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# MODERN TELECOMMUNICATIONS COMPANIES: THE POTENTIAL BANE OF MANY AN ECONOMY

The many and huge debts of telecommunications companies in the US could be the one straw to break the camel's back.

And should that transpire, the situation, definitely, would impact on international telecommunications companies, from Europe, to Asia, to the Antipodes.

While the debts of US-based, telecommunication companies are unlikely to lead to a crisis of any great proportions, such as bringing down the US economy, completely, it is clear that the debts of many telecommunications companies, especially those companies that over-traded in 1999 and into the middle of 2000, could lead to tens of thousands of more people, being thrown out, onto the streets of many a city of the US.

Those effects are likely to be felt, internationally, too.

Investment in telecommunication infrastructure has been an important *'engine'* of growth in recent years as international telecommunications companies have tried to position themselves for the new era of telecommunications, to wit, the so-called Third Generation Telecommunications System (3-G).

Since 1999, it is estimated that telecommunications companies raised not less than $US160 billion (about $HK1,246 billion) from various sources, in addition to syndicated loans from traditional lending institutions, such as banks.

One way or another, it is thought that banks, mostly those banks, domiciled in the US or those banks, which depend on US operations for the bulk of their profits, are holding onto the short end of the telecommunications debt *'stick'*, however, since, at the end of the day, banks will suffer the most from any failure of major customers to which they are, painfully, exposed.

Nearly all of the telecommunications companies, that opted to take part in international auctions in order to obtain 3-G telecommunications licences from governments, just a couple of years ago, had to front up with billions of dollars for their licences.

But obtaining the 3-G licences was just Phase One of the operation: The cost of the licence did not include the cost of laying in the infrastructure to accommodate the new system.

In addition, it will take another 3 years, or longer, before those recipients of the 3-G licences will be able to tap the (new and improved) telecommunications market in order to obtain any income, at all.

In the meantime, the interest clock is ticking away and Opportunity Cost Losses are mounting.

For many of these companies, they have no way to service debt, let alone repay the principal.

The result is clear: The weaker companies, those that are unable to service debt and, being pressured hard by lenders, will have to close up shop unless they can locate alternate sources of funding in order to keep creditors from breaking down their doors.

Without the new 3-G infrastructure in place, it is impossible for these companies to reach a position of self-sufficiency.

And they cannot achieve that position because the money *'well'* has run dry, by and large.

The pressing concern, at this juncture, aside from the spate of companies, seeking protection of US Bankruptcy Courts, is that banks may be hard pressed, too.

It is said that when a company owes a bank $US1 million and cannot repay the loan, the company is in trouble.

But, when the loan is in the hundreds of millions of US dollars, or even in the billions of US dollars, it is the bank that is in serious trouble.

That is the situation, today, for many a bank, the world over.

If banks are over-exposed and start to suffer extensive, non-performing loans, it could impact on liquidity in the worst possible way: It could affect the availability of credit to new, bona fide borrowers.

Depending in the severity of the situation, banking solvency could even become an issue in the near future.

It is unlikely that the US Government would want to have another 1930s depression on its hands because the domino effect of bank failures, cascading from one to another, could just be catastrophic.

While it is highly unlikely that the banking industry in the US will buckle under the heavy weight of a rash of non-performing loans and bankruptcies of former, important customers, not so for banking institutions in other parts of world, at least, not to that extent.

The scenario of seeing another 1930's depression, when money was as short as hen's teeth, as the saying goes, and when soup kitchens sprung up in many parts of the US, in many other parts of the world, banks are not sufficiently capitalised and earnings' bases are not as well diversified.

The failure of the Ming Tak Bank Ltd of Hongkong, about 4 decades ago, was a prime example of a bank, which was too narrow in its outlook and which had failed to put in place checks and balances with regard to lending policies.

Things have changed, appreciably, in the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC), but it was not all that long ago that PRC, State-run companies went belly up, one after another, a situation that took most people by utter surprise.

**<u>It Is Coming</u>**

That a telecommunications meltdown is coming is without question.

The only real question is this: How severe will that meltdown become?

