



The Telecommunications Industry

STRATEGY AND BUSINESS IMPROVEMENT CONSULTING

Growth Opportunities For Minority-Owned Businesses

MED Week 2001

**The
Asaba
Group**

This Report Was Written And Produced For:

U.S. Department of Commerce

Minority Business Development Agency

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This analysis on the telecom industry was prepared by The Asaba Group and is the Group's interpretation of the telecom trends of the automotive industry. The study is not a Commerce Department report, but was developed for the sole purpose of discussion amongst industry experts. The conclusion and analysis of the report do not necessarily reflect the views of the U.S. government.

Express Gratitude And Acknowledgement For Contributions To The Project:

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Network Engineering, Furnish & Installation (EF&I)	40-47
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Project Charter

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Create An Industry Report Which Identifies the Growth Opportunities For Minority-Owned Businesses In The telecommunication Industry

It should place emphasis on the following:

- Industry trends and issues within the industry
- Identify market opportunities for growth
- Growth strategies and critical success factors
- Identify opportunities for partnership between Minority Businesses and Telecom Companies

The Asaba Group Retained To Identify Growth Opportunities

Project Approach



Executive Summary

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Overcapacity and overbuilding coupled with economic slowdown have reduced demand for telecommunication equipment and services

- Significant equipment glut and inventory levels in the supply chain

Capital markets and investors unwilling to fund weak business models

- There has been an increase in the number of companies in financial distress and bankruptcies

However industry fundamentals remain strong

- Wireless, Data and Broadband hold future promise

An evolution of drivers of value creation occurring with the Industry

- Transforming a regulated industry to a technology driven model
- Convergence between cable, telecommunication and wireless

Industry evolution present growth opportunities for Minority-Owned Business

- Engineering & Installation and customer contact management are near term opportunities
- High growth, capital intensive opportunities in contract electronic manufacturing, optical networking and IP applications

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Current Trends In The Telecommunications Industry

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Collapse of equipment demand has led to glut of product and high inventory levels along industry supply chain

- Driven by economic slowdown, overcapacity and overbuild in transport network, change in investor sentiments and reduced level of competitors in certain sectors
- “Dot-Com” sector collapsing driving down demand for telecom networking equipment
- Bandwidth pricing dropping due to excess fiber capacity

Industry shakeout occurring in every sector of the industry

- Increased number of bankruptcies, industry exits, and consolidation
- Shakeout has resulted in weakening the competitive intensity in certain sectors

Demand fundamentals remain strong, but underlying characteristics are changing

- Wireless growth strong with future potential in data applications
- Data growth outstripping voice, but voice accounts for significant share of current revenues
- Traffic evolving from “user-to-user” (voice telephony) to “user-to-objects” (ARS) and “object-to-object” (web servers, fax, etc.)

Current Trends In The Telecommunications Industry (cont'd)

Broadband applications seen as platform for future industry growth

- Business sector evolving business processes into e-commerce/e-business
 - Employees adapting to new ways of working with the Internet and increasing productivity
- Residential consumers adapting broadband services slowly
 - Function of slow deployment and absence of mass market applications
- Usage shifting from “fun” to “real world” applications
 - From convenience to enhancing productivity

Intensive performance pressures from investors and capital providers on industry players

- Companies with high levels of debt falling into financial difficulties
 - Strong implications for MBE's' choice of growth capital
- Investors seek quicker returns on Invested Capital and withdrawing Capital from weak business models
 - Weak business models defined as those not earning positive cash flows before expanding infrastructure

Response From Industry Players

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Industry players responding to new pressures and dynamics by reducing operating expenses, divesting assets and reducing capital expenditures

- Payback period shortening to 24–36 month time frame
- Greater desire to generate real cash flows from current investments and assets before embarking on new ventures
 - Maximizing returns on deployed/existing technologies

Declines in Capital Expenditures most significant issue in the industry

- Industry analysts forecast continued declines through 2003
- However wireless sector capital expenditures continued to grow
- Industry analysts expect Service Providers' CapEx will return to historical level of expenditures

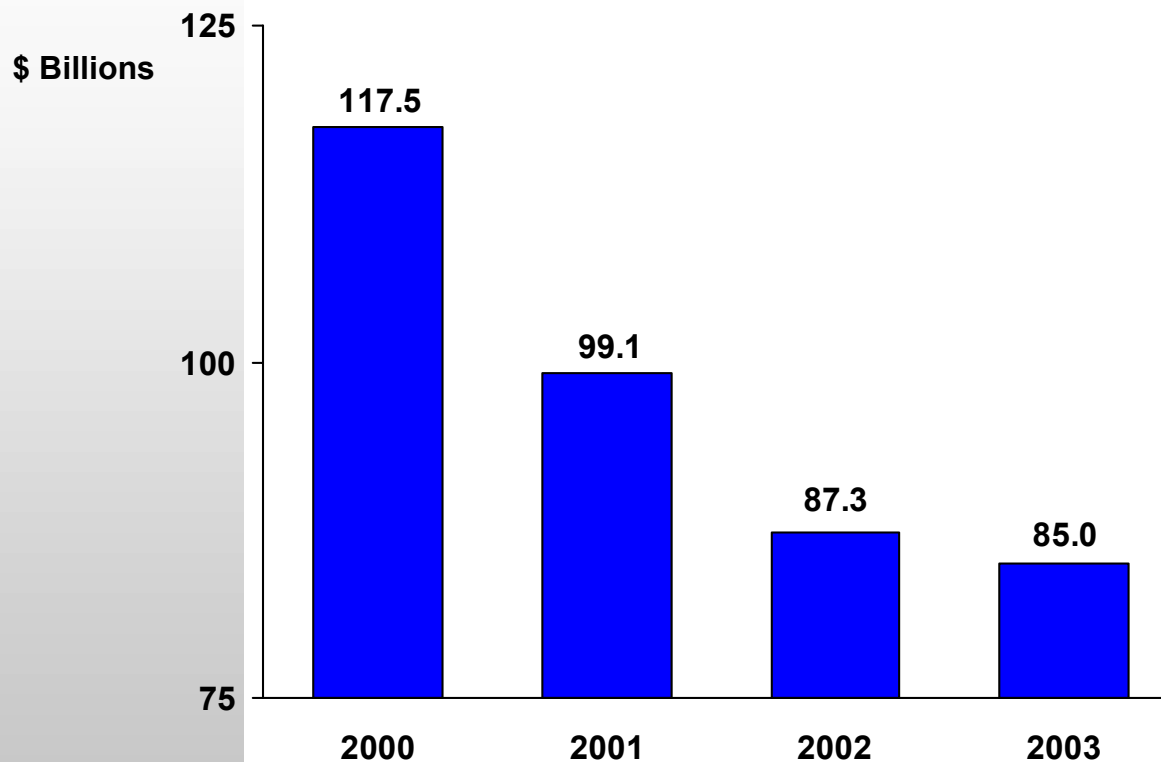
Players divesting assets to achieve greater focus and competitiveness

- Trimming cost and reducing headcounts
- AT&T separates its consumer, broadband, and wireless businesses
- Lucent spins-off Agere and divests some manufacturing assets

Decline In Capital Expenditures By Service Providers Causing Slowdown Within Supply Chain

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Telecom Service Providers' Capital Expenditures



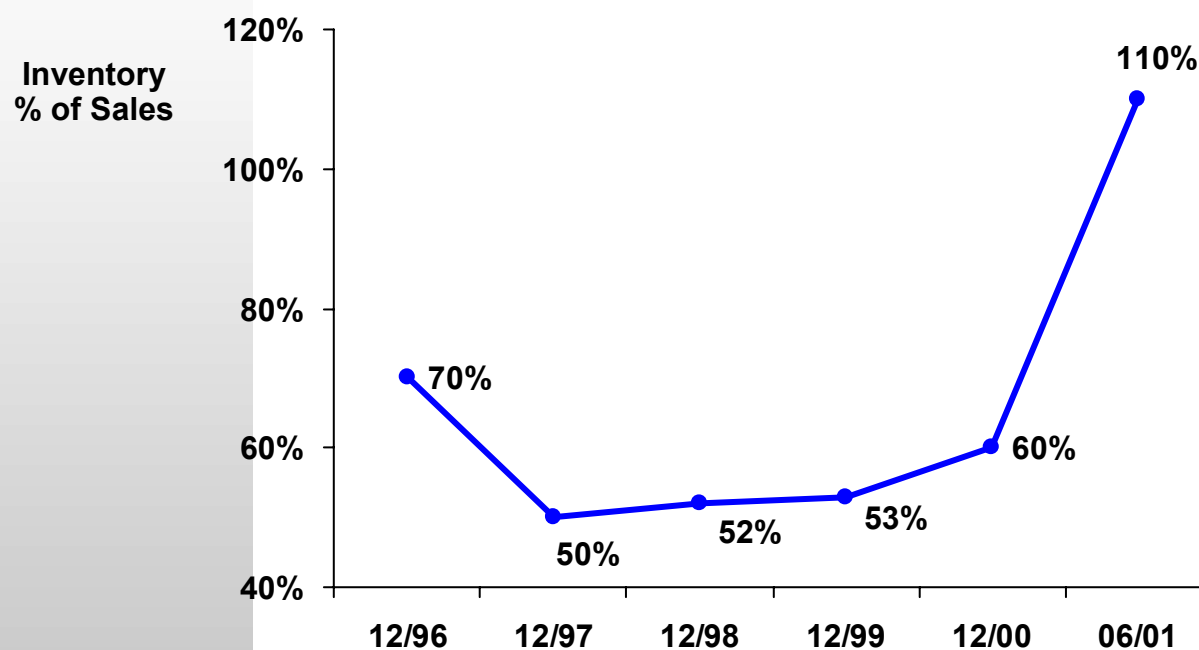
Key Drivers

- Contraction of business plans by newer players due to current capital market environment
- Delay and cancellation of many telecom/Internet infrastructure projects
- Most long-haul transport infrastructure near completion
- Easing of competitive pressure for ILEC's
 - Less aggressive push with CapEx upgrades

Inventories In The Supply Chain Have Risen

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Inventory Levels With Telecommunications Suppliers



Recent Inventory Losses

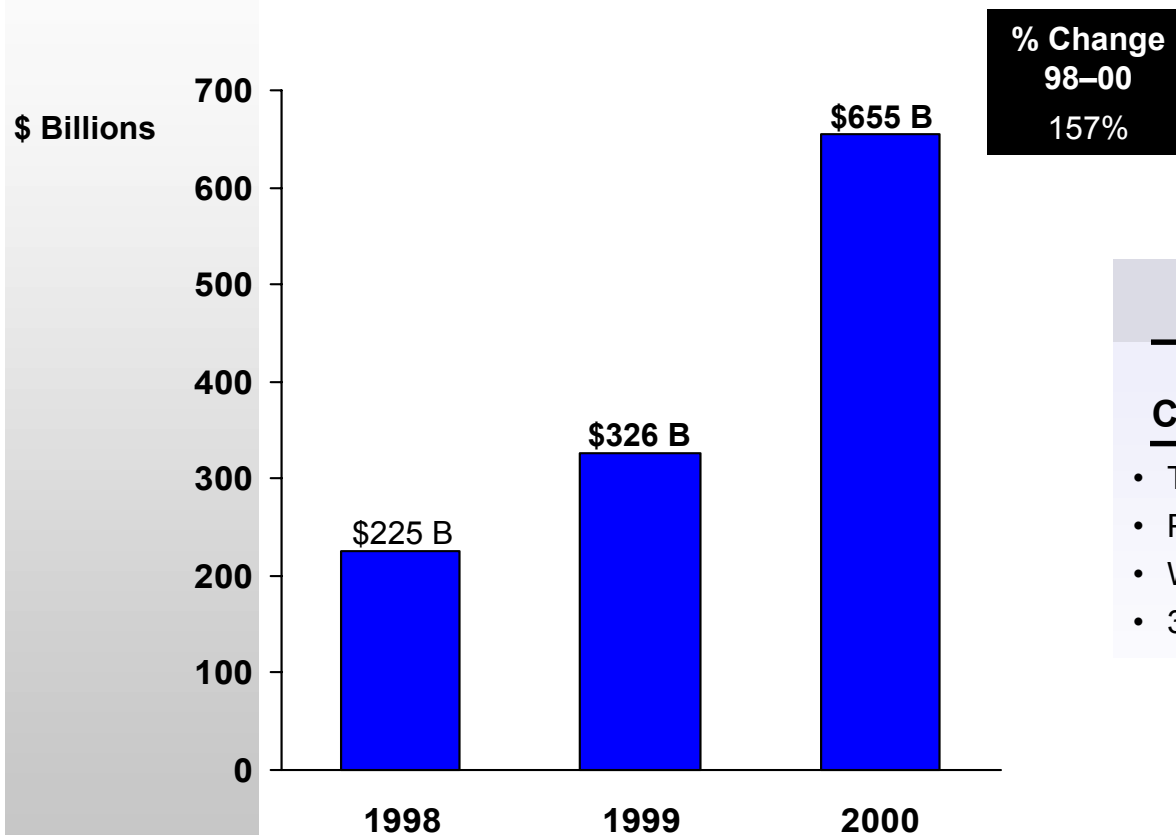
- Lucent Technologies \$1.0 B
- Cisco Systems \$2.2 B
- JDS Uniphase \$2.50 MM

SOURCE: Merrill Lynch, Wall Street Journal

Excessive Debt Carried By Some Providers Has Led To Financial Crises

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Debt Load by Telecom Carrier



Some Recent Bankruptcy Filings

Company	Total Debt	Qtr Interest	Qtr EBITDA
• Teligent	\$1.44 B	\$30 MM	(\$119 MM)
• PSInet	\$3.7B	\$166 MM	(\$19 MM)
• Winstar	\$4.1B	\$103 MM	\$20 MM
• 360 Networks	\$1.9B	\$53 MM	\$10 MM

Recent Bankruptcies May Provide Cheap Entry Into Industry

SOURCE: Wall Street Journal, Lehman Brothers, Nortel Networks

Industry Slowdown Leading To A Shakeout Among Competitors

Evidence By Bankruptcies In Every Segment Of The Supply Chain

Internet Service Providers

- Adaptive Broadband
- Metricom

DSL Providers

- Covad
- Rhythms Net Connections
- Northpoint Communications

Service Providers (CLEC's)

