Planet Telecom

FOR THE WORLD'S TELECOMS ECOSYSTEM, WORKING CAPITAL IS A CRUCIAL REQUIREMENT TO SUPPORT GROWTH, PARTICULARLY IN THE KEY EMERGING MARKETS. **MARK D TWEEDIE** LOOKS AT A COMPLEX SECTOR WITH A SIMPLE NEED FOR EXPERT FINANCE.

The telecommunications ecosystem is among the most dynamic in the world. The three anchor tenants of the industry – device manufacturers, infrastructure providers and operators (both wireless and fixed-line) – have huge opportunities for growth, especially in rapidly growing emerging markets. Each group also faces a myriad of commercial, technological and financial challenges that they must successfully navigate.

The telecoms ecosystem is complex. Within each group of anchor tenants, there is a further group of satellite firms that orbit and serve their respective spheres. For example, underlying device manufacturers subcontract to a wide range of casing specialists, LCD providers and microprocessor companies. Similarly, operators rely on resellers of airtime minutes to advance sales and outsourced network managers and tower companies on the supply side.

Within the telecoms market many relationships within the constituent spheres are "open loop", with suppliers servicing rival firms. For example, enterprise manufacturing services, such as those offered by Sanmina, Flextronics and Hon Hai, are used by a number of device manufacturers and infrastructure companies. Understanding these intricate dynamics is critical to assessing the challenges faced by individual firms.

Corporates working in these sectors will recognise the associated challenges and solutions such as the need for trade financing to inject much needed liquidity into the value chain.

CHALLENGES IN EMERGING MARKETS While many of the issues facing the telecoms industry are similar worldwide, emerging markets inevitably pose unique challenges. Working capital is crucial to the ability of the largest telecom infrastructure companies in the world, two of which are based in China, to ensure continuous supply and facilitate sales while replenishing inventory.

To support this growth and to finesse equipment sales financing in this all-important ecosystem, these companies will often look to discounting receivables from international telecom operator clients. With a direct banking presence in 100-plus countries and client relationships with 838 telecom companies, Citi is optimally

positioned to play the intermediary role and to finesse equipment sales financing.

Customers seeking this type of financing will expect their banks to have knowledge and confidence in the buyer, and close knowledge of the supplier's business model and historic delivery performance.

The other side of the same coin is about buyer-centric structured solutions for operators. Citi has arranged this type of supply chain finance solution for Vodafone, to enable it to source equipment effectively and consequently improve its cashflow – while also delivering diversified funding and lower capital cost benefits for suppliers.

STRENGTH IN CHINA The scale and potential of China's telecoms market is awe-inspiring: 47 million smartphones are currently in use in the country and Citi research indicates that more than 600 million will be in use by 2015 as China's middle class grows and $150 Android units, set alongside the iPhone march, inflect the market. Meanwhile, the roll-out of TD-CDMA and LTE (third- and fourth-generation) mobile infrastructure is gathering pace, providing subscribers with ubiquitous and high-speed internet access on the go.

As smartphone uptake is growing and 4G technology is adopted, China's mobile operator market – dominated by three state-owned firms: China Mobile, Unicom and Telecom – is responding to customers' changing needs. As China's global influence increases, its citizens are increasingly mobile (in both cellular and geographic terms) creating international financial flows of a magnitude previously unseen, encompassing customer roaming settlements, enterprise revenue from overseas sales and imports from foreign suppliers. Needless to say all such flows require clearing and payments services through a partnership with a bank that has the best footprint and counterparty coverage to match. Many of these challenges have been faced by OECD operators in the past, creating replicable precedents to build on, albeit on a different scale.

Competition among infrastructure providers for operator mandates is intense globally, prompting many ecosystem majors to deploy leading-edge spend management tools such as commercial card programmes to enable sales and account managers to devote more time to scoping and serving client needs.

DIFFERENT APPROACHES IN INDIA While China and India are often mentioned in the same breath, the challenges facing companies in each country differ markedly. India remains predominantly a voice market (just 5% of operator billings are for data), with a subscriber demographic that is overwhelmingly prepaid and an average revenue per user (ARPU) of around $2 per calendar month. In India, volume and third-party billing reconciliation and receivable matching are paramount.

Operators need efficient intra-day cash management so that more minutes can be released to distributors for sale. This level of detailed service extends to inbound straight-through processing requirements and hourly reports that are fed directly into operators' ERP systems, enabling real time reconciliation and automated workflows for all-critical airtime minute sales.

In a different area, in the US, operators like Sprint offer cash incentives to subscribers to attract their friends to the network, growing top-line sales. In India, given the country's comparatively low ARPU, the application of the prepaid card will differ, with user payments likely being limited to Tier 1 smartphone subscriber cashbacks. While such consumers presently represent just 1–2% of the market, in a country with a population of more than one billion people such a niche is a worthwhile target.

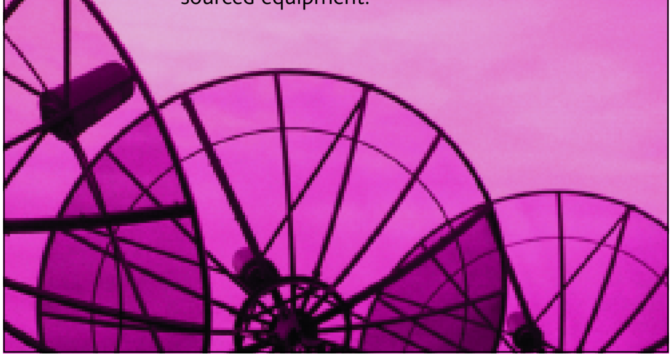
In addition operators are considering whether the "cash and carry" models where distributors are paid in minutes (internal currency) will persist indefinitely or whether hard cash (rupee) "channel sales" incentives (disbursed on a prepaid card) to the 650,000 or so airtime resellers will help to distinguish brands and enhance agent loyalty in a very crowded marketplace.

CASH MANAGEMENT LEVERAGE As evidenced in this piece, the telecom ecosystem plays host to a variety of different anchor tenants, challenges and associated transaction banking solutions. In the current economic climate, the telecoms sector is no different to other business sectors where there is an accentuated need to leverage domestic and foreign trade financing techniques, such as receivables purchase, to support improved working capital cycles, along with proven and highly efficient cash management structures.

A changing environment

Telecoms infrastructure spending in emerging markets is huge and continuing to grow. For example, McKinsey expects a trillion dollars of infrastructure spending in Africa in the next decade, 65% of which will be on telecoms. Growth is being driven by operators building out their networks, with a view to monetising the potential of next-generation technology and increased spectrum availability. Governments are also encouraging growth given the strong causal correlation between high-speed broadband and GDP growth (as shown in a 2009 World Bank report).

Consequently, there is an increased focus on financing capital expenditure requirements. Buyers will look to banks to have the capabilities and the appetite to act as lead arranger to structure export credit agency finance – an increasingly popular choice – for buyers to pay for externally sourced equipment.



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