If the meltdown is extensive – which is quite likely – then it could weigh on investor sentiment, spreading negative vibes and resulting in many investors, being unwilling to fund telecommunications projects for years to come.

As more telecommunications companies cave in to credit pressures, then funding will continue to dry up.

Telecommunications companies, historically, had been able to fund investment in new infrastructure from internal resources.

Those days are past because infrastructure is costly, today, more costly than ever before.

This is the result of fast-moving technological changes, which continue apace.

For telecommunications companies that cannot stay up with the pack, they will be left behind, ending up in the knackers' yards in due course.

For the failed telecommunications companies, their partly used equipment will be up for grabs at, perhaps, 10 cents on the dollar.

Again, this will exacerbate investments in new equipment since a saving is a saving and, in these times, any saving is a welcome saving.

One notes that, recently, Cisco Systems Incorporated wrote off more than $US2.50 billion in inventories.

Further, it is forecasting sales to decline by about 30 percent in the succeeding 2 quarters of its financial year.

Nortel Networks, the Canadian company, which was all the rage, just a few short years ago, is on the ropes; it has had to slash its workforce by more than 20,000 employees.

Sunday Communications Ltd (Code: 866, Main Board, The Stock Exchange of Hongkong Ltd) announced, recently, that it would purchase new telecommunications equipment from Nortel Networks in order to increase its wireless Global System Mobile network.

Although it was not, definitively, stated, it is a safe bet that Nortel Networks gave Sunday a special deal in respect of financing, with Nortel Networks, acting as *'banker'*.

The US, investment-driven economic expansion is in grave trouble since investments in computer software and computer hardware are grinding to a halt: There is insufficient cash available for any new investment.

If investments in the telecommunications industry in the US contracts, appreciably, in the coming next half of this year, the recent growth engine could stop … and the entire telecommunications vehicle may start slipping backwards.

Many telecommunications companies forgot that, at the end of the day, they are there to make profits for shareholders; they were not founded and engineered to make losses.

There is no joy in losing money; and, there is no credit to management to tell shareholders that, for the next 3 years or so, please expect to lose money.

But the situation is even more complicated than that because, in the more recent past, equipment vendors have been funding customers.

Many companies, 3Com Corporation, Nortel and Cisco, included, used their own funds to bankroll customers in the past.

This, they thought, would keep the customers as captives to them and would ensure that the customers continued to purchase their (the equipment vendors') products.

Surely, this is the situation in respect of Sunday Communications Ltd.

Vendor financing, on the surface, had a great deal of merit: It ensures lucrative contracts for the equipment vendors; and, on the other side, telecommunications companies – such as Sunday Communications, to name but one company -- can move along at a faster pace, having equipment vendors as their *'partners'* since there is no pressing requirement for the hunt of additional capital to fund new equipment purchases.

But, when many a telecommunications companies, financed by equipment vendors, failed to turn a profit, the equipment vendors were faced a double-whammy: They had to continue to service their debts to bankers for their customers' purchases from them; while, at the same time, they had to put up more cash to finance the equipment that they had sold to the telecommunications companies on what turned out to be on the never-never plan.

Like any business cycle, after the dust settles, there will be those survivors, which will still have money in the bank – and they will reap the benefits from the adoption of a more frugal and balanced outlook to business.

They will gobble up the telecommunication failures as soon as the price is right if there is synergism to the acquisition.

But that will take a few years, yet, and, in the meantime, leaner times can be expected.

In the meantime, many of the international companies that voyaged afield and purchased 3-G telecommunications licences, selling some of the *'family jewels'* in order to be seen as major international players, may find the going too tough to continue without jeapardising parts of their companies that can stand as profit centres in their own right.

This could well result in *'garage sales'* in the near future.

CCT Telecom Holdings Ltd (Code: 138, Main Board, The Stock Exchange of Hongkong Ltd) has, already, set the pace in the HKSAR, putting up the *'for sale'* sign on its unprofitable wireless Internet venture.

Other HKSAR companies are sure to follow suit.

Translating the HKSAR situation into international languages and one cannot help but fear that the worst is not too distant into the future.

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