- PSI Net
- Winstar Communications
- Pacific Gateway Exchange

Network Builders/Providers

- Viatel Inc.
- Teligent Inc.
- RSL Communications
- 360° Network

Contract Manufacturers

- MCMS

Have Reduced Competitive Intensity In Some Segments

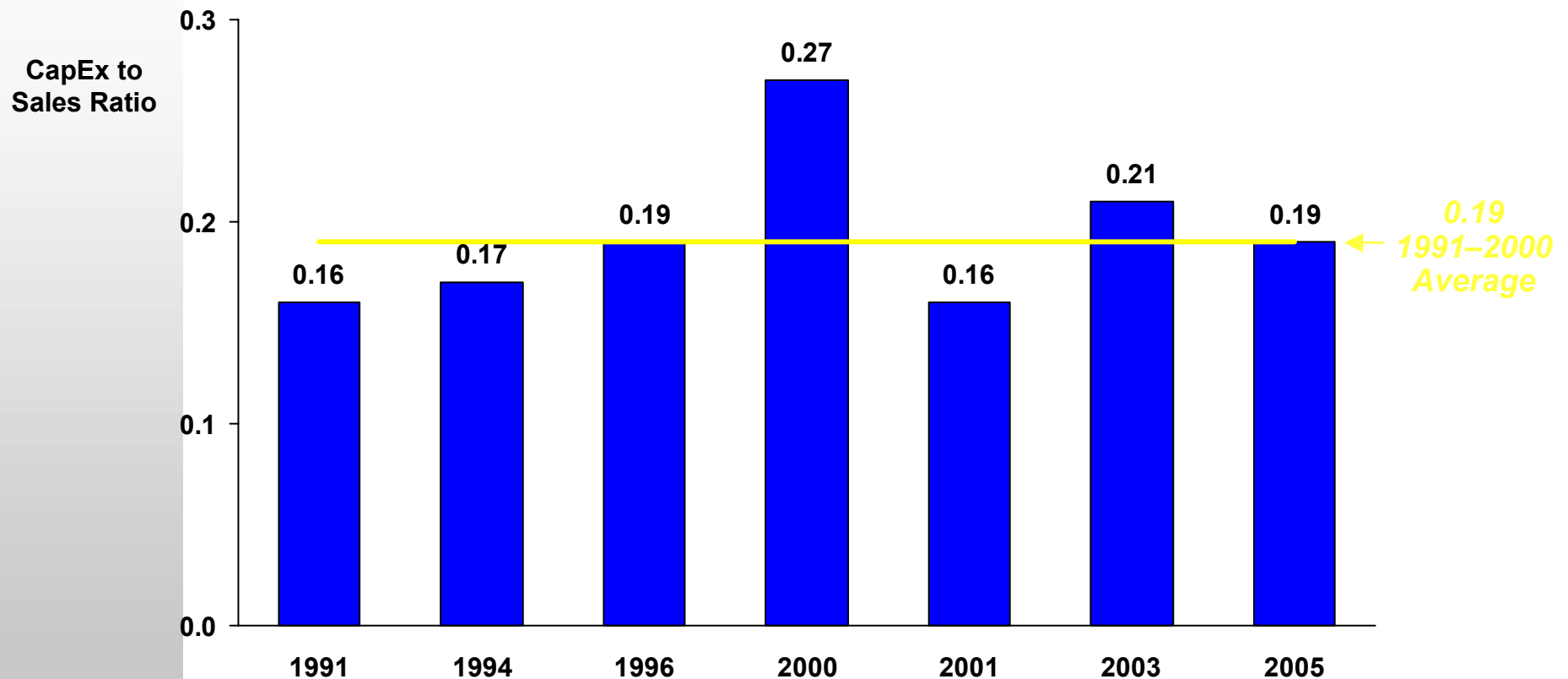
Surviving Players Trimming Cost Structures To Adapt Current Industry Demand

Most Efforts Focused On Layoffs And Asset Divestitures

Segment	Company	Announced Layoffs
Contract Manufacturers	Selectron	20,000
	Celestica	2,900
Component Manufacturers	PMC — Sierra	230
	Vitesse Semiconductor	153
Network Suppliers	Cisco	8,500
	JDS Uniphase	15,000
	Alcatel	25,300
Equipment Manufacturer	ADC Telecom	7,000
	Lucent Technologies	30,500
	Nortel Network	30,000
	Tellabs	1,000
Service Providers	Verizon Communications	10,000
	McLeod USA	525

Analysts Believe Service Providers Will Maintain Historical Level Of Capital Expenditures

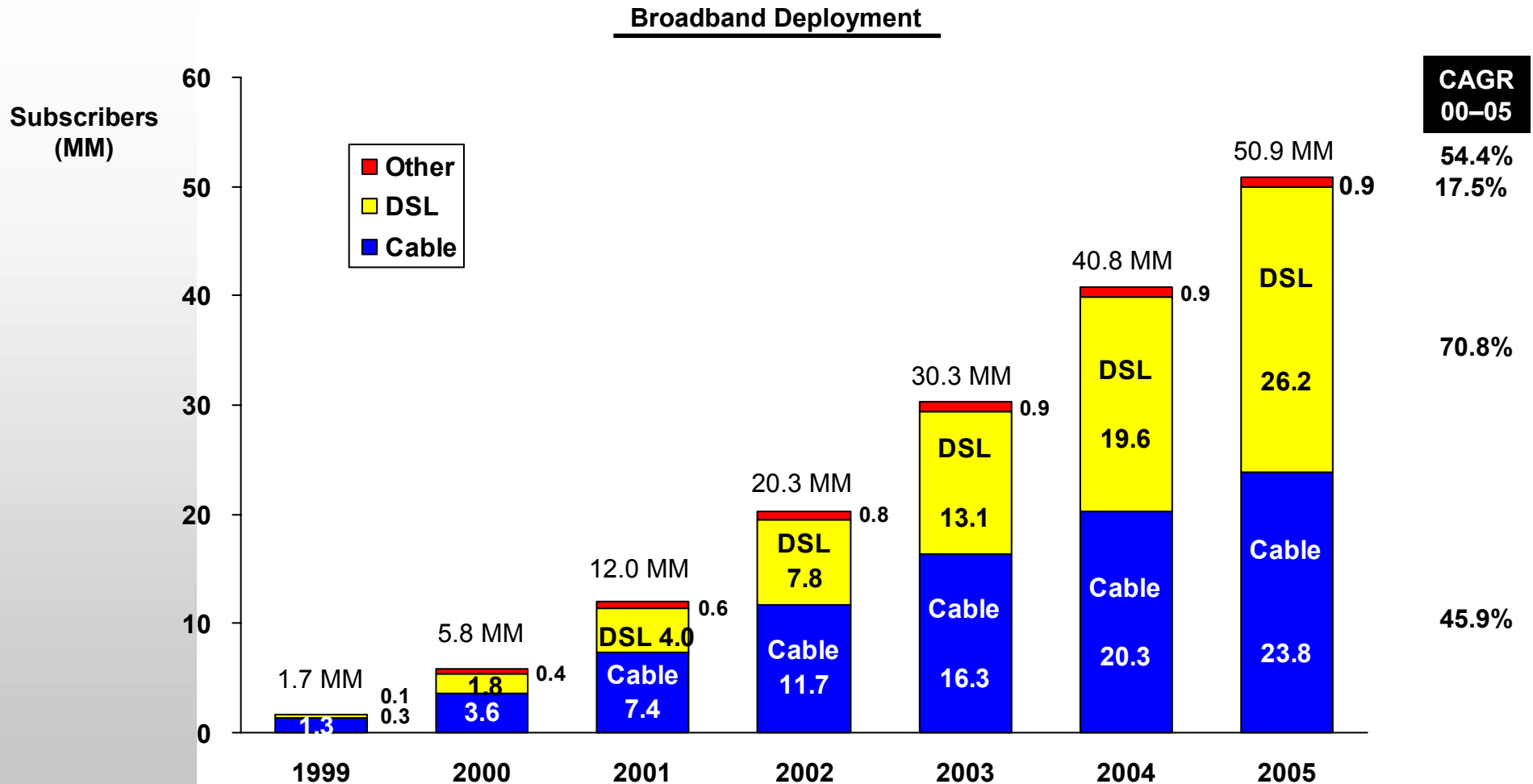
Telecom Service Industry Average CapEx-to-Sales Ratio



1. Includes AT&T, BellSouth, Quest, SBC, Verizon, Worldcom, CenturyTel
Source: Morgan Stanley Dean Witter, Financial Times

Demand For Data Services Expected To Remain Strong

Broadband Experiencing Strong Growth

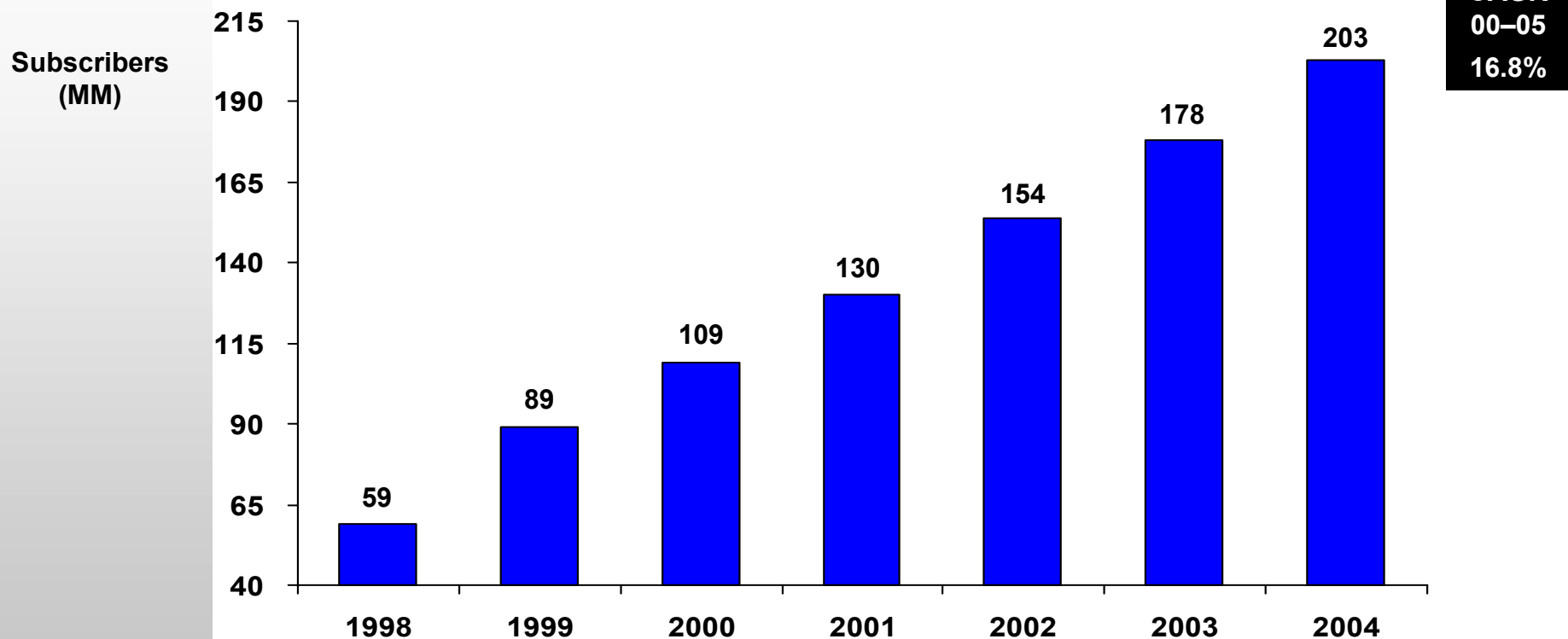


Expect Continued Investments In Broadband Infrastructure

Future Demand For Wireless Services Remains Strong

Predominantly Voice; Explosive Potential Exists
With Data-based Applications

Wireless Phone Subscribers

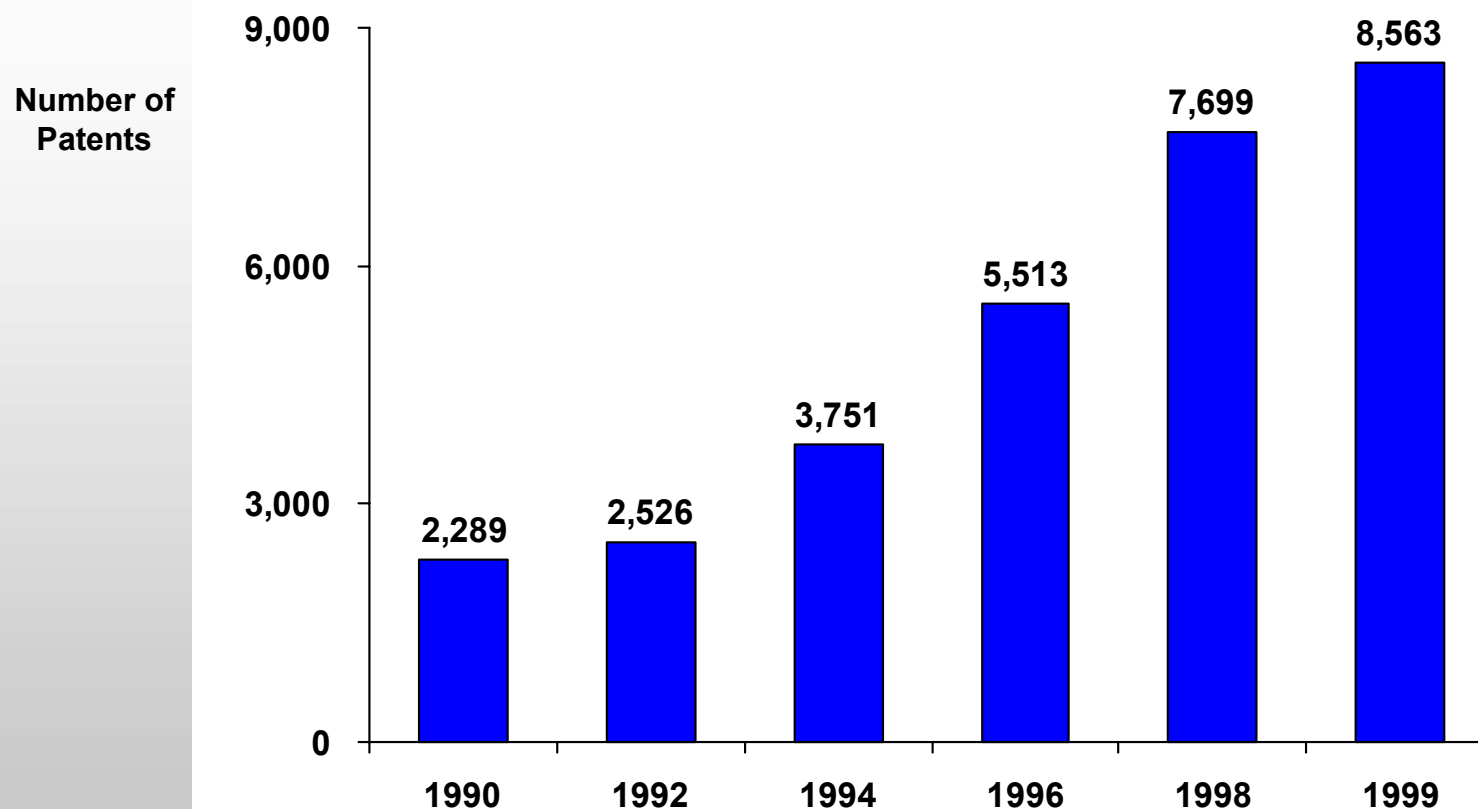


Expect More Investments Focused On Full Service Mobility

Pace Of Innovation Has Accelerated With The Industry

Driving Significant Levels Of Price/Performance Improvements

Telecom Industry Patents*



**CAGR
90-99
15.8%**

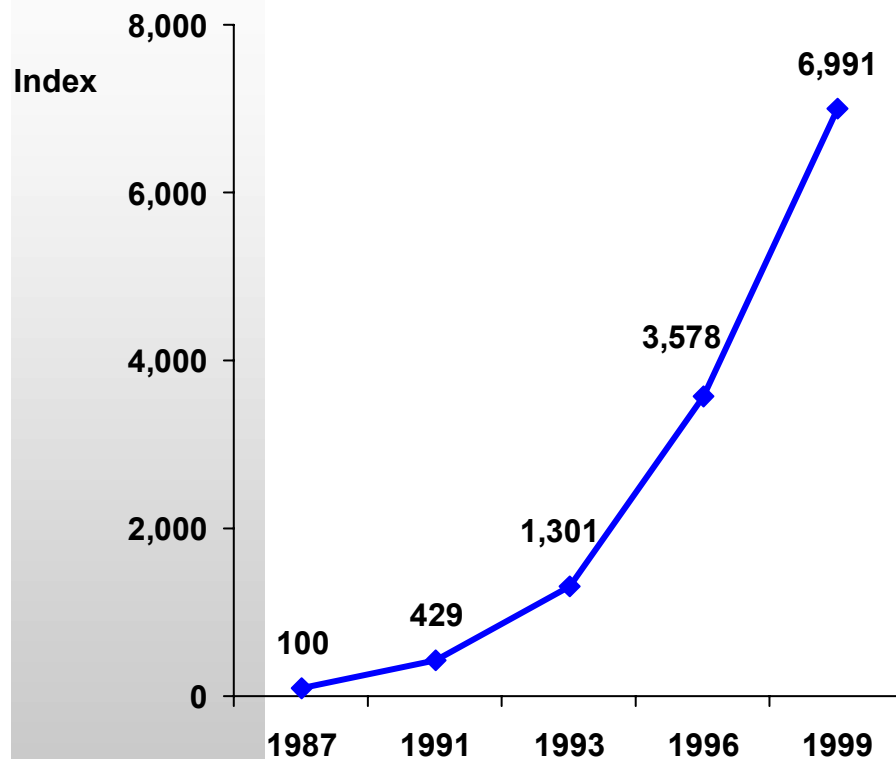
Price/Performance Improvement Has Accelerated Demand

