

Competitive Telecom Advisor



NEW PARADIGM RESOURCES

Strategic Consulting and Research for Communications Innovators

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2006 Carrier CapEx Looking Up

Carrier capital expenditures (capex) are a good barometer of the overall health of the telecom industry. Wireline and wireless carriers deploy capex primarily for network infrastructure expansion and modernization in the form of property, plant, and equipment (PPE) investments that equipment and service vendors monitor very carefully.

Mid-year Results

Aggregate capital spending among U.S. wireline and wireless carriers for 1H06 came in at \$29.5 billion, down – 3% compared to \$30.5 billion in 1H05. For the first six months, the carriers spent 49% of the collective \$60.8 billion budgeted for 2006. That compares to 1H05 spending that accounted for 50% of the total \$62.0 billion spent in 2005.

Wireline spending in 1H06 came in at \$18.8 billion, up +15% from \$16.4 billion in 1H05. 1H06 wireline capex accounted for 52% of the \$36.1 billion budgeted for 2006 versus 47% of the \$35.1 billion spent in the same period in 2005.

RBOCs led wireline capex as investments in their respective FTTx projects gained momentum. Including capex for the acquired AT&T and MCI long distance networks, RBOCs capex tallied \$11.7 billion in 1H06, up +28% over the \$8.5 billion spent in 1H05. For the first six months, RBOCs capex represents 54% of current guidance compared to 46% during the same period in 2005. RBOCs accounted for 62% of total wireline capital expenditures in 1H06.

Cable MSOs were the other big spenders in 1H06 with \$5.0 billion accounting for 26% of total wireline capex. That compares closely to the \$4.8 billion or 29% of the wireline total that the cable companies spent in 1H05. Cable MSOs allocate a large portion of their capex, roughly 40%, to customer premise equipment (CPE) such as cable modems and set-top boxes that are used for digital television, Internet access, and increasingly, new VoIP services.

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The remaining 12% of 1H06 wireline capex divides among Independent operating companies (IOCs), CLECs, and IXCs that collectively spent \$2.1 billion, down -32% from \$3.1 billion in 1H05.

The main difference between the two periods is that in 1H05, capital spending for AT&T and MCI was included in the IXC sector whereas in 1H06 that investment is part of the RBOC sector. Excluding IXC results, collective spending among IOCs and CLECs is up +4% in 1H06 compared to a year ago.

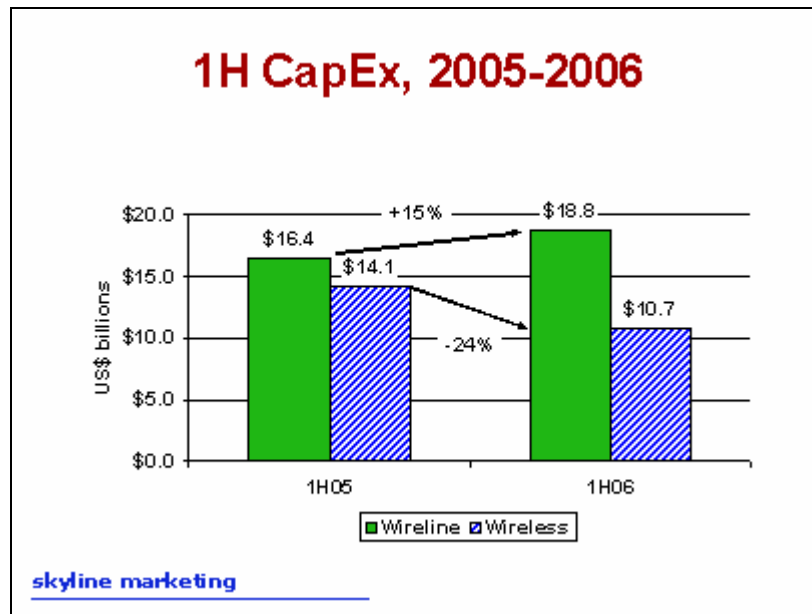
Wireless carriers in 1H06 spent \$10.7 billion, down -24% from \$14.1 billion in 1H05. For 1H06, wireless capex totaled \$10.7 billion or 43% of the \$24.7 billion budgeted for 2006. That compares to 1H05 total of \$14.1 billion or 52% of the \$26.9 billion spent in 2005.

Roughly 1/3 of total wireless capex is now being allocated to 3G high-speed data overlays with the balance for continuing network improvements in quality and coverage.

