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Canadian Telecommunications

2004 Canadian Telecom Summit Conference Highlights

Event

Highlights from the 2004 Canadian Telecom Summit Conference in Toronto.

Investment Opinion

- **Bell Canada \$5 Flat Rate LD Initiative.** Bell Canada's \$5/month plan for 1,000 LD minutes anywhere in Canada and U.S is designed to (1) reward continued customer loyalty; (2) increase the sales of bundled offerings; and (3) lever a product that is in decline but which still offers value to customers. While there will be contraction in the margin in the near-term, we believe that this is a positive longer-term move.
- **Project Galileo** (Bell's internal productivity improvement plan) may be proceeding better than expected. Mr. Sabia's indicated Galileo will cut "more than \$1 billion annual cash costs over the next 2 years" – compared with the original target of "\$1 billion by the end of 2006".
- **Calls for CRTC Reform.** Several speakers called for a fundamental reform of the CRTC. The most contentious issues are: (1) timeliness of decision-making; (2) need to refocus on priorities and essentials; (3) frameworks for VoIP regulation and local forbearance. The imminent federal election may spark considerable change in public policy.
- **Tests for Local Market Forbearance.** Before granting local forbearance, the CRTC will have to set the market share erosion test, and define the scope of the market. When asked for views on appropriate market share tests, the response(s) varied from 5%-7% and one potential VoIP operator indicated that 15% market share loss measured on an exchange-by-exchange basis would be likely to establish a sustainable alternative.
- **Use Deferral Account To Bridge The Digital Divide?** The CRTC has yet to decide how the Deferral Account (created by the Price Cap decision in May, 2002) should be allocated. The accumulated amount (\$800MM) could be used to fund the majority of the \$1 billion estimated to reach the federal government's goal of providing broadband access to all Canadian communities.
- **Enterprise Market.** The enterprise market remains soft overall, although select elements of the products are growing strongly (e.g. security and SANs). When asked to identify the most promising products, the ILECS indicated (1) wireless data applications; and (2) managed network services; whereas Allstream referred more generically to the Triple Threat (i.e., the ability to develop, host and deliver applications).
- **U-Telcos.** Utility-Telcos are another form of non-traditional competition. Toronto Hydro and Hydro One Telecom highlighted the evolution of their networks from local, dark fibre facilities to province-wide coverage and interconnection with utilities across Canada. Broadband-over-Power (BPL) technology appears to require further work on the quality and cost of service before it is commercially ready.

Details

Over the past two days, we attended the 2004 Canadian Telecom Summit conference held in Toronto. Presentations were made by senior representatives from government departments (the CRTC, Competition Bureau, Industry Canada) and each of Canada's major telecom service providers. The following are our key takeaways:

- **Bell \$5 Flat Rate LD Initiative.** As discussed in greater detail in today's morning comment on BCE, Bell Canada announced a \$5/month plan for 1,000 minutes of long distance anywhere in Canada and U.S. (peak or off-peak) provided that customers use Bell for at least two of either DSL, video or wireless services with a minimum two-year contract. This initiative is designed to (1) reward continued customer loyalty; (2) increase the sales of bundled offerings; and (3) lever a product that is in decline but which still offers value to customers. While there will be contraction in the margin for LD service, and upfront subscriber acquisition costs will increase in the near-term, we believe that this is a positive longer-term move that should result in increased revenue generating subscriptions in higher profit services.
- **Bell Announcements to Continue.** The pace of announcements from Bell Canada has intensified this quarter with the following highlights: (1) **New Products:** Launch of new portal Sympatico.MSN.ca (material increase in traffic hits and bundle sales), Launch of national Managed IP Telephony platform, Launch of Institutional Trade Management solution; (2) **M&A:** sale of BCE Emergis for \$307MM, purchase of 360networks (\$275MM) and sale of eastern operations to CallNet, purchase of Infostream Technologies (for Enterprise applications), purchase of Elix (Contact Centre applications).

Looking forward, future key announcements are expected with respect to: (1) **Project Galileo** (Bell's internal productivity improvement plan which Mr. Sabia seemed to imply yesterday may be more substantial than original expectations. Mr. Sabia's speech now indicates that Galileo will cut "more than \$1 billion annual cash costs over the next 2 years" – compared with the original target given in February of "\$1 billion by the end of 2006"; (2) Launch **Mobility Push-to-Talk** product; (3) Enhancement of the **ExpressVu value** proposition; (4) Expand the rollout of **video service to MDUs**; (5) **VoIP** market trials.