* Patent filings as a proxy for innovation

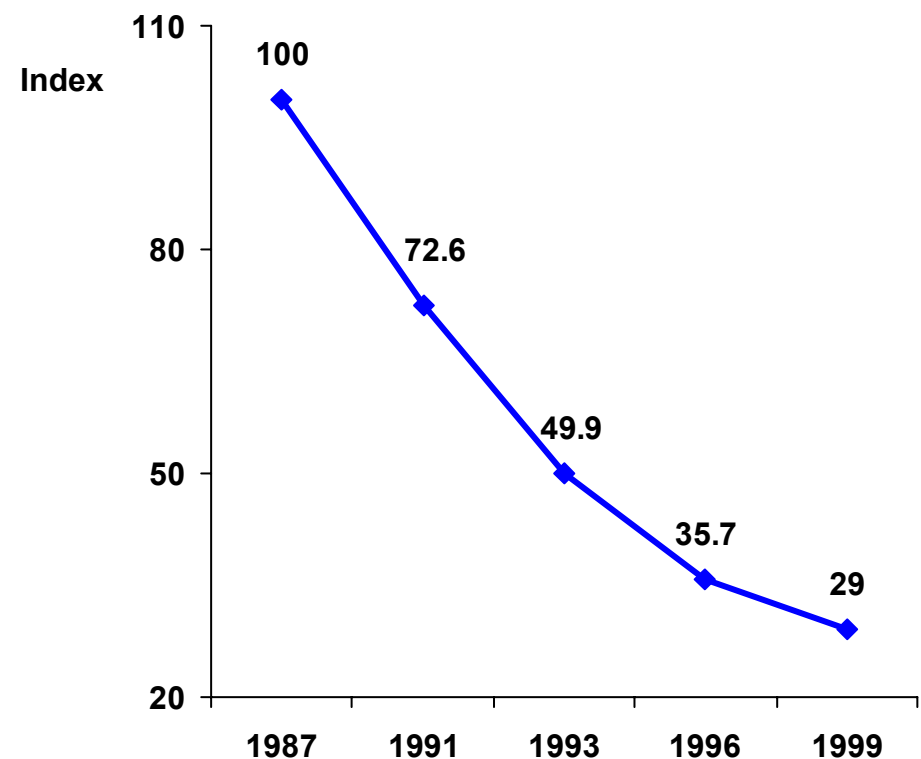
SOURCE: Federal Communications Commission (FCC)

Wireless Subscriber Growth Provides Insights Into Industry Price And Demand Relationships

Wireless Subscriber Growth



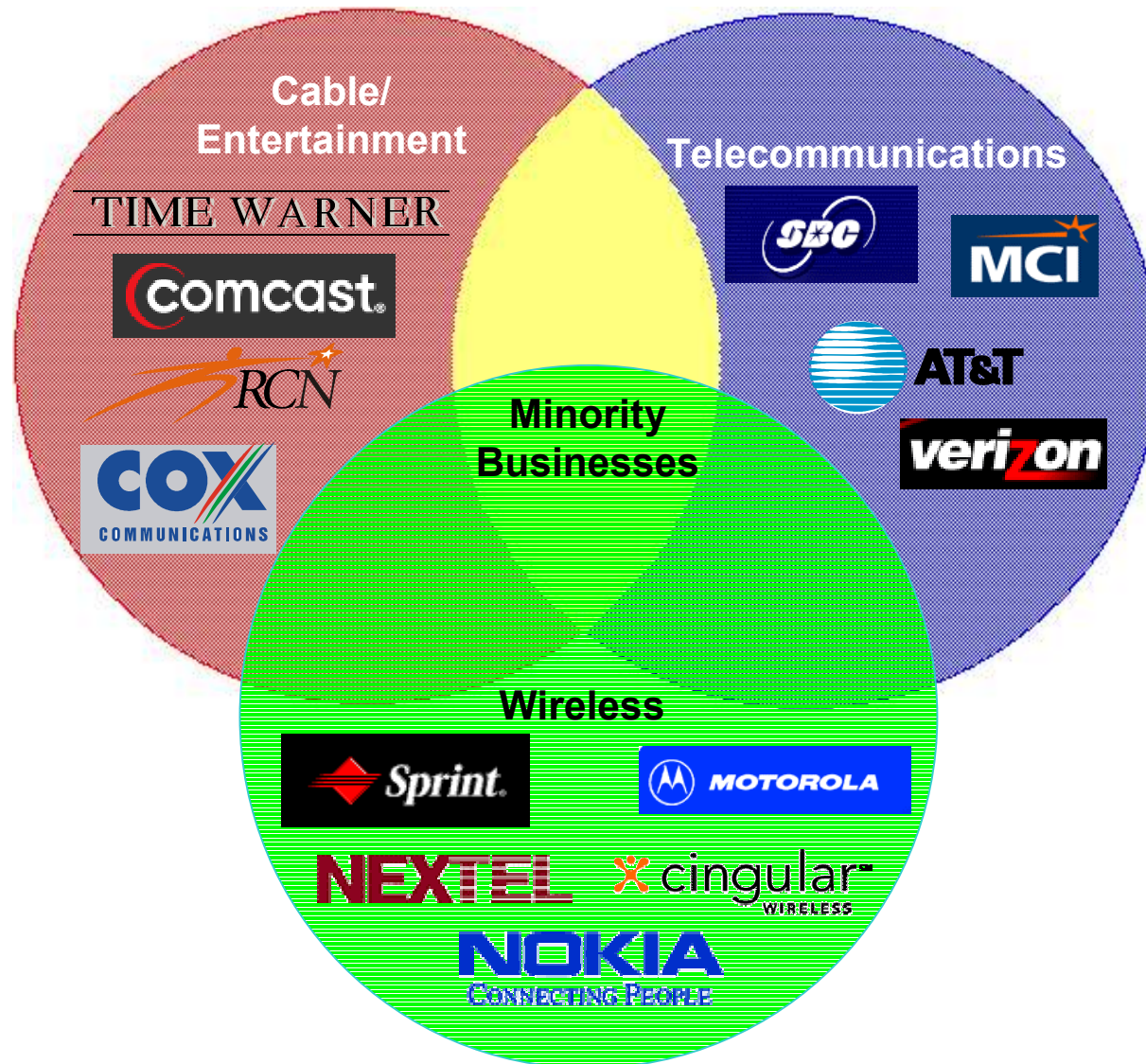
Average Monthly Bill



Price/Performance Improvements Drive Subscriber/Penetration Growth

Landscape And Industry Boundaries Are Changing And Blurring

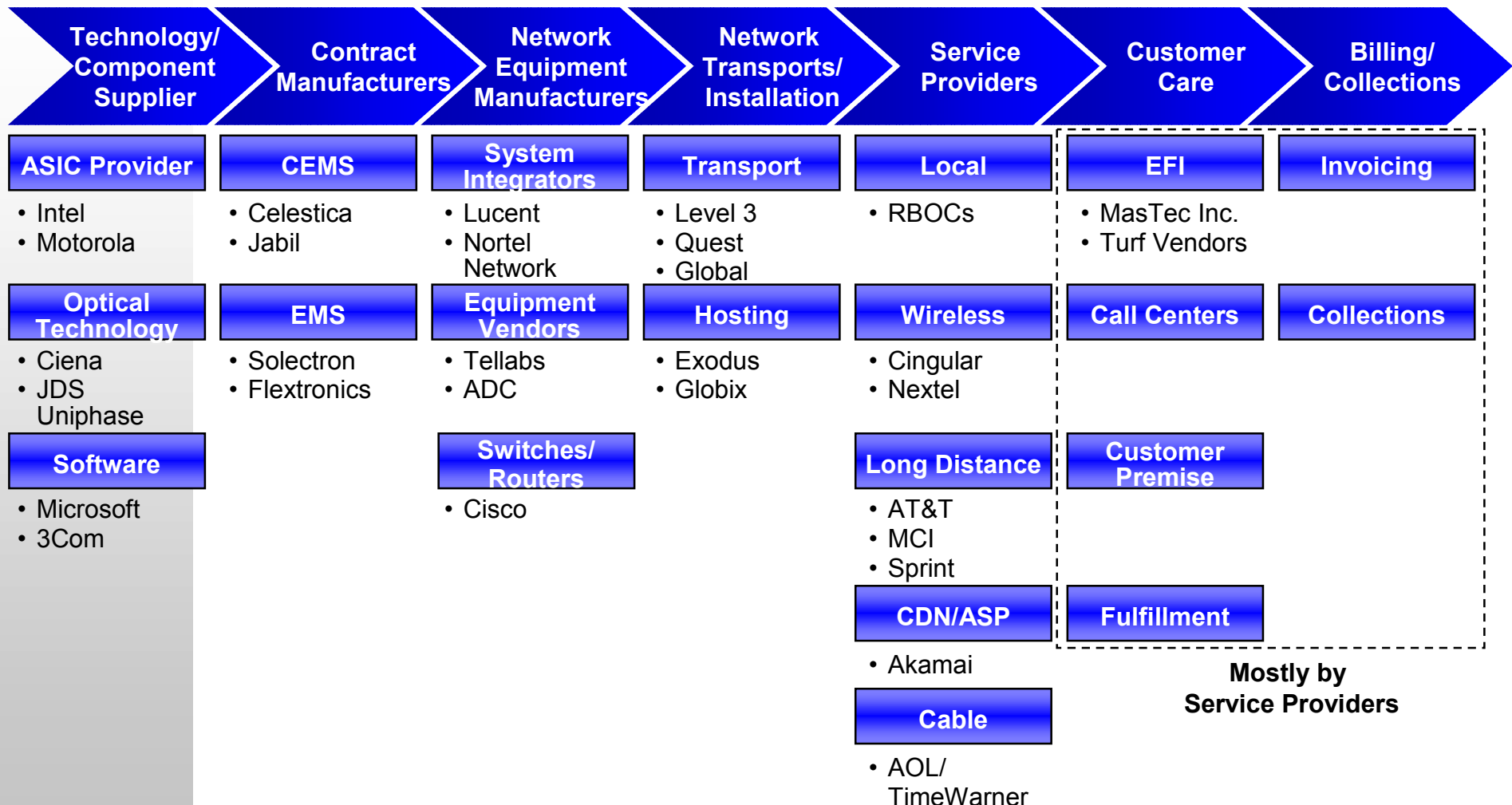
Converging Industries Create Growth Opportunities For Minority-Owned Businesses



Business Opportunities Typically Present Themselves As Capability Gaps Along Value Chain

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Telecom Industry Value Chain



Opportunities For MBE's Everywhere Along Chain

Key Takeaways And Strategic Implications

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Industry evolving into a technology-driven model

- Value creation is driven by rapid price/performance improvement and high price elasticity of demand for product/services
- Similar to industry dynamic observed in the computing sector
- Expect industry to rapidly depreciate assets and drive for shorter asset lives
 - Faster deployment and faster obsolescence

Emerging evolution would require different business models and vendor relationships

- New models and interaction must capitalize on rate of technology innovations and rapid deployment
- Procurement cycles will be in sync with technology development cycles
 - Vendor relationships will evolve to supply chain partnering to reduce operating risks
- Customer relationship management will be essential to success with service providers
 - Repair, provisioning, installation (deployment), billing must be customer-adaptive
 - Quality and reliability will become a key differentiator

Industry players will drive for increased focus on core competencies and build new capabilities which enhance competitive positions

- Will seek partnerships and relationships with suppliers to complement operations

MBE's Must Define Focus and Value Propositions to Be Successful

Identified High Growth Opportunities For Minority-Owned Businesses

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**Customer Call
Center
Management**

**Contract
Electronic
Manufacturing**

**Network
Installation**

**Optical
Networking**

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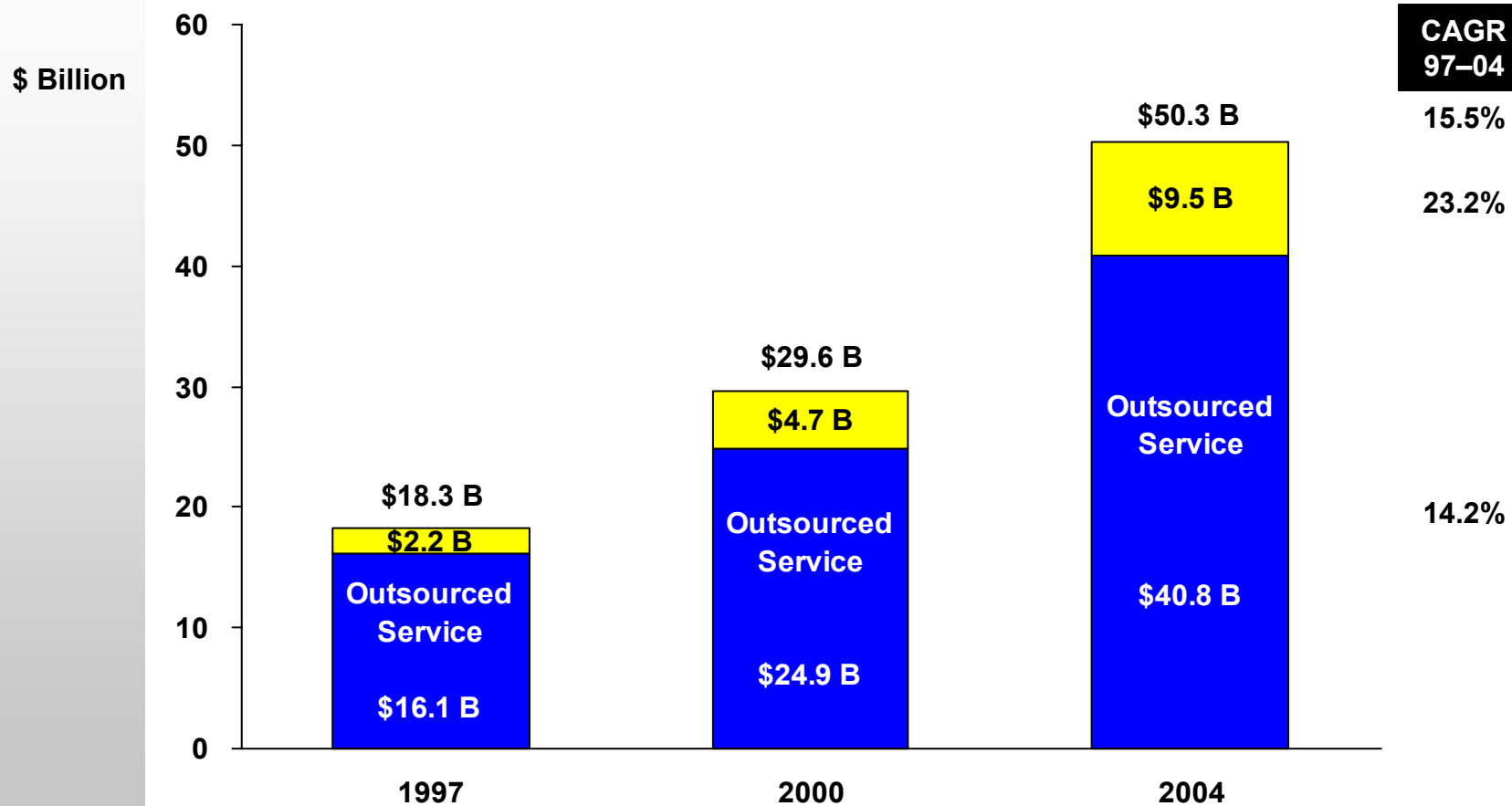
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The Call Center Services Market Has Grown Steadily