The four national carriers (Cingular, Verizon Wireless, Sprint Nextel and T-mobileUSA) accounted for 90% of the wireless aggregate. With consolidations and acquisitions, Sprint Nextel's results now include a number of its former regional affiliates.

Exhibit 1 compares wireline and wireless capex between 1H05 and 1H06.

Exhibit 1



Two significant one-time events occurred in 1H05 that pushed wireless spending levels well above comparable 1H06 results:

- in 1Q05, TmobileUSA spent \$2.5 billion specifically related to the unwind of its joint venture with Cingular, and
- in 2Q05, Cingular incurred higher-than-expected capex levels on activities related to its integration of AT&T Wireless.

Without these two occurrences, capex for 1H05 would have come in slightly above 1H06 levels and around 43% of the 2005 budgets.

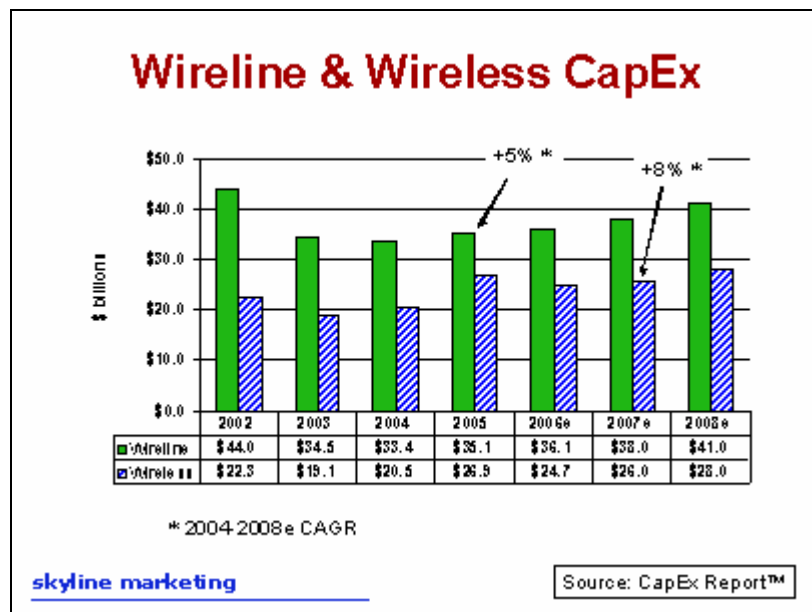
Outlook

The telecom industry today has a lot of moving parts when you consider carrier and vendor consolidations, wireline and wireless technology advancements, and regulatory changes,

With current guidance, aggregate 2006 wireline and wireless capex budgets total \$60.8 billion, down -2% from \$62.0 billion spent in 2005. Within that total, the wireline carriers plan to spend \$36.1 billion, up +3% from \$35.1 billion in 2005. Guidance for wireless capex tallies \$24.7 billion, down -8% from \$26.9 billion in 2005. Without the two one-time occurrences in 1H05, however, wireless capex for 2006 would be up +3% for the year, and aggregate 2006 spending would be up +3%, as well.

Exhibit 2 shows our wireline and wireless capex outlook to 2008.

Exhibit 2



In both sectors, the capital spending outlook is positive over the next couple of years driven primarily by infrastructure upgrades and modernization for broadband that enables delivery of triple-play services and drives new revenue streams.

Among the wireline carriers led by the RBOCs, almost 50% of capex budgets is allocated to DSL deployments over both existing copper facilities and new fiber optic-based platforms along with circuit-to-packet switch upgrades. Over the five-year period between 2004 when the spending turnaround first began and 2008, we expect wireline capex to grow at a +5% compounded annual rate (CAGR).

Wireless carriers have a similar motivation to increase investments in their networks. They continue to add new cell sites for improved call quality and coverage. Network quality and reliability is becoming a key differentiator in retaining customers as subscriber growth slows down. At the same time, wireless carriers continue to beef up the data handling capabilities of their networks with 3G overlays and Sprint's just-announced 4G plans. Accordingly, we expect wireless capex to grow at a +8% CAGR through 2008.

**This edition of NPRG's CTA is written by one of our strategic partners – John Celetano at Skyline Marketing Group. John is President of Skyline Marketing Group, a telecom market analysis and consulting firm based in Ruxton, MD, and is publisher of the CapEx Report™, the authoritative source of capital spending analysis among 60 wireline and wireless carriers in the U.S.*

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