Facilities-based CLECs on the Upswing

New Paradigm Resources Group, Inc.[1]

Like the universe, the telecommunications industry continues an outward expansion; this expansion, however, is driven by economic forces of market competition. For the first century of its existence, the telecommunications industry was tightly packed and monolithic. At its center was American Telephone & Telegraph (AT&T) - more affectionately known as "Ma Bell." This core was shattered in 1984 by Judge Greene's gavel and the ensuing injection of competition in long distance markets. AT&T's break-up, though, was just the warm up act.

In the late 1980s and early '90s, competitive forces struck the very core of the U.S. telecommunications industry - the local exchange. Seemingly overnight, local exchange carriers - primarily the "Baby Bells" - were thrust into a marketplace battle few industry observers anticipated. The first competitive entrants were cleverly dubbed "Competitive Local Exchange Carriers," commonly known now as "CLECs." By 2000, there were approximately 170 facilities-based CLECs operating in the U.S. with a steady stream of new entrants following.

This initial generation of facilities-based CLECs smashed the last remnants of any thought that any telecommunications market could be insulated from competition's grasp. These CLECs were vital to setting the stage for the vast array of competitive carriers we see in today's market. These competitive carriers range from fixed wireless operators to pure-play VoIP providers, all of which follow on the trail blazed by the CLEC sector.

The CLEC Sector At a Glance (2009)

	Count
Total # of Facilities-based CLECs:	56
Total Sector Revenues	$27,929,800,000
Total Capital Expenditures	$2,651,700,000
Total Switches (Circuit + Packet)	1,866
Total Metro Fiber Route Miles	185,000
Total Buildings On-Net	77,900

Source: New Paradigm Resources Group, Inc.

The Continued Importance of the CLEC Sector

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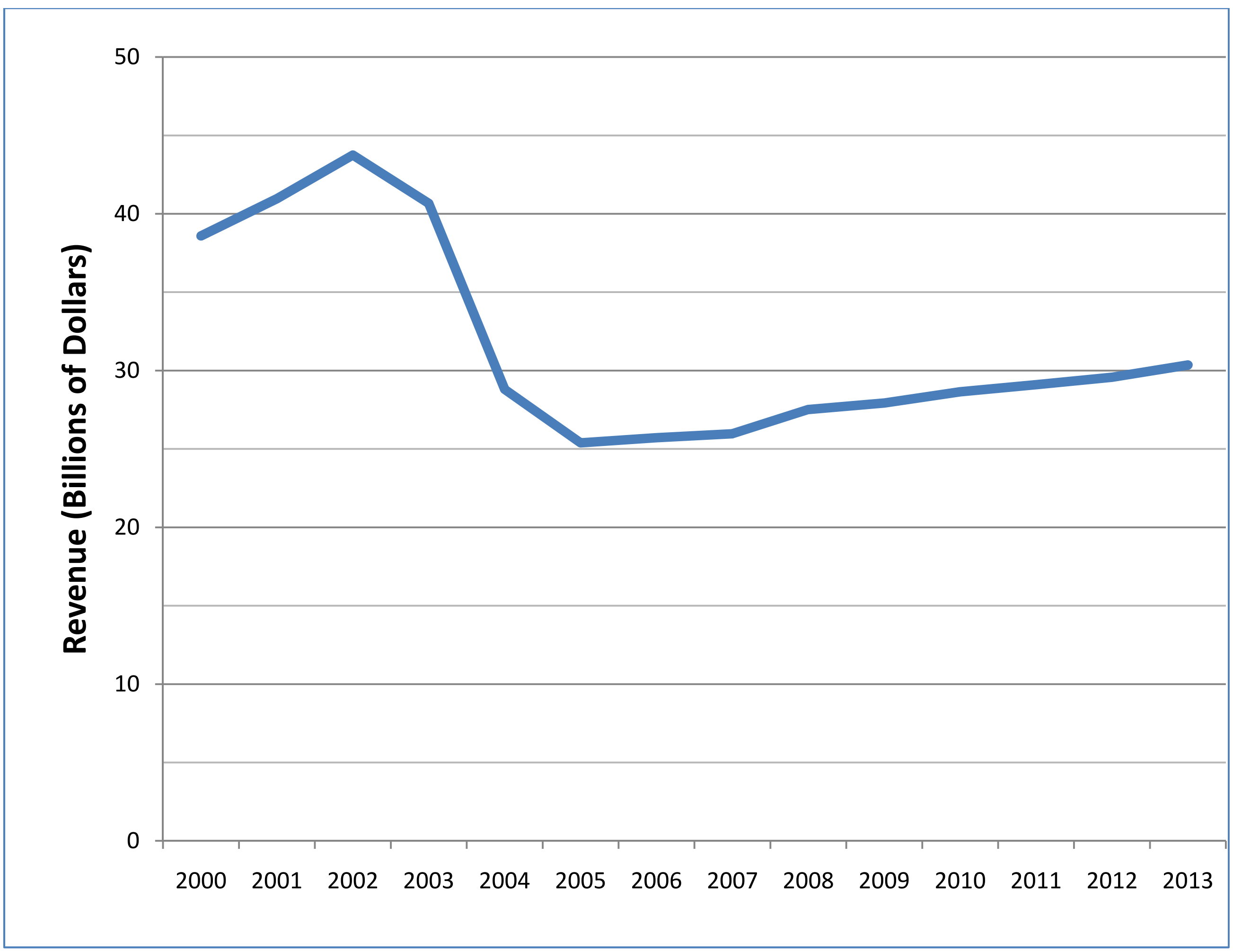
Today’s facilities-based CLECs are significant in the communications industry for three reasons. First and foremost, they have a physical presence—actual network infrastructure—that is fundamental for the provisioning of service to customers. Companies without facilities can also provide service, but such operators are wholly dependent on the network facilities of another provider.