Outsourced Service Expected To Grow To \$40 Billion

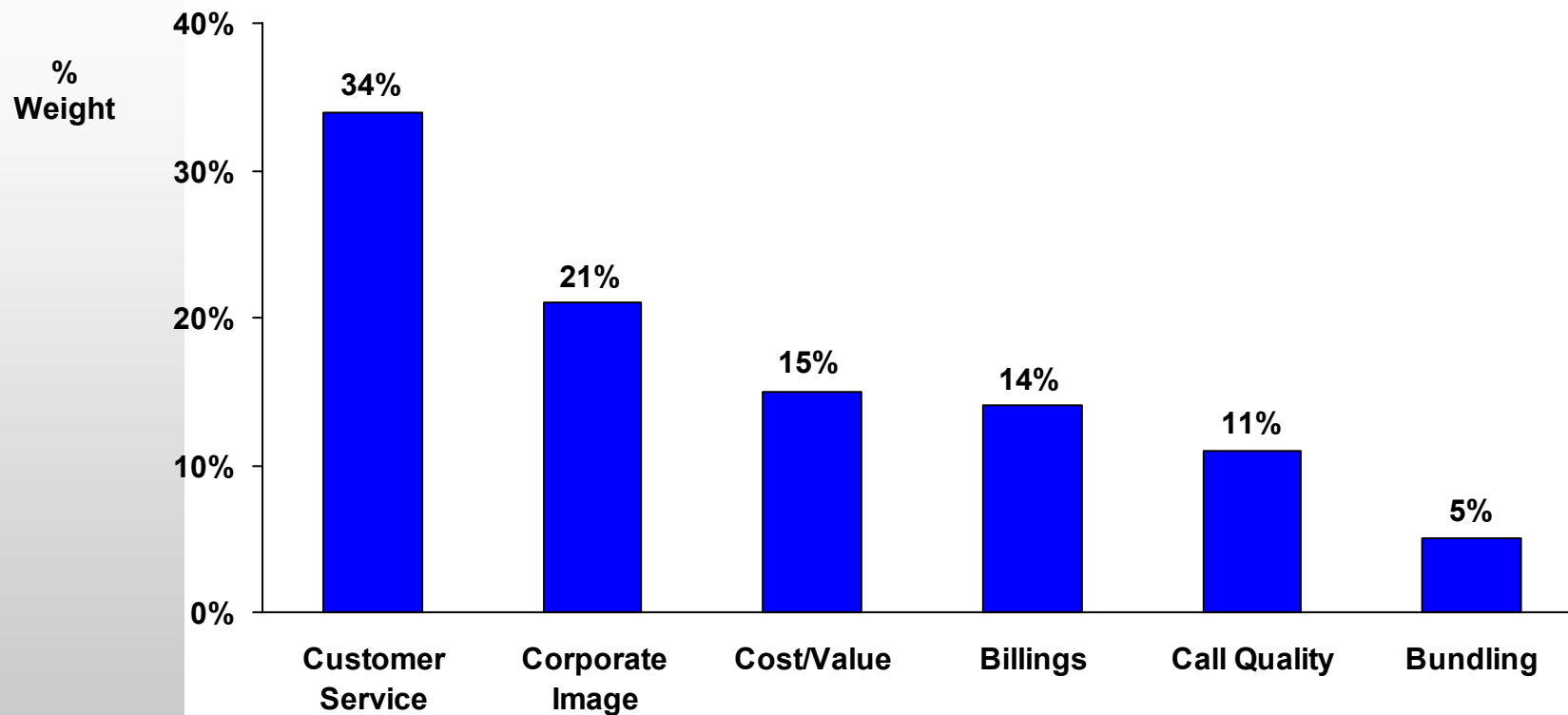
Call Center Services Market



SOURCE: Frost & Sullivan

Customer Service And Corporate Image Impact Consumer Choice Of Service Providers

Factors Which Impact Residential Customer Choice of Provider



Minority Business Involvement In Customer Contact Processes Adds Value

Types Of Call Center Outsourcing

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Infrastructure Outsourcing

- Client outsource management of voice and data infrastructures while maintaining the operation of the call center.

Facilities Management

- Very similar to traditional data center facilities management. Outsourcing firms becomes the site manager of the facility, equipment, and personnel.

Remote Call Outsourcing

- Outsourcing firm is responsible for handling all interactions with customer and is integrated into the client's business process

Trends Which Favor Continued Outsourcing By Telecom Industry

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Companies choosing to focus on other competencies where they can build differentiation

- Focusing on innovation and deployment rather than customer support
- Added benefit of achieving better asset utilization

Outsourcing firms provide 10% to 30% cost reduction because of better economies of scale

- Firms can be leveraged as incremental capacity driving overflow situations

High cost associated with employee turnover and training

Changing customer demographics requires new set of skills and capabilities to interface with multicultural consumers

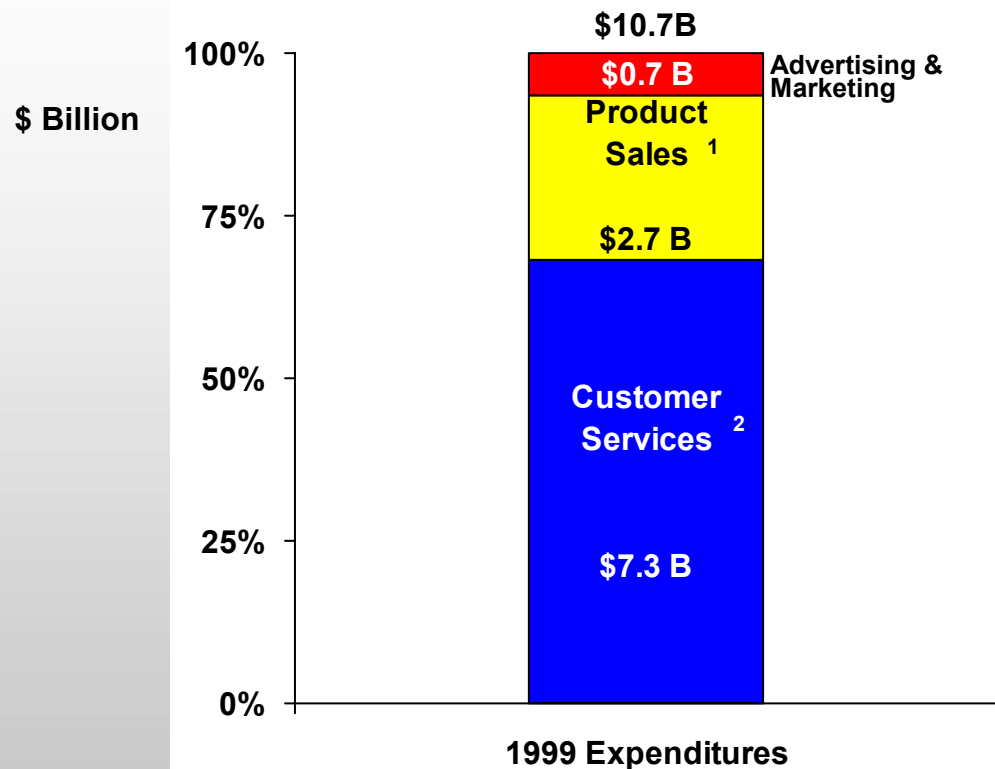
- Focused firms, particularly MBE's, more suited to provide these services

With deployment of new technical innovative services, customer support function is key in building loyalty

Call Center-Related Expenditures In Telecom Estimated At \$7.3 Billion

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Estimated Customer Management Opportunity



Key Trends

- With industry focused on building new competencies, expect certain customer care functions to be outsourced
- Growth largely driven by cost reduction and assets
 - May be focused on lower-end functions (e.g., support, order-taking)
- Lucent Technologies announces intent to sell its Customer Care and Billing Division

\$7.3 Billion Relevant Market For Call Center Services

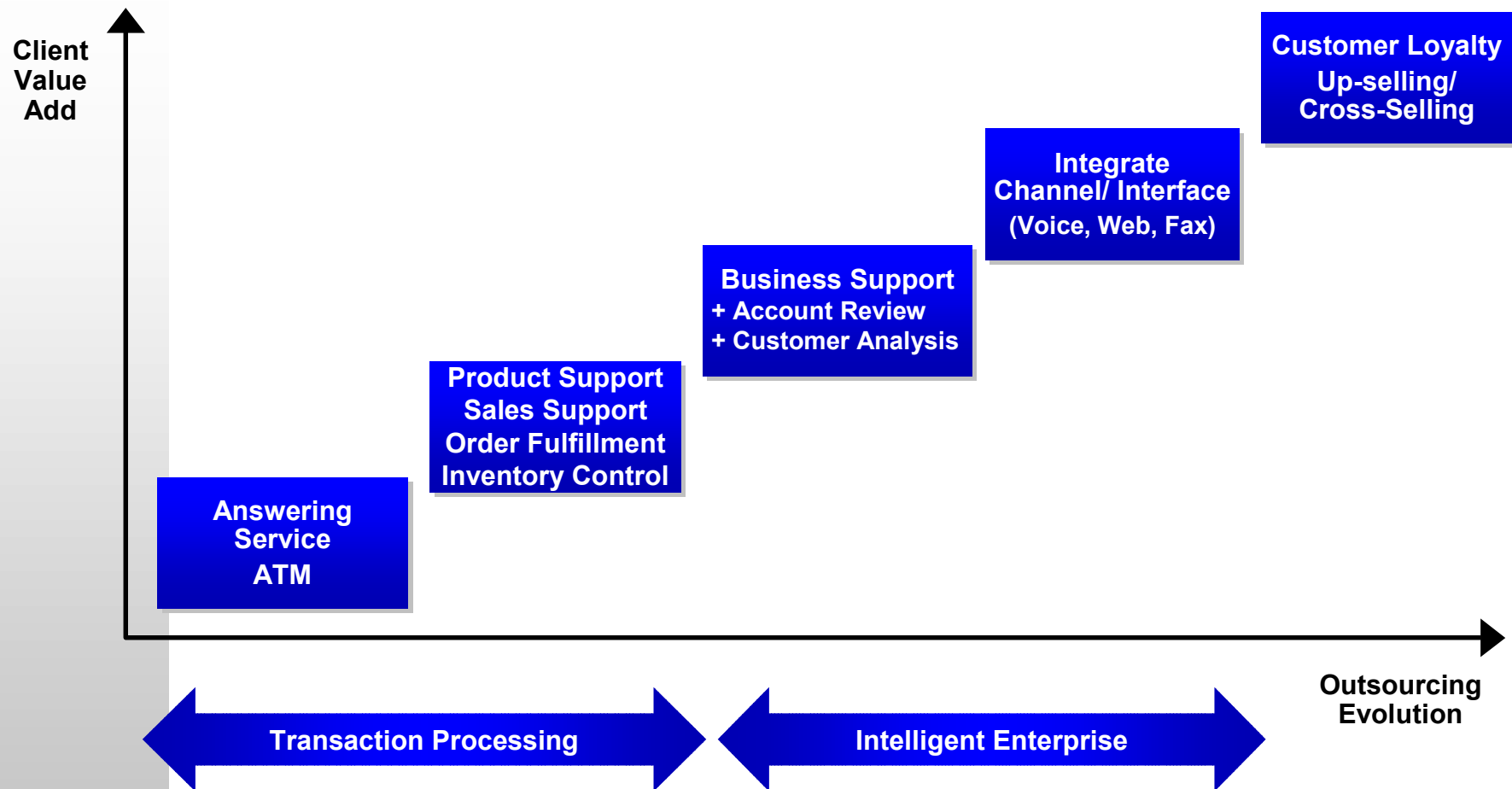
1. Based on major ILEC aggregated expenditures

2. Includes Call Center Operations

SOURCE: Federal Communications Commission (FCC)

Evolution In Call Center Roles To Service Providers

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Significant Opportunities For MBE's To Provide These Services

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Trends In Contract Electronic Manufacturing (CEM)

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Industry sector currently in a downturn due to economic slowdown following a decade of 20% to 25% growth

- High levels of inventory among CEM suppliers
- Reduced revenues and earnings forecast by major manufacturers

Slowdown has increased level of consolidation among industry players

- Selectron agreed to buy C-Mac Industries for \$2.4 Billion
- Sanmina acquires SCI Systems for \$4.5 Billion
- Top five competitors control 50% of industry revenues

Telecommunications industry has increased outsourcing to contract manufacturers

- Lucent Technologies sells facility to Celestica and enters into a \$10 Billion outsourcing revenue opportunity
- Nortel Network sells 9 facilities to Selectron with a \$10 Billion revenue opportunity

Telecom industry moving to a technology industry model, similar to computing

- Outsourcing trend likely to continue into the future

Why Telecom Players Outsource Manufacturing

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Allows to focus on mainstream business

- Core competency
- R&D, Innovation
- Marketing

Provides access to vertically integrated leading-edge global manufacturing

- Innovation
- Full solution providers from product design and procurement to repair and technical support
 - Economies of scope

Provides for faster time to market

- Shortening the lifecycle between order and delivery
- Flextronics' "Industrial Park" model reduces time associated with manufacturing and supply chain coordination
 - Complete on-site production

