, the purchase in March 2006 of the British mobile communications operator O2 (The O2 brand was kept even after the purchase). This has led to considerable increases in sales. However, operating profit margins in fiscal year 2006 were down as a result of the increased expenses from the merger. Fiscal year 2007 saw increases both in sales and profits against a background of good performance in the mobile telephone business and the broadband business (Figure 11).

Figure 11: Business conditions at Telefonica



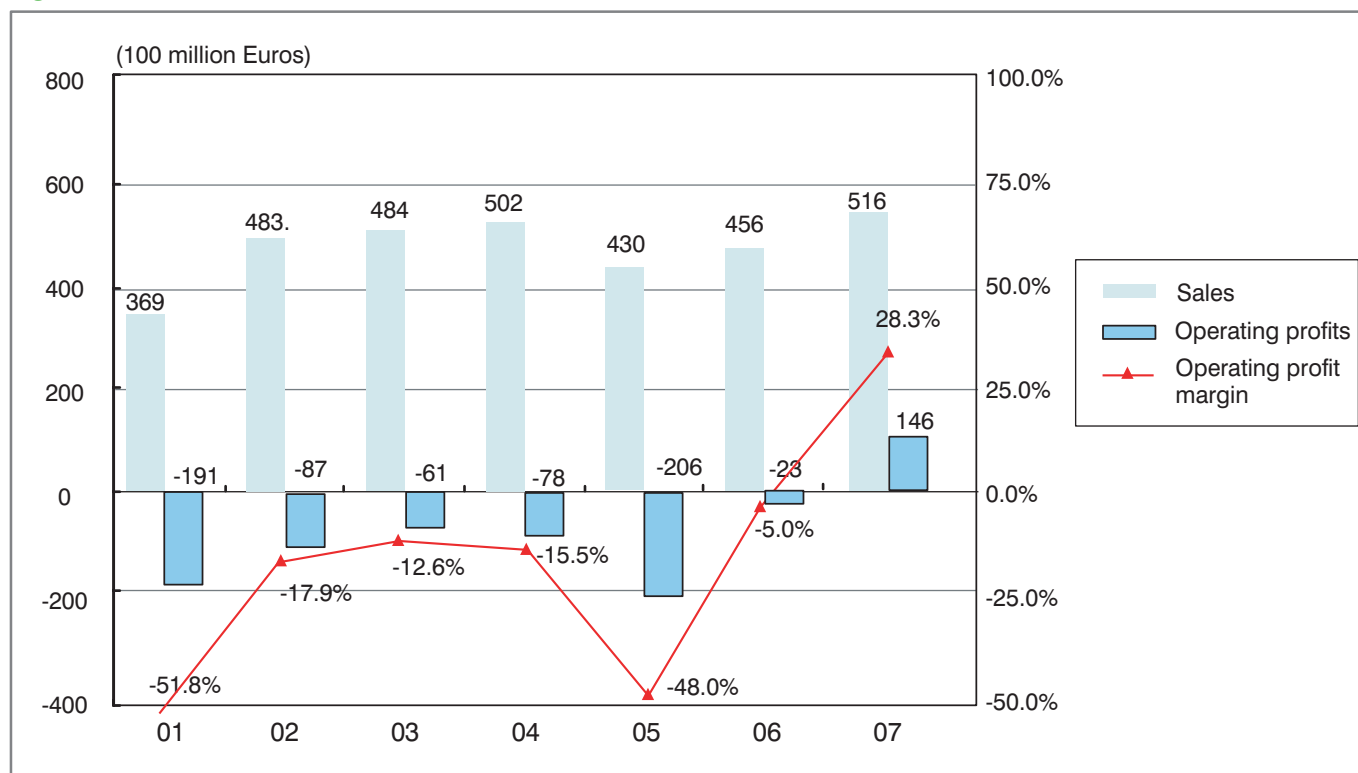
With regard to France Telecom, the result of the accumulated liabilities that came from numerous M&A's and the acquisition of 3G licenses resulted in a major loss at the net profit level (calculated including non-operating profits and losses) in fiscal year 2001 and fiscal year 2002 (operating profits were in the black). Subsequently, however, the company has seen a steady recovery with the mobile telephone business and the ISP business making up for the slump in the fixed communications business. In fiscal year 2006, the operating profit margin was down temporarily due to increased expenses in conjunction with corporate acquisitions, but in fiscal year 2007, strong performance in the mobile telephone business led to a return to higher operating profit margins and increased in both sales and profits. One characteristic of the company is that it has been working on an aggressive international development through its wholly-owned mobile communications subsidiary, Orange, and the penetration of the Orange brand is well under way, principally within Europe and in parts of Africa (Figure 12).