The CLEC sector's second role is in providing competitive, viable, and meaningful alternatives to incumbent telecommunications carriers. Although no single CLEC competes with any particular ILEC in all of its customer segments, against all of its services, across all of its franchise territory, one or more among the universe of CLECs does or could choose to do so. A healthy CLEC sector ensures that customers of all types have options available to them, and provides downward pressure on both pricing and margins.

Third, in their quest to identify and satisfy underserved customers, CLECs extend upgraded service to areas or specific locations that would otherwise have no recourse if the incumbent deemed it an insufficiently profitable opportunity. While this in no way guarantees that customers can obtain any service they want at a price they are willing to pay, the explosion of fiber deployment and the development of new services as a result of the Telecommunications Act of 1996 and earlier deregulation is a testament to the catalyzing effect of CLECs.

CLEC Sector Total Revenue (2000-2013)



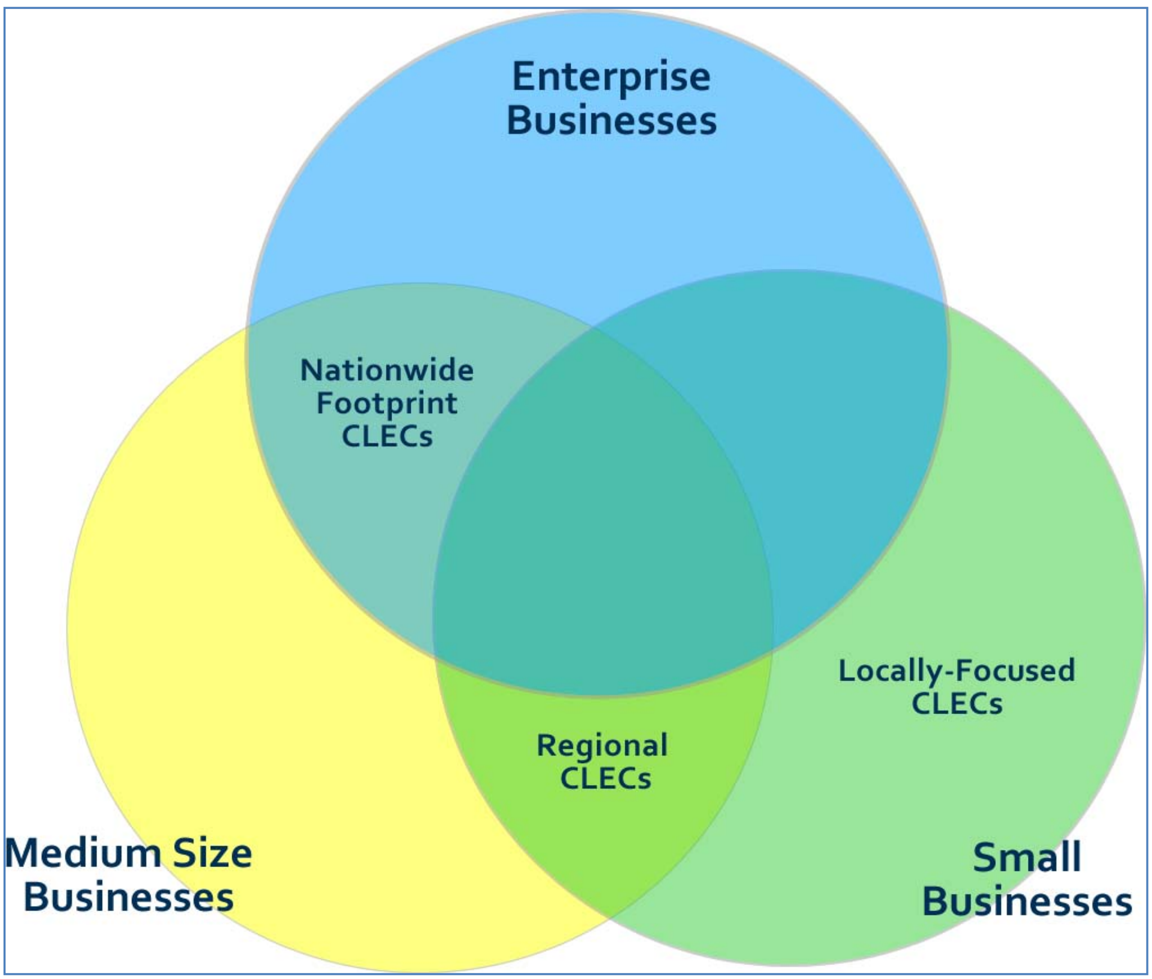
Source: New Paradigm Resources Group, Inc.