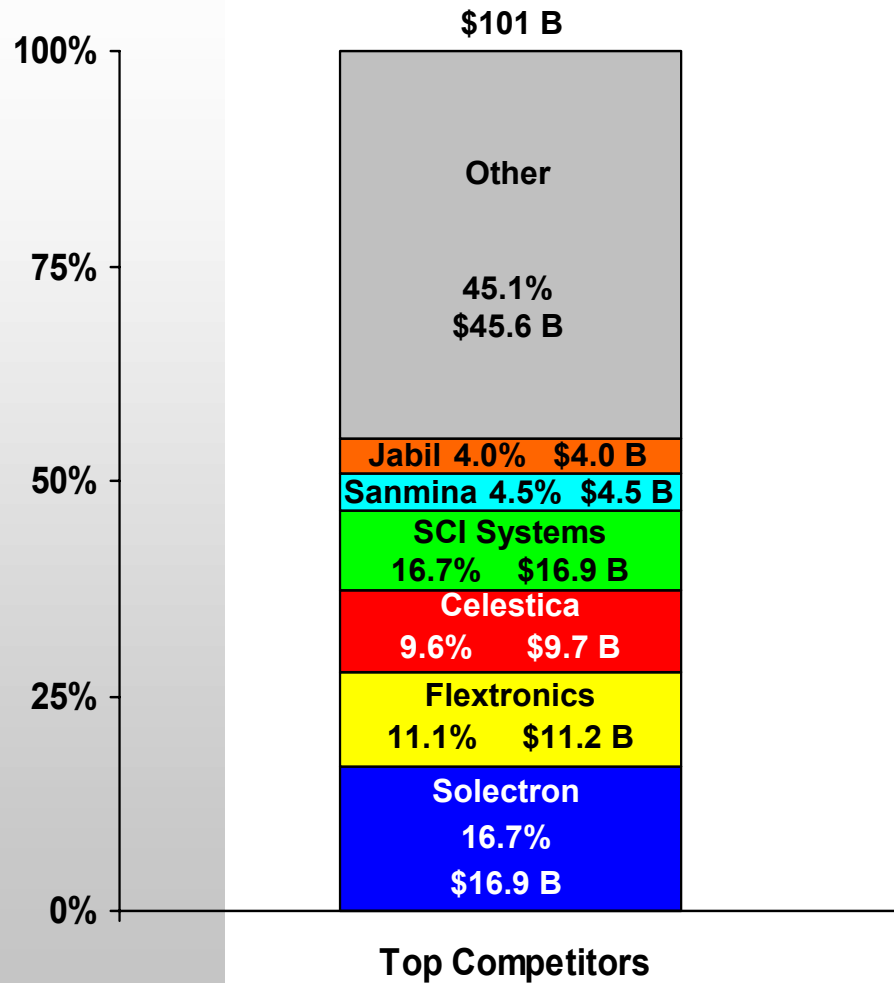
Reduces Cost

- Worldwide low-cost factory locations
- Better Leverage of Economies of Scale that enable Moore's Law price/performance
 - Better logistics
 - Ability to procure materials cheaper
- Reduces factory/capital investments
 - Higher Return on Invested Capital

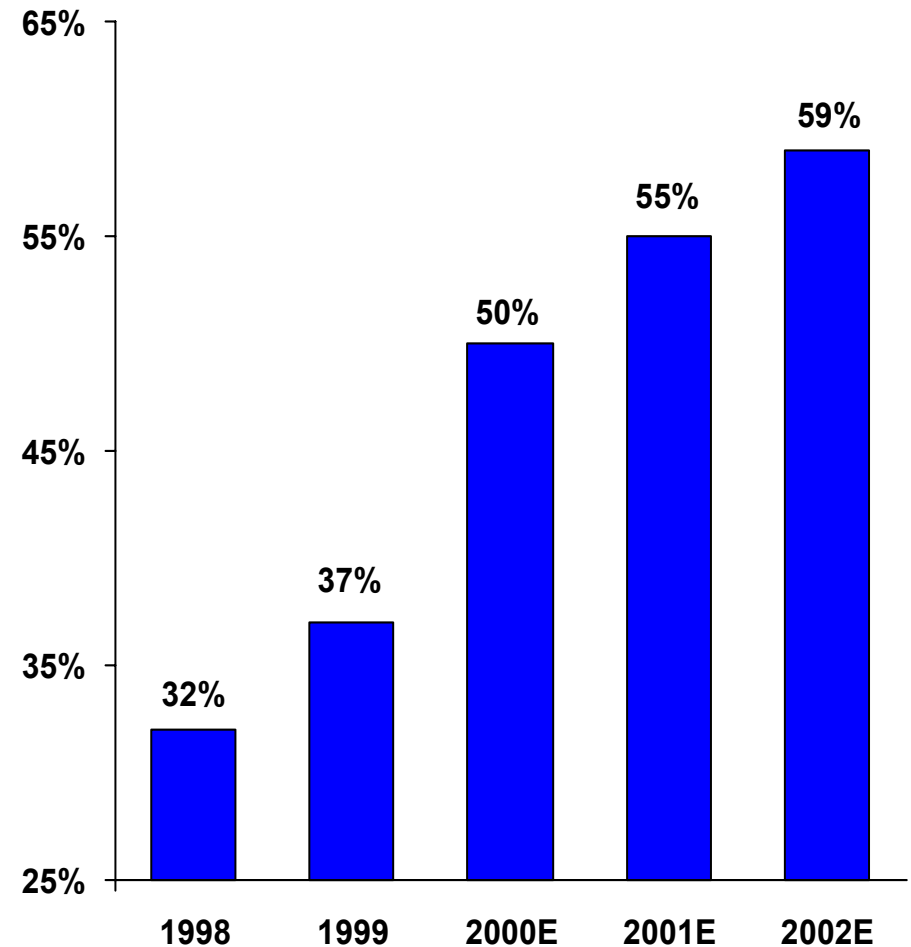
Top 5 Players Accounted For 50% Of The \$101 Billion Industry In 2000

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Worldwide Market 2000



Market Share of Top Five EMS Providers

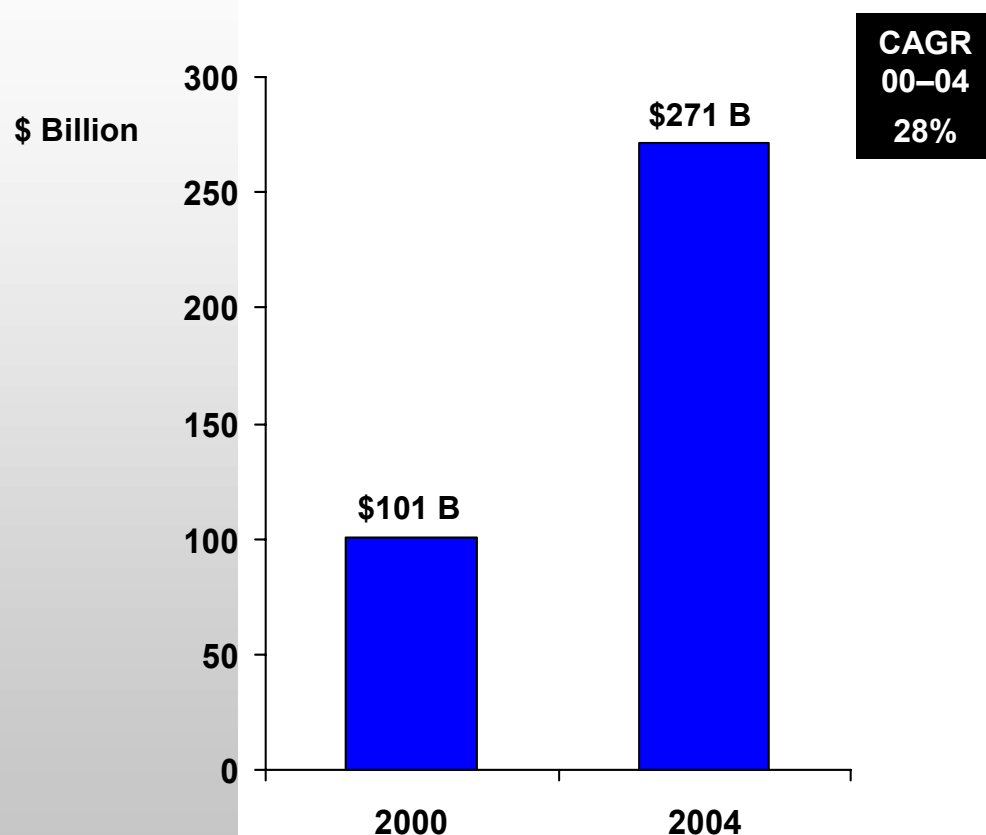


1. Acquired by Sanmina July 2000

SOURCE: Wall Street Journal, Financial Times, Upside Today

Industry Expected To Experience Tremendous Growth Over Next Four Years

Contract Electronic Manufacturing Growth

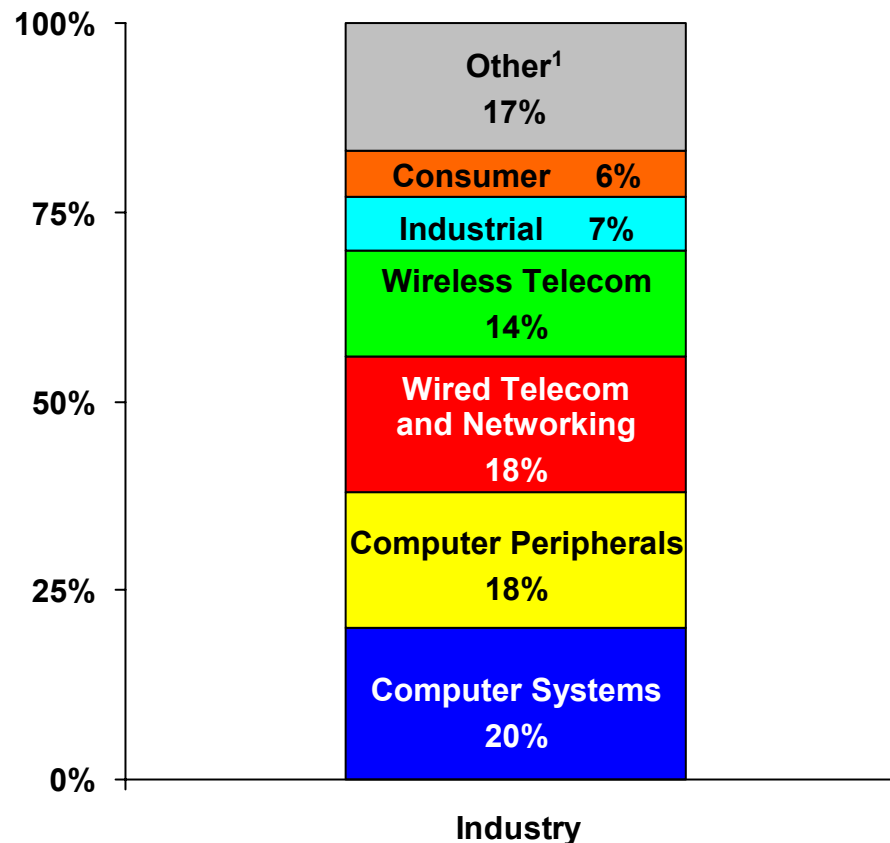


Key Trends

- Balance sheet optimization and cash flow improvement
- Achieve flexible, variable cost structures
 - Reduce operating risks
- Better leverage of Economies of Scale and innovation
- Achieve better focus on core competencies
- Industry convergence of cable, telecom, and wireless

Client/Industry Diversity Is A Key Survival Tool In A Downturn

EMS Market Breakdown By Industry



Wide Selection Of Clients Smooths Out Peaks And Valleys Of End-User Demand

1. Includes Instrumentation, Medical Instrumentation, Military/Aerospace (4% each); Automotive (3%), and Other (2%)
SOURCE: Upside Today, Asaba Group Analysis

Critical Success Factors For Contract Manufacturers

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Size and Scale

- Must be able to achieve economies of scale
- PCB assembly and testing comprises roughly 67% of most CEMs' revenue but has a gross margin of only 8 to 9%. Huge volume is necessary to survive in the business

Global Presence/Footprint

- Must be where your customer is to control logistics cost
- Must be able to enjoy cheap labor rates – Far East, Mexico and Africa
- Must be able to provide round-the-clock services
 - Code writing and product development

Ability to make products in one place

- Keeps costs down
- Faster production means faster time to market
 - Flextronics' "Industrial Park" model

Ability to provide complete service solutions (vertical model) or diversify across industries (horizontal model) or both

Opportunities For Minority-Owned Businesses

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The EMS Industry being shaped in economy slowdown

- Missing out today means losing market share tomorrow
- Telecom companies making outsourcing decisions

Opportunities exist in the Repair, Warranty, Optical Components, Modules, and Subassembly segments

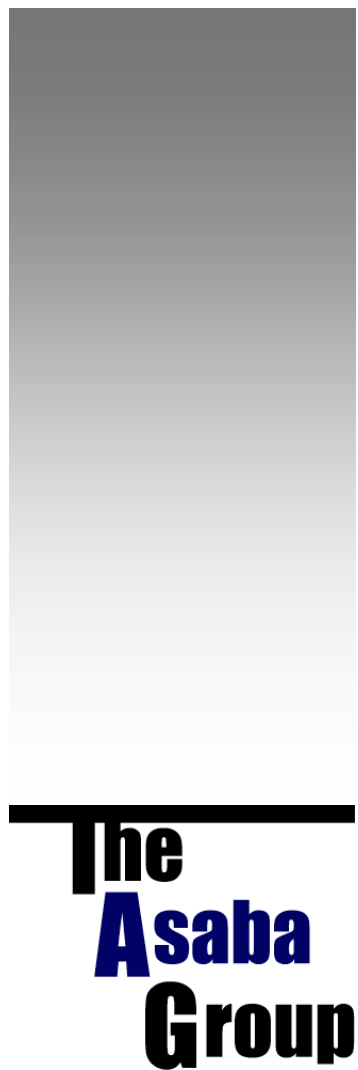
- The \$100 Billion Repair, Re-manufacturing and Warranty market is only 1% penetrated

Acquisitions expected in areas of design, technical solutions and support services

- Must strategically position the company today for tomorrow's growth
- Adopt the horizontal model and stick to it
 - Size required for vertical model
 - Horizontal model allows concentration on core competency
 - Greater diversity necessary to survive demand slowdowns can be achieved
 - Allows the company to become best in its niche and grow from there

Joint Ventures and Alliances are necessary to achieve stability and size

- Locate geographically near partner's or client's facility
- Recruit top talent to drive innovation
- Perform better, faster, cheaper in your niche and force an alliance or joint venture