Figure 12: Business conditions at France Telecom



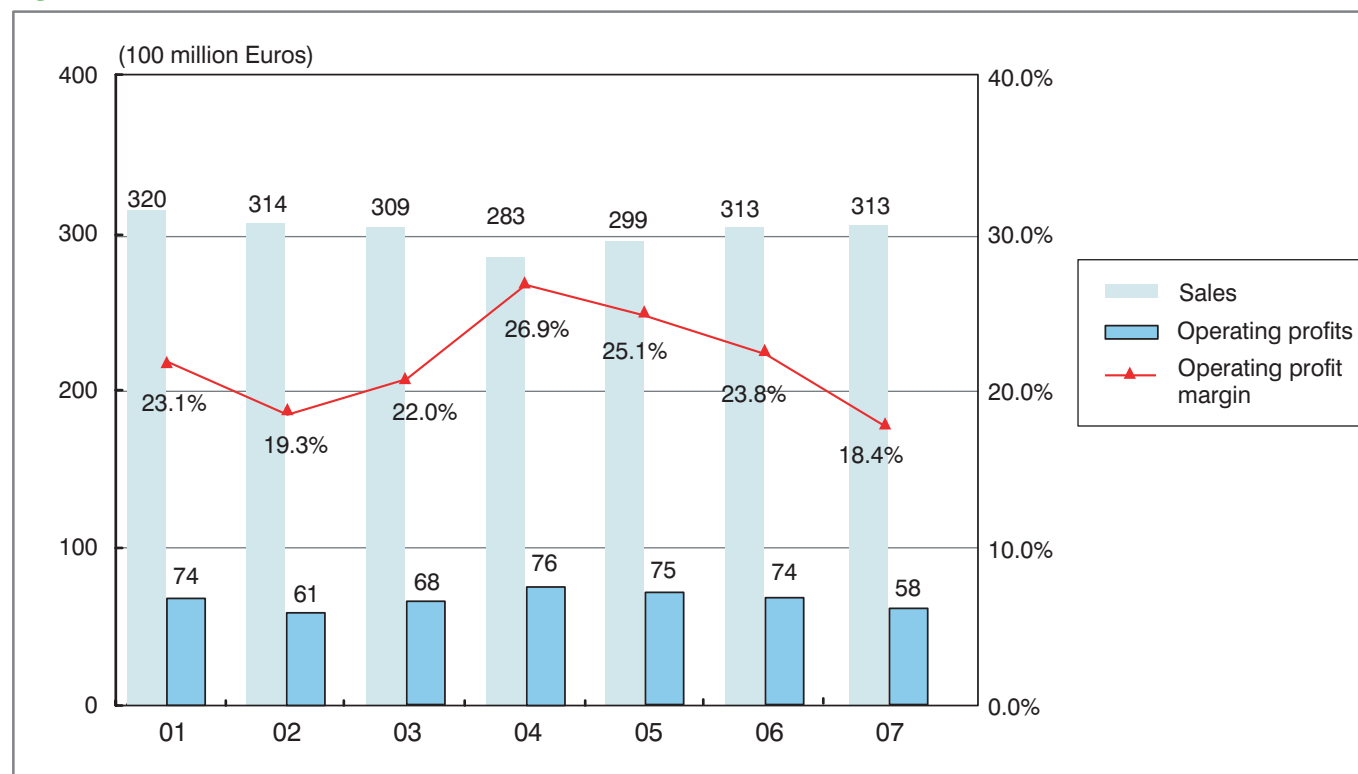
With regard to Vodafone, the slump in operating profit margins has been ongoing for some time and, in fiscal year 2005 in particular, there was a major loss in conjunction with capital investment related to putting in place a 3G network. But as a result of withdrawing from unprofitable regions such as Japan and Sweden, the trend has been towards a recovery in recent years, and the company was able to eliminate its losses in fiscal year 2007 (Figure 13).

