

Growth at a Price

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The past six months have seen COMSYS involved in an extensive market survey on the VSAT industry. As part of our primary research for the 2003 VSAT Report we conducted over 500 interviews with operators, manufacturers and users worldwide and found some interesting results which yield some key trends in the marketplace. The big departure for the VSAT industry over the past two years has been the move into broadband access. This takes the technology away from its core root of transactional services which find a value proposition in the worth of the traffic, rather than its volume. Services such as POS, credit verification lotteries and other transactions have formed the bedrock of VSAT networking sales over the past almost 20 years and largely continue to do so. Some huge names have either lined up behind the technology or reaffirmed their use of it in 2001 and 2002. In the United States the major service providers, Hughes Network Systems and Gilat's Spacenet, have signed contracts and extensions with the likes of Sears, the US Postal Service, Cendant (the owners of Century 21, Avis and Quality Inn), Chrysler, Rite Aid and Wendy's. Beyond the United States the list is no less impressive, but with some names less immediately recognisable. The Bombay Stock Exchange, the Brazilian Government GESAC program, Caixa Economica Federal, Esso, SK Corporation, the Reserve Bank of India and ExxonMobil are all organisations which have implemented or expanded networks of thousands of sites in all parts of the globe. The figures show that the fundamental enterprise networking business remains alive and kicking, despite cutbacks in IT investment which have impacted the size of many deployments and extended contract negotiations, in some cases by at least a year.

It was the consumer satellite internet access services, primarily led by Hughes' DirecWay and Gilat's StarBand in the United States which started volumes flowing through the manufacturing lines from 2001 onwards. These initial ventures were followed by some other more tentative launches in Europe with Tiscali and BT Openworld and in Brazil by Star One. StarBand's progress was halted by its entry into Chapter 11 after being caught in the crossfire of EchoStar's attempt to acquire DirecTV, but DirecWay has continued to expand in a low key way without the benefit of mass marketing and now stands at over 160,000 subscribers as of March 2003, adding almost 10,000 new users a month. These numbers seem huge by VSAT standards and paltry in comparison to terrestrial DSL services, but the real issue is the fact that the march towards selling bandwidth and connection as a commodity, rather than a networking service as a value, has shown that the technology in terms of hardware and space segment is not quite ready for the mass market. Whilst the service works well, it has proved challenging to provide the user with performance and still make money at consumer pricing levels.

Shortly after the launch of these services, these lessons were quickly learnt and every broadband access platform which has been launched since has targeted the SME segment at significantly higher prices. These services sell bandwidth and connectivity in the same manner, but the value proposition is based more firmly around a needs of a business rather than a the desires of a consumer, and it is reach and functionality which form the core of the offer, rather than price. For this market segment, broadband access is a better descriptive term and it has caused a major change in the way that the primary providers do business. Traditionally, large corporate networks were sold through direct sales forces, consumer services are carried by major retail chains, but small businesses can only be reached cost effectively by value added resellers specialising in the

supply of IT and communications services and systems. As a consequence, each new launch of a service product is built on the basis of a VAR program which relies on a simple and effective packaged product. The best examples of these can be seen in Europe, India and the United States, with countries like Brazil, Argentina and Nigeria following suit.

Broadband access has pushed open the door to reveal a large market of disenfranchised businesses desperate for connectivity. Once again, whilst a major opportunity for the VSAT industry, it is small by consumer standards - at least for the moment. Studies which COMSYS has undertaken show that the addressable market numbers millions of SMEs, but reaching these customers will be a function of price and performance. The DVB-RCS standard launched in 2000 foresaw the potential of satellite-based broadband access in much the same way that the established vendors did, but chose to create a design specifically crafted for this market. Results for the DVB-RCS system vendors have been sluggish, not least because initial systems carried costly architectures which were capable of supporting hundreds of thousands of users, but the vendors are re-orientating and re-engineering their products and the technology is now beginning to see traction in the market with sales of hubs for these and similar systems increasing dramatically over the past 18 months. In addition to straight forward broadband access sold directly to businesses, the technology has become a prime enabler for many government initiatives aimed at encouraging and sponsoring broadband deployment at schools, universities, libraries and community centres. Initiatives such as these, are currently in deployment or in consideration in countries as far apart and Spain, Mexico, Malaysia, Canada and Ethiopia and number thousands of sites. Again, these projects represent great potential for satellite technology to create value where the terrestrial infrastructure simply cannot compete. However, they also bring a volatility to a market which could use greater stability.