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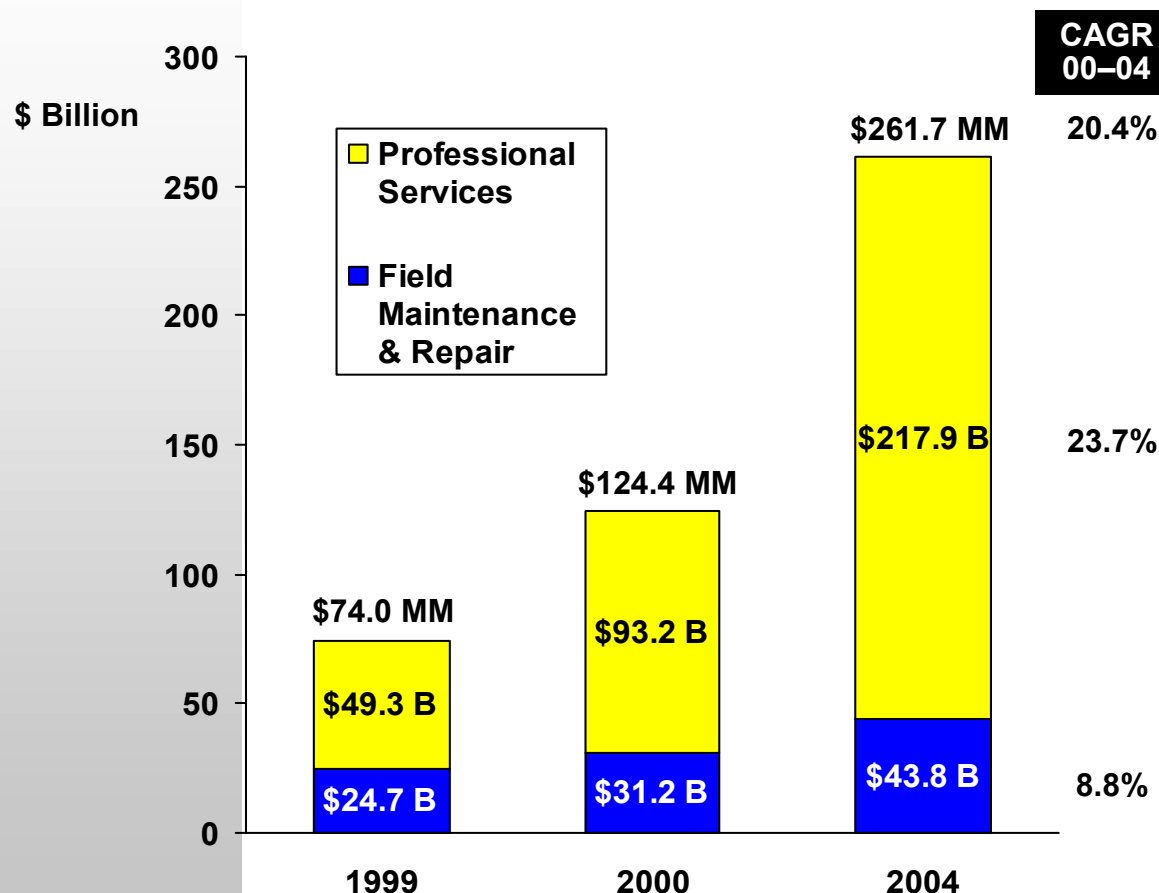
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Telecommunications Engineering, Furnish And Installation Expected To Grow

Currently Estimated Spending Is \$124 Billion

Telecommunications EF&I Spending



Network Installation and Construction Shifting From Long Haul To Metro/CPE Environment

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Prior investments focused on building long-haul networks

- Network builders and telephone companies spent \$90 billion over least four years on fiber optic network
 - An estimated 39 million miles of glass fiber exists
- Analysts estimate less than 5% is used today
- Expect minimal investments in installation expenditures focused on long haul fiber networks

Fiber optics under-utilization is a function of an absence of local high-speed networks

- Local networks unable to handle large volumes of traffic

As new innovative applications come to market, service providers will be compelled to invest in “last mile” upgrades

- Financial investment will be closely tied to growth and profitability of new services

MBE's Can Expect Long-Term Opportunities From Upgrades In Local Networks

Telecom Industry Dynamics Which Favor Network Installation Services

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Telecommunications networks require ongoing maintenance and upgrades

- Service providers seek “Five Nines” (99.999%) reliability and installation integrity
- Industry players continue to downsize and seek partners to outsource installation and deployment services

Constantly changing and new innovative technologies require rapid deployment

- Broadband (cable and DSL) deployment growing
 - Central offices, fiber optics, and cable upgrades
- Convergence of the network to incorporate optically networking
- Opening the bottlenecks associated with metro networks

Equipment Suppliers and System Integrators desire to partner with strong reliable EF&I firms

- Strong regional footprint desired

Consolidation by Telecom carriers driving need for network integration

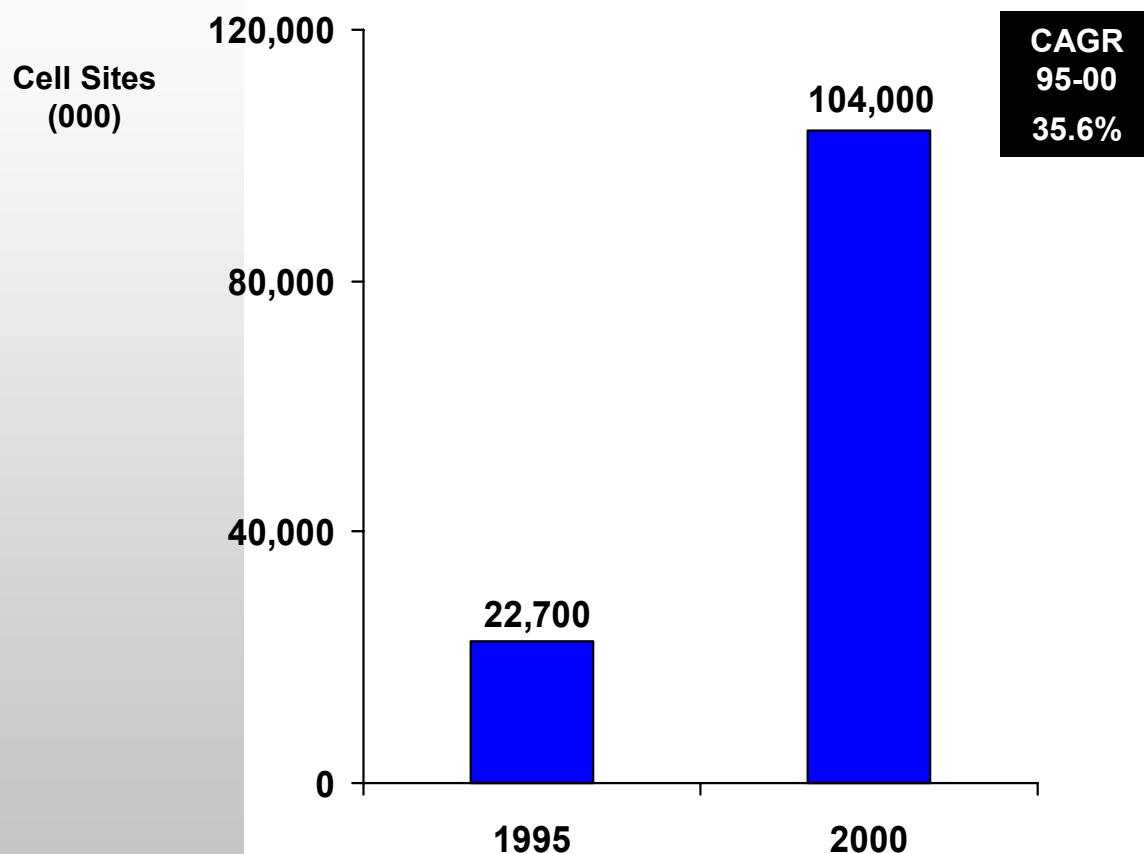
- Demanding System Integrators and equipment suppliers to deliver “turned-up” working system
- Opportunities for EF&I vendors to serve contiguous areas
- Shrinking lifecycle of technology equipment

Industry convergence with wireless, cable, and telecommunications increasing network installation complexity

Potential Opportunities For MBE's To Grow In This Sector

Wireless Industry Growth Provides Opportunities In Cell Site Construction And Network Support

U.S. Cell Sites



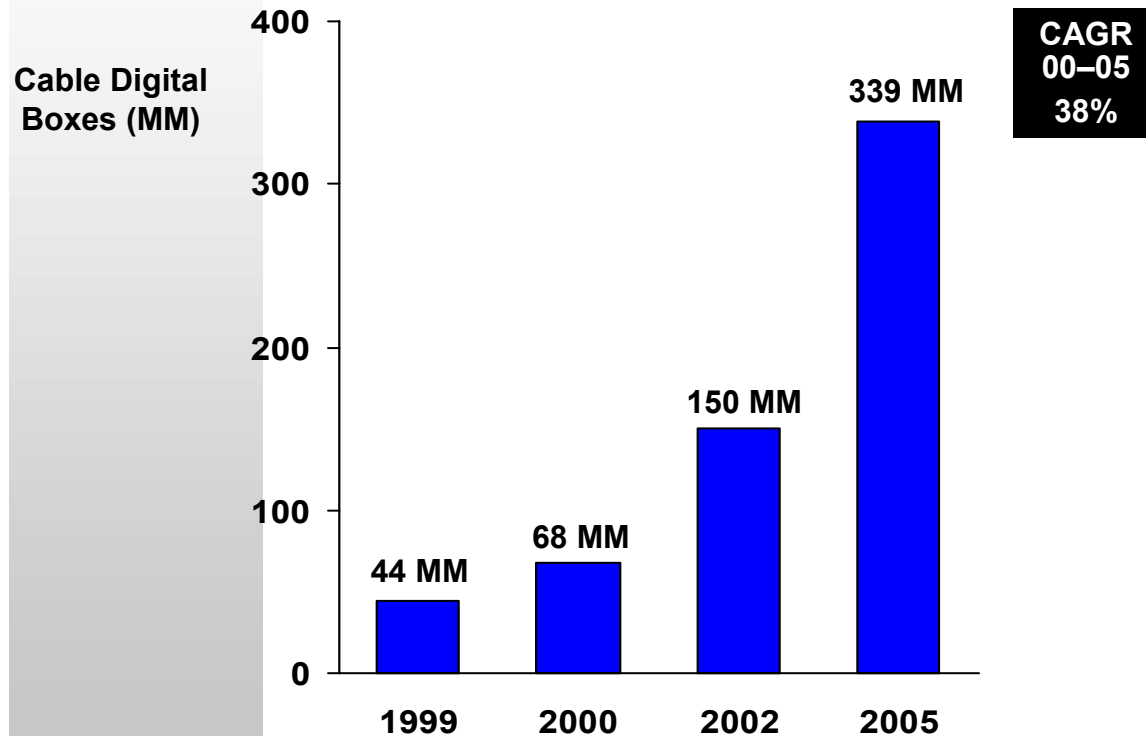
Key Trends

- Completion of nationwide build-out by wireless service providers
- Regional players and broadcast also building out territories
 - Bring on additional capacity or fill-in sites
- 2.5G and 3G services driving network upgrades
- New auctioned spectrums will increase need for more cell sites

Cable Providers Also Increasing Expenditures In Network Upgrades And Installation

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Worldwide Installed Base Cable Digital Boxes

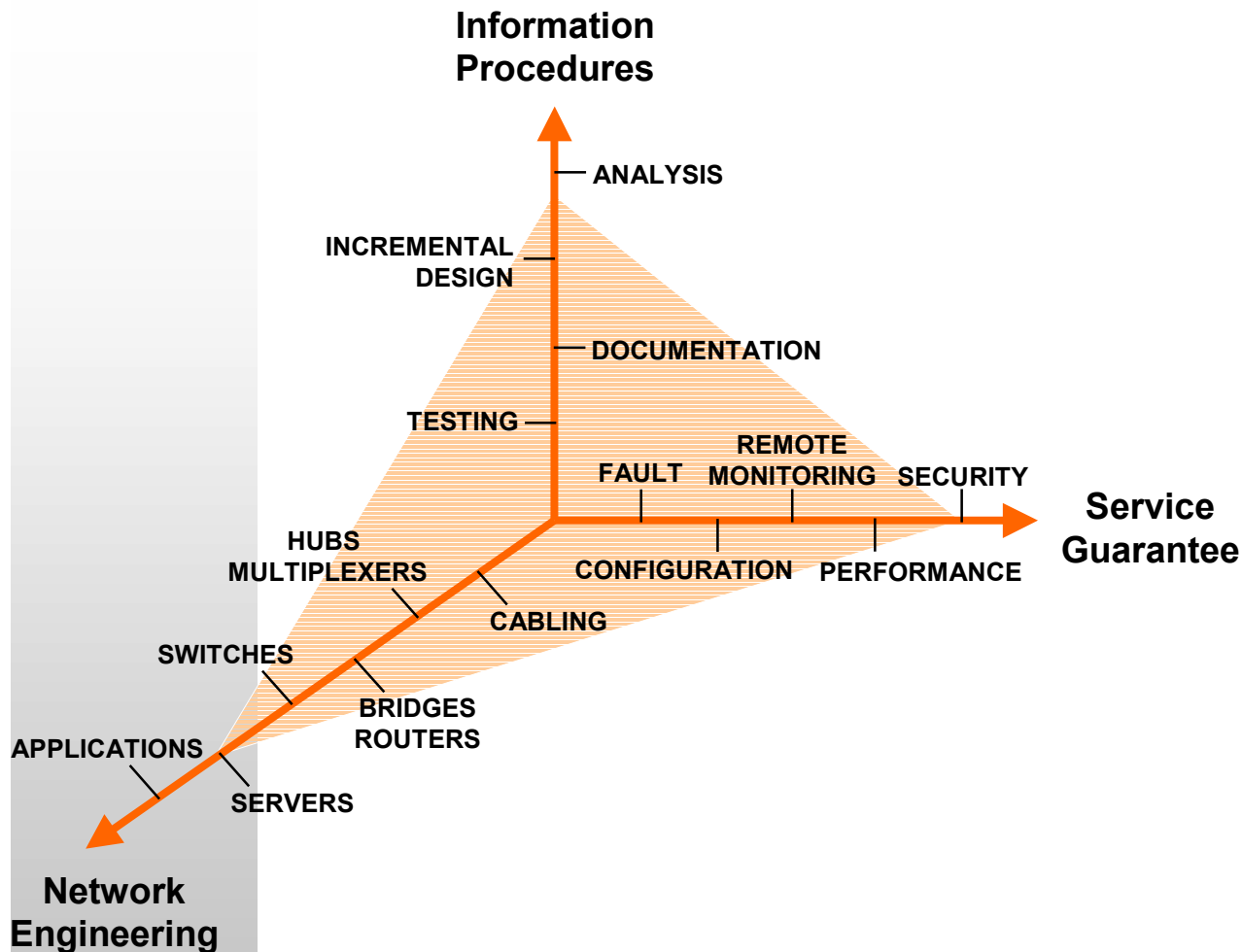


Key Trends

- Cable companies replacing coaxial cable with fiber options
 - “Last mile” upgrades
- Cable companies providing new bundled services
 - Video, telephony, broadband
 - Interactive entertainment

SOURCE: Allied Business Intelligence, Master Company Reports, Wall Street Journal