Figure 13: Business conditions at Vodafone



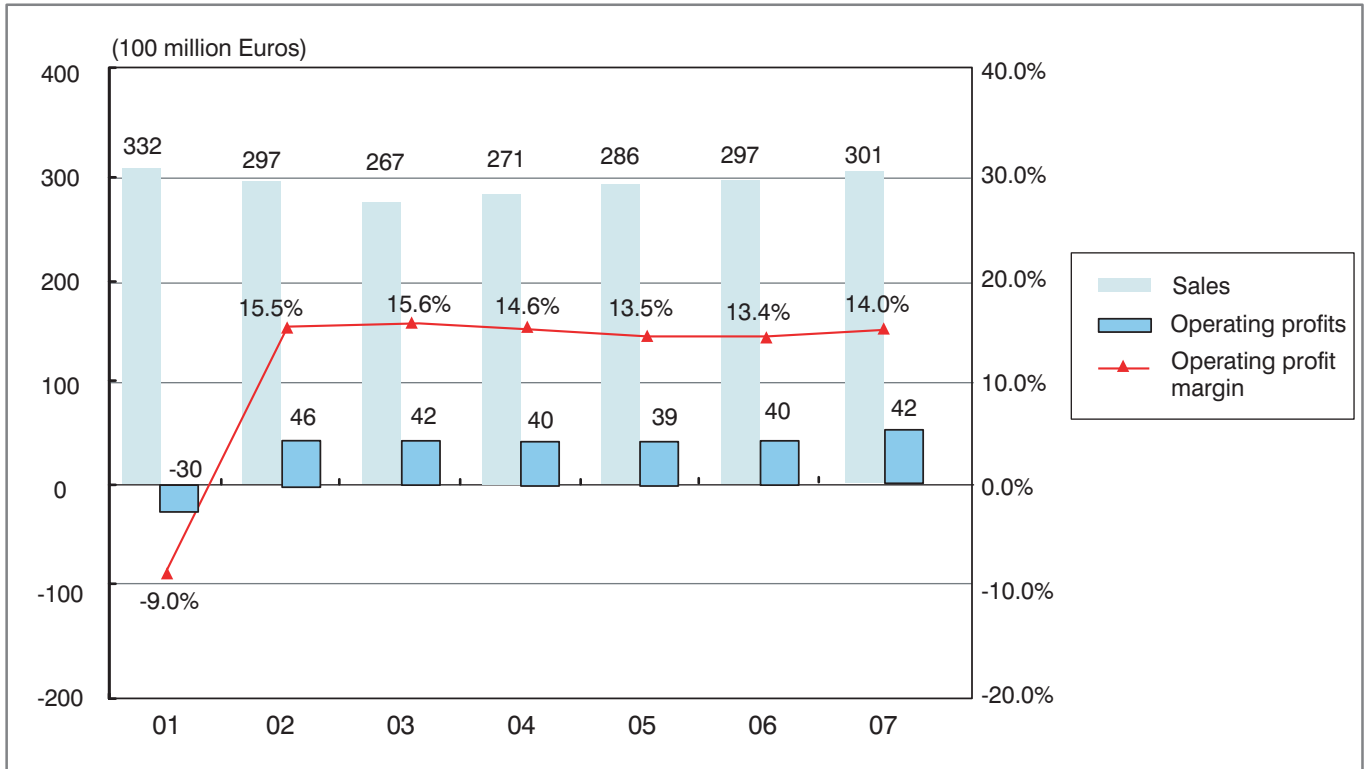
With regard to Telecom Italia, sales have been kept more or less flat against a background of good business in Europe and Brazil but, in conjunction with domestic business, in particular the fixed communications business, being depressed, operating profits have been on a downward trend, with operating profit margins also on a deteriorating trend. The basic structure remains one of being sustained by overseas business, with the slump in the fixed communications business being covered by the mobile telephone business (Figure 14).

Figure 14: Business conditions at Telecom Italia



With regard to the BT Group, the structure remains one in which the ongoing slump in the fixed communications business is being covered by the broadband business division, and both sales and operating profits are remaining flat. The company was in the red in fiscal year 2001 but, as a result of an aggressive implementation of structural reform since that year, the company has been in the black since fiscal year 2002. Furthermore, it is said that approximately 40% of BT's sales come from "New Wave" services such as broadband, ICT solutions, and BT Fusion. In addition, since it split up its mmO2 (now Telefonica O2) mobile communications division in November 2001, its mobile communications business has been very limited (it does not have its own mobile communications-related network and was using networks from Vodafone, Orange, T-Mobile, O2 and others, so that its mobile communications business development was limited to reselling), so that the scale of its sales figure is relatively small compared to the leading carriers in other major countries (Figure 15).