Key CLEC Strategies

There is no single CLEC model or flavor. CLECs vary widely, more so than most other sets of telecom carriers, and assessing sector leaders and laggards ultimately depends on one's perspective. The differences among CLECs are reflected in such things as the mix of technologies used in their networks, their strategic foci, and their customer segmentation.

CLECs' footprints vary considerably in regards to geographic reach. CLECs with similarly sized footprints share other characteristics in common, such as comparable total revenue growth and target customer segmentation. A CLEC's geographic reach drives, to a significant extent, the customer classes it can effectively serve. The accompanying figure illustrates the customer focus by CLECs' geographic scope.

Business Customer Focus by CLEC Category



Source: New Paradigm Resources Group, Inc.

The Coast-to-Coast Strategy

CLECs with a nationwide footprint principally provide advanced telecommunications services to enterprise businesses. Such CLECs became nationwide providers specifically to target this high revenue, high margin customer segment. CLECs falling into this category include Level 3, PAETEC, tw telecom, and XO

Communications. These carriers share several characteristics. Specifically, they own expansive fiber networks, focus primarily on major metropolitan markets, and have total annual revenue in excess of $1 billion.

The Regional Strategy

Whereas nationwide CLECs focus primarily on enterprises, regional competitive carriers tend to focus on small and medium size businesses, and in some instances even offer residential services. Regional CLECs operate in a handful of states to as many as a dozen or more. While some nationwide CLECs have acquired large carriers to build a national footprint, acquisitions in the regional CLEC segment tend to be much smaller and are often initiated to increase market density or expand in-region reach.

Regional CLECs vary in size much more greatly than those in the nationwide segment. Regional CLECs tend to have total annual revenues between $100 million and $800 million. With $784 million in total revenue for 2008, One Communications is the largest regional CLEC. Other notable regional competitive carriers include Integra, NuVox, and Deltacom.

The Stay-at-Home Strategy

Locally-focused CLECs are the most numerous of the three CLEC geographic strategies considered here. These carriers tend to be only a fraction of the size of their larger regional and nationwide counterparts. Total annual revenues for carriers in this segment can range up to $50 million, though the majority fall well below the $20 million mark. Locally-focused CLECs include Buckeye TeleSystem, CIMCO, and NTS Communications.

While some locally-oriented CLECs focus on only one market, others also build out to nearby communities from one or two core markets. Local CLECs view themselves as integral parts of the communities in which they operate and are more likely to offer residential service than regional providers.

These CLECs often offer fewer complex services than regional and nationwide competitive carriers. As most local CLECs operate in second and third tier markets, where there are often no enterprise businesses, their commercial customer base consists mostly of small businesses. This customer segment does not have the telecom requirements of medium or large businesses. As a result, local CLECs can build sustainable businesses providing only basic telephone service and DSL internet access. Some are deploying their own fiber, however, often with financing from the Rural Utilities Service (RUS) fund.

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