Successful MBE's Will Develop Capabilities In The Following Three Areas



Key Success Factors

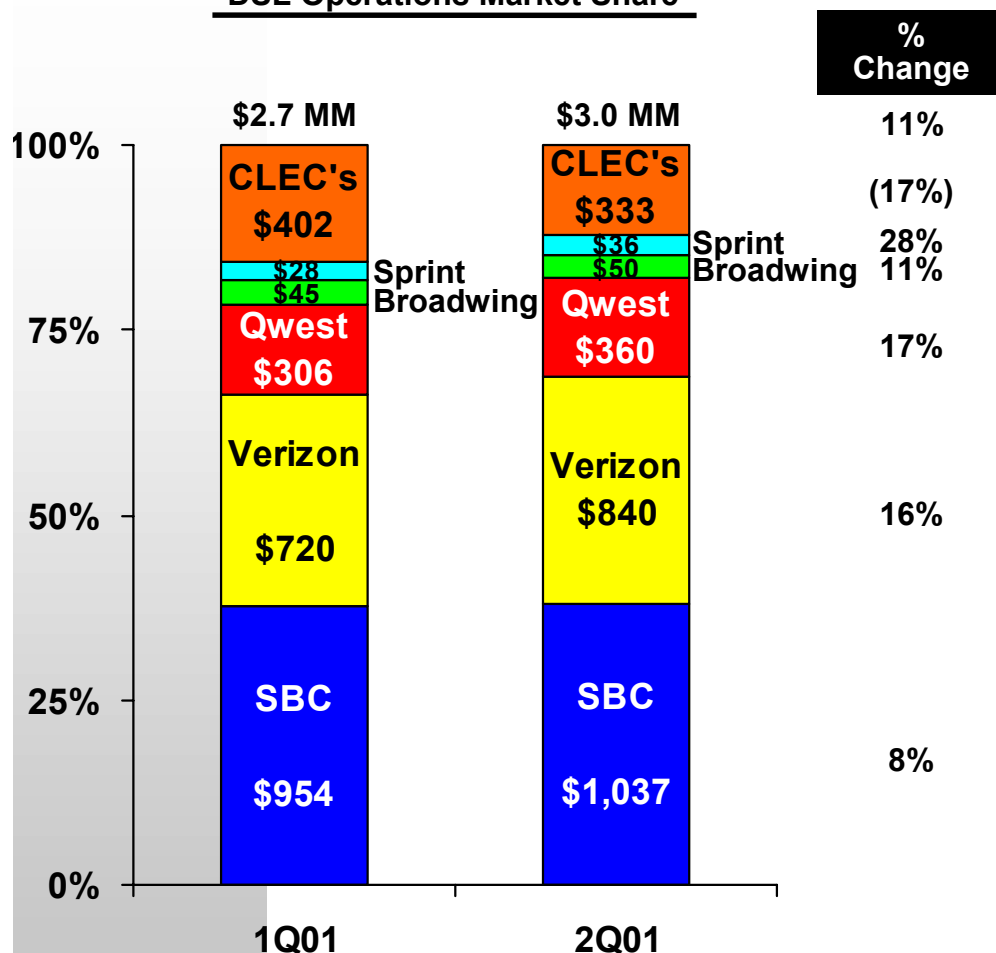
- Strong regional scope
 - Ability to service large regions
 - “Turf vendors”
- Run multiple jobs simultaneously
- Pull multiple disciplines together to generate customer solutions
- Tightly integrated into OEM and service provider operations

Essential In Building Winning Value Propositions

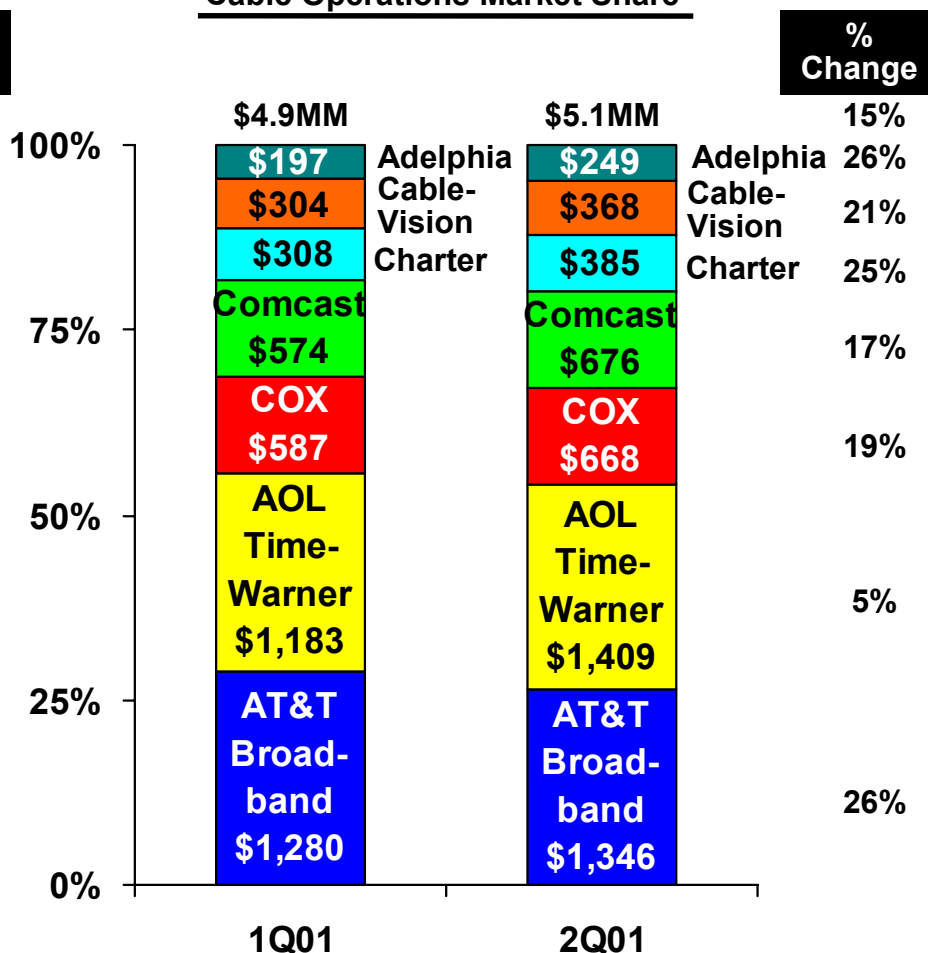
MBE's Should Target The Top Tier Players In The Industry

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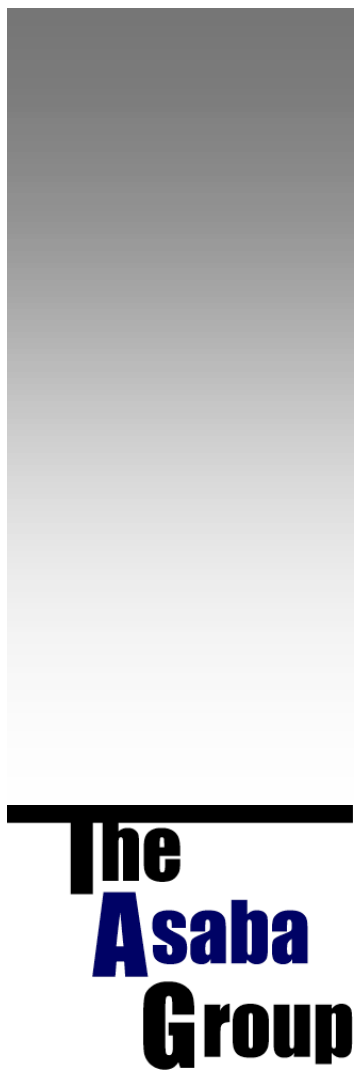
DSL Operations Market Share



Cable Operations Market Share



Leading Players Will Most Likely Continue EF&I Investments



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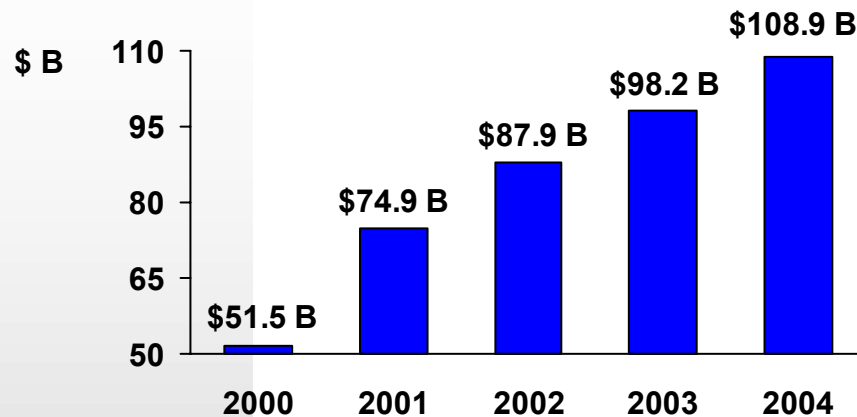
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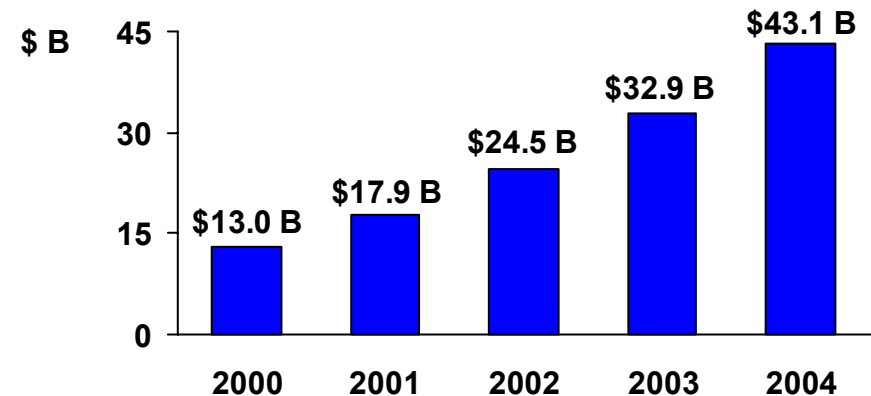
Wireless, Broadband, And IP Applications Are Areas Of Future Growth

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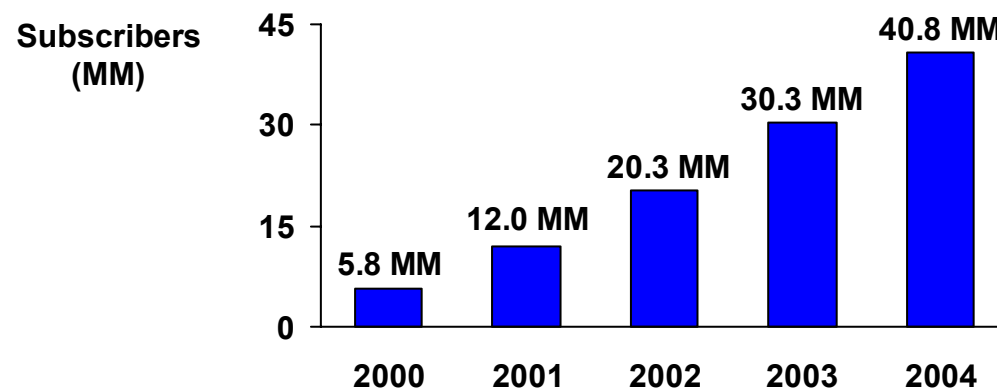
Wireless Services Revenue Forecast



IP Revenue Forecast



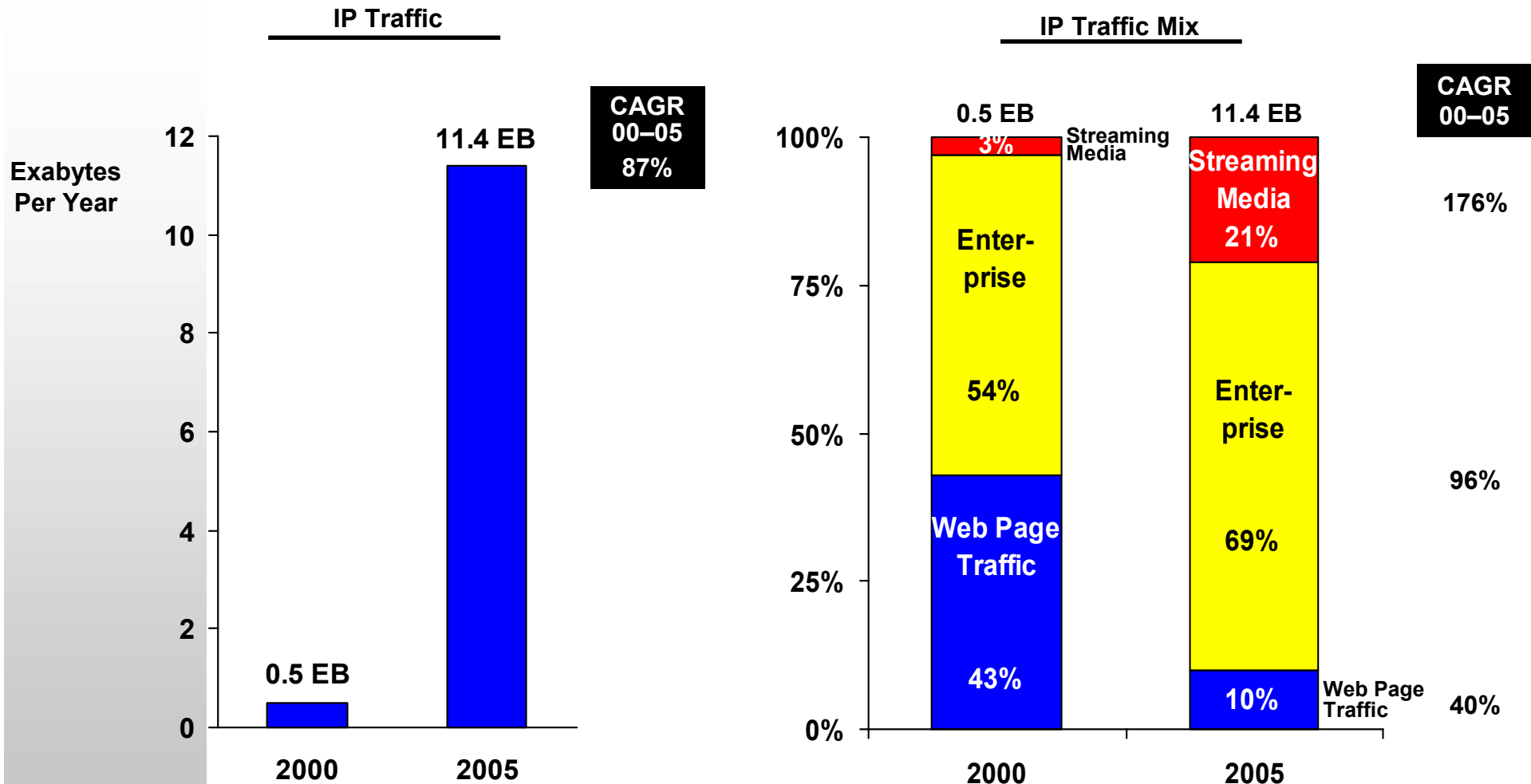
Broadband Subscriber Forecast



SOURCE: Merrill Lynch, JP Morgan, McKinsey & Company, MultiMedia Telecommunications Association, Asaba Group analysis