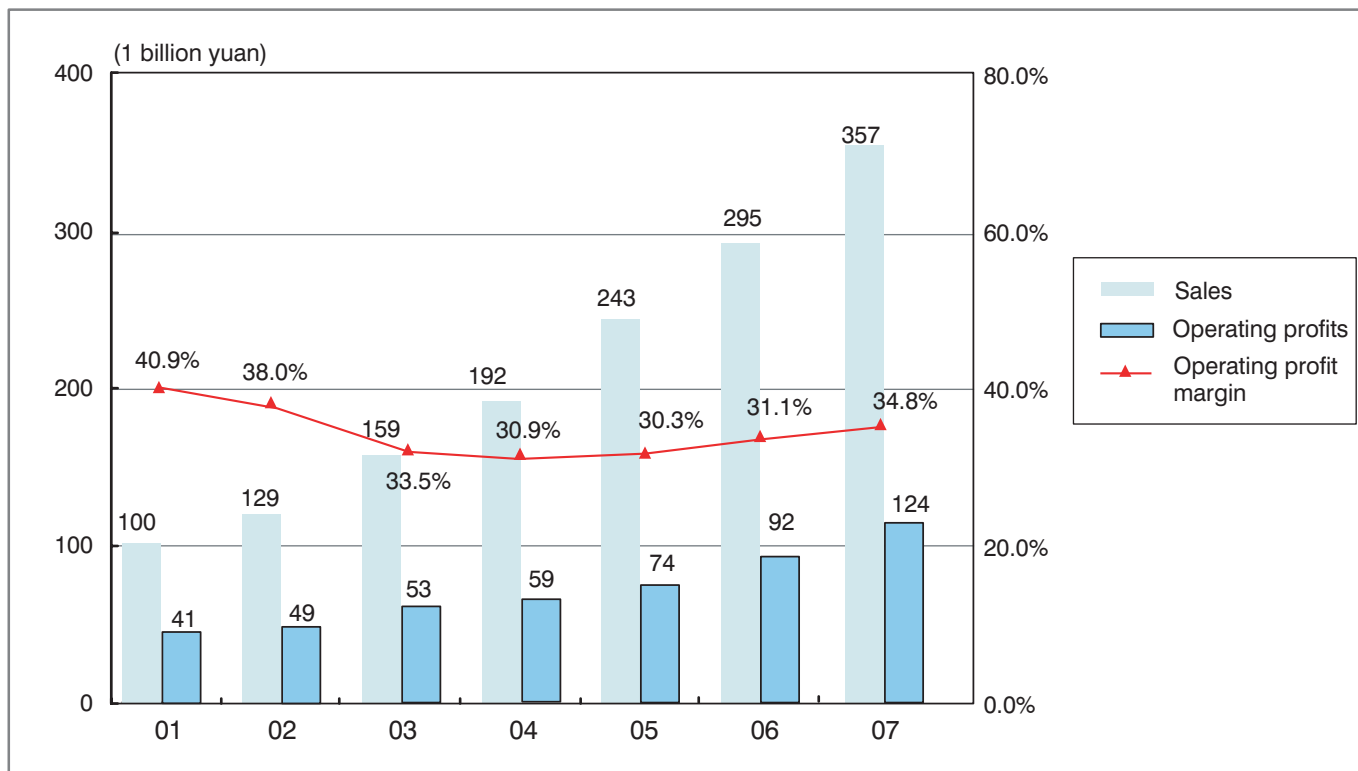
Figure 15: Business conditions at the BT Group