- **Call for CRTC Reform.** Several speakers called for a fundamental reform at the CRTC. Sheridan Scott, Commissioner of Competition called for (1) an increase in information sharing between the CRTC and the Bureau (particularly when evaluating proposed business combinations); (2) review of areas where overlap may exist; and (3) increased Bureau role particularly for forbearance analysis. A major operator called for a five-point transformation strategy including: (1) setting key performance indicators (with specific limits for timelines of decision-making); (2) re-focus on essential elements (establish priorities, eliminate unnecessary activity, redeploy resources efficiently); (3) enhance compliance activity; (4) avoid favouring/disadvantaging particular operators; (5) adapt to disruptive change (focus on VoIP regulatory framework and criteria for local forbearance).
- **Use Deferral Account To Bridge The Digital Divide?** Several operators complained that the CRTC has yet to decide how the Deferral Account (created by the Price Cap decision in May, 2002) should be allocated. The estimated amount (\$800MM) could be used to fund the majority of the \$1 billion estimated to reach the federal government's goal of providing broadband access to Canadian communities. Industry Canada's Assistant Deputy Minister Michael Binder indicated that while the CRTC had yet to release its decision on this issue, the Government's views on the importance of 'connecting Canadians' was well known, implying that using the Deferral Account to subsidize deployment of broadband in rural communities would be encouraged. While neutral for the ILECs, such a decision would not benefit the CLECs who have argued that the Deferral Account could be used to encourage competition by reducing their costs of accessing ILEC networks.
- **Regulation and Public Policy – At a Pivotal Point?** With the federal election less than two weeks away and the two leading parties in a tight race, there is increased uncertainty over the direction of future public policy and regulation. While the Conservative Party has yet to comment on its policy towards Telecom, there is potential for a significant shift in policy, particularly given its reported view on Media/Broadcasting. Additional considerations including: (1) Retiring members at the CRTC this year (four of the current nine Commissioners including both Vice-Chairpersons Colville and Wylie); (2) Review of Foreign Ownership Limits; (3) Consideration of current business combination proposals; and (4) Significant pending decisions (e.g., VoIP Regulatory environment due early 2005; Local Telephony Forbearance 2005-6; and the CDNA ruling due late 2004).
- **VoIP Proliferation Expected.** While Vonage and Primus have been the first major operators of VoIP service in Canada, virtually all operators indicated a desire to offer the service. Primus indicated that they have achieved 10,000 VoIP customers in less than six months. This is impressive, particularly since Vonage took ten months to reach the same level in the much larger U.S. market. Canada's ILECs were vocal in their desire to be able to offer VoIP service at untariffed rates for SIP-based services (over the public internet). CallNet is trialling VoIP service and expects to launch service this year.

- **Comcast VoIP Update.** Comcast, the largest MSO in the U.S., is currently trialling VoIP in Philadelphia, Indianapolis and Springfield (MA). 50% of its territory (equivalent to 20 million homes) should be telephony enabled by year-end, with an additional 20 million homes covered by year-end 2005. An unlimited 'bucket' plan would initially be offered with the potential for detailed billing later. One of the biggest learning experiences for Comcast has been the importance of testing and 'de-bugging' the software. Comcast has qualified Cisco and Cedarpoint gear.
- **Tests for Local Market Forbearance.** A key priority for the CRTC is Aliant's application for regulatory forbearance of its local telephony operations. The CRTC is planning an industry-wide process on this issue with a decision targeted in the 2005-6 timeframe. Apart from determining a market share test, the CRTC will have to define the scope of the market (e.g., a geographic determination or an exchange-by-exchange approach). When asked for views on appropriate market share tests the response(s) varied from 5%-7% (ILEC – based on Aliant's proposal) to 50% (tongue-in-cheek response from a CLEC). One potential VoIP operator indicated to us that 15% market share loss measured on an exchange-by-exchange basis would be likely to establish a sustainable alternative. This comment implies that Aliant's forbearance application might be granted – but given the CRTC's timeline, we do not expect a decision for 1.5-2 years.
- **Enterprise Market.** The top 0.3% of businesses generate 56% of business telecom revenue. The market remains soft overall, although select elements of the enterprise area are growing strongly (e.g. security and SANs). The ILECs, Allstream and CallNet all appear to offer comparable basic services, thereby raising the issue of how each differentiates itself. When asked to identify the most promising products, the ILECs indicated (1) wireless data applications; and (2) managed network services, whereas Allstream referred more generically to the Triple Threat (i.e., the ability to develop, host and deliver applications). Allstream's John Macdonald highlighted the following as the most promising services for the next 12 months: (1) Deep Packet inspection (firewall security); (2) verify ID (esp. for database tracking); (3) OC-3 applications; and (4) a range of security applications such as biometric data, detection of spam and DOS attacks/worms.
- **U-Telcos – New Kids on the Block.** Utility or U-Telcos represent another form of non-traditional competition in the telecom market. Toronto Hydro and Hydro One Telecom highlighted the evolution of their networks from local, dark fibre facilities serving large enterprises to province-wide coverage and interconnection with utilities across Canada. U-Telco revenues grew from nil in 1998 to \$100MM+ by 2002. Financially, they are responsible for raising their own funding independent of the electric utility. Toronto Hydro is not currently interested in providing residential telephony services – deferring to its sister retail distribution companies. In terms of Broadband-over-Power (BPL), Toronto Hydro has examined the technology but believes that further work on the quality and cost of service is required before it is commercially ready.
- **Other Tid-bits.**
 - Sprint Canada indicated that it expects 400,000 local customers by 31/12/04 (including customers acquired in eastern Canada following the sale of 360networks operations from Bell Canada) compared with 250,000 at 31/3/04.
 - MTS/Allstream demonstrated that, despite its hybrid ILEC/CLEC nature, the regulatory function (run by Chris Peirce, formerly Allstream's chief regulatory officer) will follow Allstream's traditional CLEC principles/perspective.
 - **Digital Ink** – Allstream's newest product that digitally captures handwritten notes and forms for conversion to digital images. It streamlines costs by eliminating scanning and re-keying handwritten data.
 - **Primus Local Update** – 27% of Primus' local customer have ported their telephone number from the ILEC and are using Primus as their primary service. 75% of local customers are new customers to Primus. Most of the customers have cable modems. There have been negligible problems with the VoIP network, although managing the feature set has been a challenge.

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