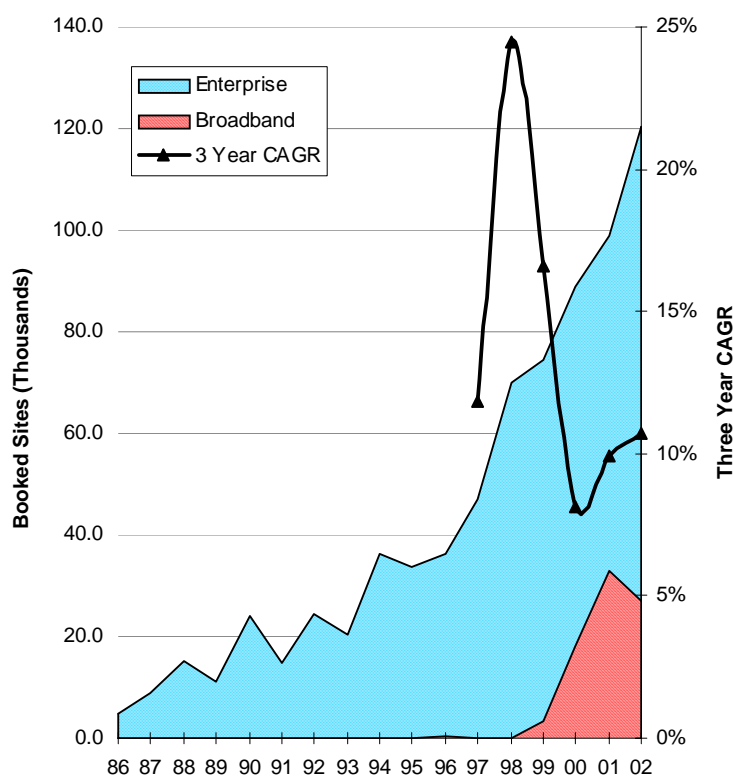


Figure 1 - Worldwide Growth of Star Data VSAT Systems

In Asia and Latin America the economic situation dominates. Latin America has seen its enterprise business suffer from severe erosion as a result of the substantial over-investment in the terrestrial infrastructure in 2000 and it has been broadband access which has begun to show a light in the region, often led by government initiatives. Asia meanwhile has seen substantial growth in the number of locations served, primarily at the large corporate networking level and some operators have seen their user bases double or more over the last two years. There are signs that economies are coming slowly back to life with real growth in some countries like Indonesia and India. This has been led by a move away from terrestrial replacement services and towards the solutions orientated networks seen in North America and Europe.

As a consequence of these trends, VSAT sales have grown, in some markets quite significantly, but there is also a dark side. The higher value, more bandwidth intensive services like SCPC (the satellite equivalent of a leased line) have suffered erosion at rates up to and exceeding 60 per cent in some cases, substantially hitting many VSAT operators. At the same time TDMA services have been transitioning from higher priced terrestrial replacement systems to cost competitive transactional systems and all this has led to a fall in the average revenue per site. The best managed and well established VSAT operators remain profitable, but revenues have stood still and margins have come under pressure whilst the number of sites served has grown - it has been a case of running faster just to maintain the business. In the broadband access segment, companies need greater volumes to drive their businesses into commercial viability because, whilst there has been a lot of growth, there are now many more operators vying for the business as the major space segment operators plunge into the business with lots of money and a desire to safeguard access to market and grow broadband to compensate for shrinking television revenues.

Companies are restructuring and refocusing their marketing to evolve to meet the demands of today's market. Technology developments, driven by the need to gain greater bandwidth efficiencies, have been introduced in tandem with better service products which, in turn, are a direct response to ongoing customer feedback. Manufacturers and operators alike are working hard to bring their services to viability, but there will, we believe, inevitably be consolidation and pain inherent as part of this process. The future holds even more interest with vertically integrated satellite broadband platforms including Hughes' Spaceway, WildBlue, Telesat's Anik F2 and Thaicom's iPSTAR due to launch in 2004. The evolution we can see in the market today is preparation for the revolution of tomorrow and, given too many caveats to list here, these new systems hold the promise of delivering exactly that - a revolution in the SME broadband access and enterprise networking businesses which might also have an effect on the terrestrial operators in some instances. Overall, in terms of both the present and the future, VSAT systems seem to have weathered the current market conditions far better than most telecommunications technologies.

The VSAT Report is published by **comsys** every two years . The study covers over 40 systems and 270 operators across the world and offers a detailed look at the dynamics of the VSAT market. It comprises an in-depth statistical analysis of the bookings, services and revenues of all aspects of the VSAT business over four volumes and 1,500 pages. The Report can be ordered from **comsys** at +44-1727-832288 or via the web at www.comsys.co.uk.

Simon Bull is a Senior Consultant at comsys and the principal author of **The VSAT Report**. **comsys** is a specialised satellite consultancy company based in the UK and the acknowledged authority on the VSAT industry.