Business conditions for telecommunications business operators in Asia

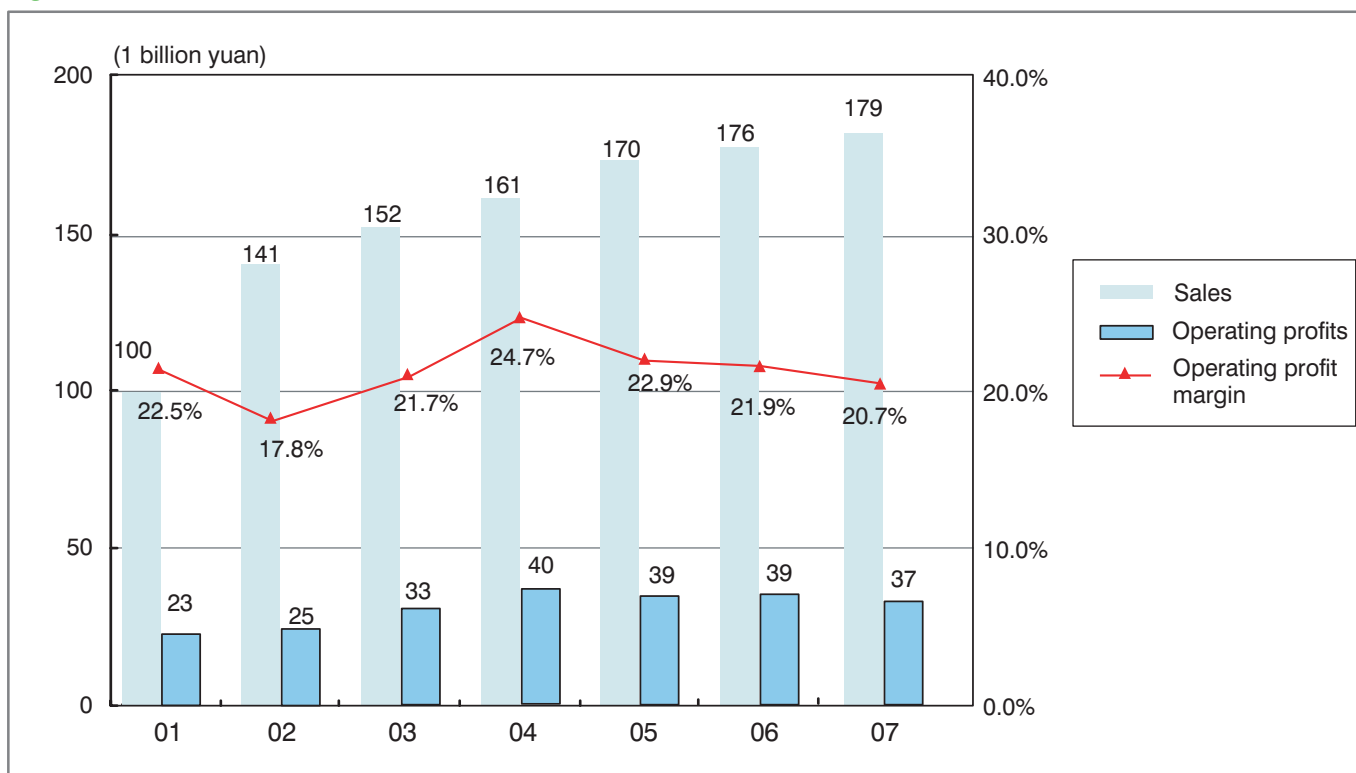
With regard to China Mobile, in addition to aggressive acquisition of regional mobile telephone companies, as well as the sharp increase in the number of mobile telephone subscribers and increased revenues from calls have led to large-scale increases in sales and profits. Since fiscal year 2003, there has also been a rapid rise in high-value added business such as data communications and short message service, which has been driving the upward trend. In addition, the successful acquisition in February 2007 of a Pakistani mobile communications operator (the old Paktel) led to further increased sales (Figure 16).

Figure 16: Business Conditions at China Mobile



With regard to China Telecom, its business was supported until fiscal year 2005 by good performance in its fixed communications business and Internet-related business, and since fiscal year 2006, decreases in the fixed communications business have been covered by other businesses such as broadband, and sales remain on a slight upward trend. As for operating profits, these maintained growth after fiscal year 2002 due to reduced costs for maintenance and repairs due to centralized network administration, but both operating profits and operating profit margins have been on a slight downward trend since fiscal year 2004 due to the effects of an increased cost burden for marketing expenses (Figure 17).

Figure 17: Business conditions at China Telecom



Conclusion

The following points emerge from analyzing the business conditions of the major telecommunications business operators in recent years: (1) a structure in which business from mobile telephone businesses, in conjunction with the expansion of the mobile communications market, has been making up for the fixed telephone business, and (2) a trend that has appeared whereby successfully pursued aggressive corporate acquisitions and appropriately timed expansion overseas have been underpinning business performance. At the same time, it is difficult to conceive that (1) above will go on forever, and a trend towards saturation is already being seen in the mobile telephone business which had been a last resort in many developed countries, and so expectations are now on the creation of new business models such as the development of wireless broadband services, the provision of services that combine communications and broadcasting. In addition to that, in terms of international strategy, the various business operators are looking to develop new markets overseas where growth is expected to be seen. For example, in November 2008, the NTT Group (NTT DoCoMo), against a background of a cooling domestic market for mobile telephones, showed signs of making a move into India, a large country where mobile telephone ownership levels have remained low, this being indicative of that trend. Against such conditions, the various telecommunications business operators will need to base themselves on the business performance of other operators, both domestic and overseas, to undertake a detailed analysis of market trends, so that they can work towards further improvements in business conditions.