IP-Related Traffic Will Experience Tremendous Growth In Next 5 Years

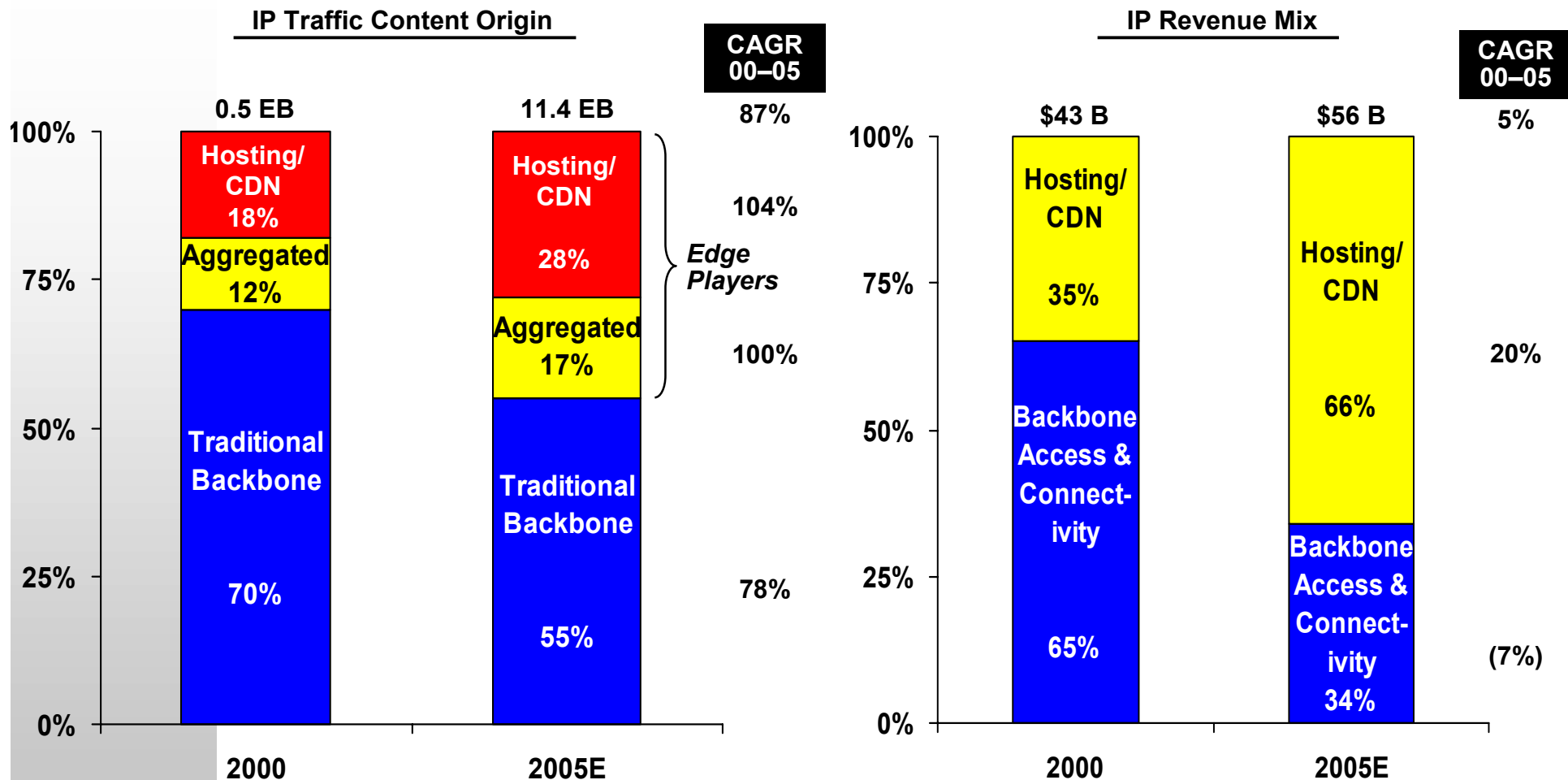
Mix Of Traffic Is Expected To Shift To Enterprise And Streaming Media



How Can MBE's Partake In This Opportunity?

Opportunities Exist For MBE's As "Edge Players" Or Aggregators

Hosting, Data Centers* Support And CDN Are Potential Value Capture Services

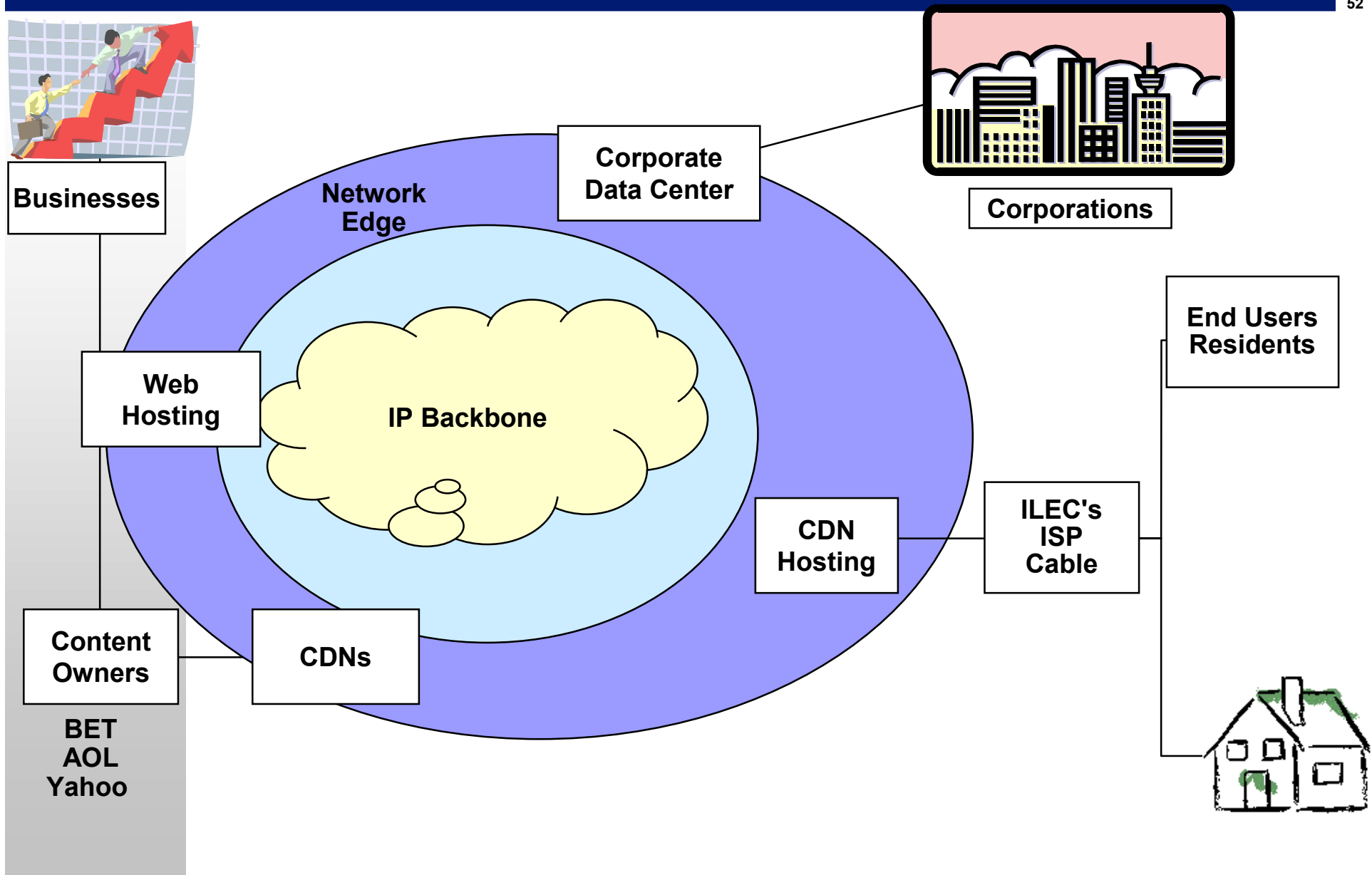


CDN = Content Distribution Networks

* Corporate Internal Data Centers

SOURCE: JP Morgan H&Q, McKinsey & Company

MBE's Should Target ILEC's, Content Owners And Corporate Data Centers

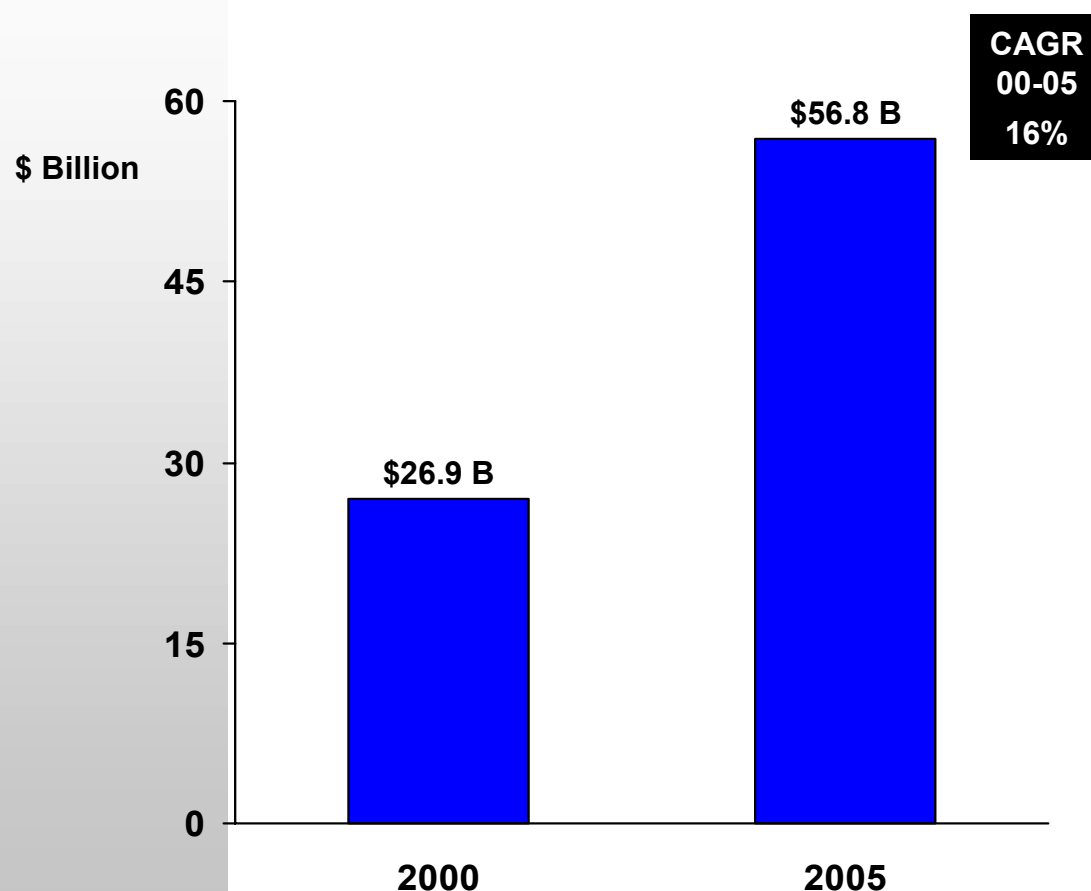


Focus And Excellent Execution Will Be Essential For Success

Potential Opportunity	Value Propositions	Potential Partners/Customers
Hosting Services	<ul style="list-style-type: none"> • Strong network and system management expertise • Fully-managed services <ul style="list-style-type: none"> – Rack rental, connectivity, security and storage • Strong niche experience 	<ul style="list-style-type: none"> • ILEC's/RBOCs • Small- to medium-size businesses • Education
Corporate Data Center Support	<ul style="list-style-type: none"> • Managing data centers • Quality of service guarantees • Extended enterprise relationship • Security 	<ul style="list-style-type: none"> • Fortune 500 corporations • Government IT centers • Traditional IT outsourcing firms
Content Distributors	<ul style="list-style-type: none"> • Strong nice experience <ul style="list-style-type: none"> – Concentrated with dominant players • Download time with streaming media applications <ul style="list-style-type: none"> – Broad range of access speeds • Enhance experience with real time and interactive broadband applications 	<ul style="list-style-type: none"> • Education establishments • Government entities • Content owners (developers) • Cable companies

Demand For Broadband And Full Service Mobility Create Growth Opportunities

DWDM and SONET/SDH Forecast

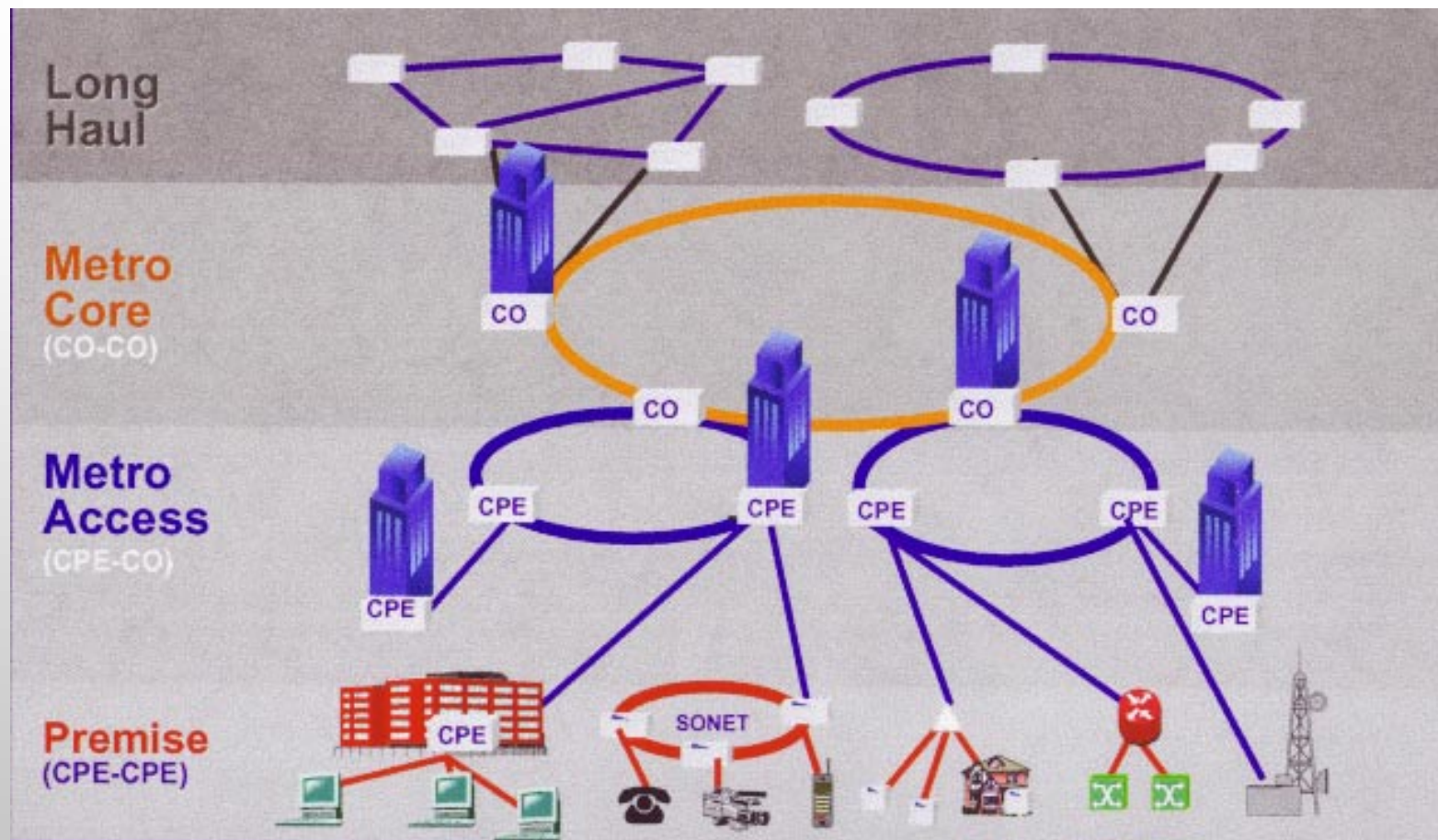


Key Trends

- Need to remove “Last Mile” bottlenecks for broadband connectivity
- Large businesses demand superfast 2Mbps access for e-services applications
- Dense Wave Division Multiplexing technology is yet to be deployed in metro areas (bottlenecks)
- DWDM will enable better cost savings and efficiency improvements

Optical Networking Technology Will Impact The Metro Bottlenecks

Service Providers Will Integrate Optical Technology Within Legacy Networks



xDSL
Cable Modem

PSTN
Cellular

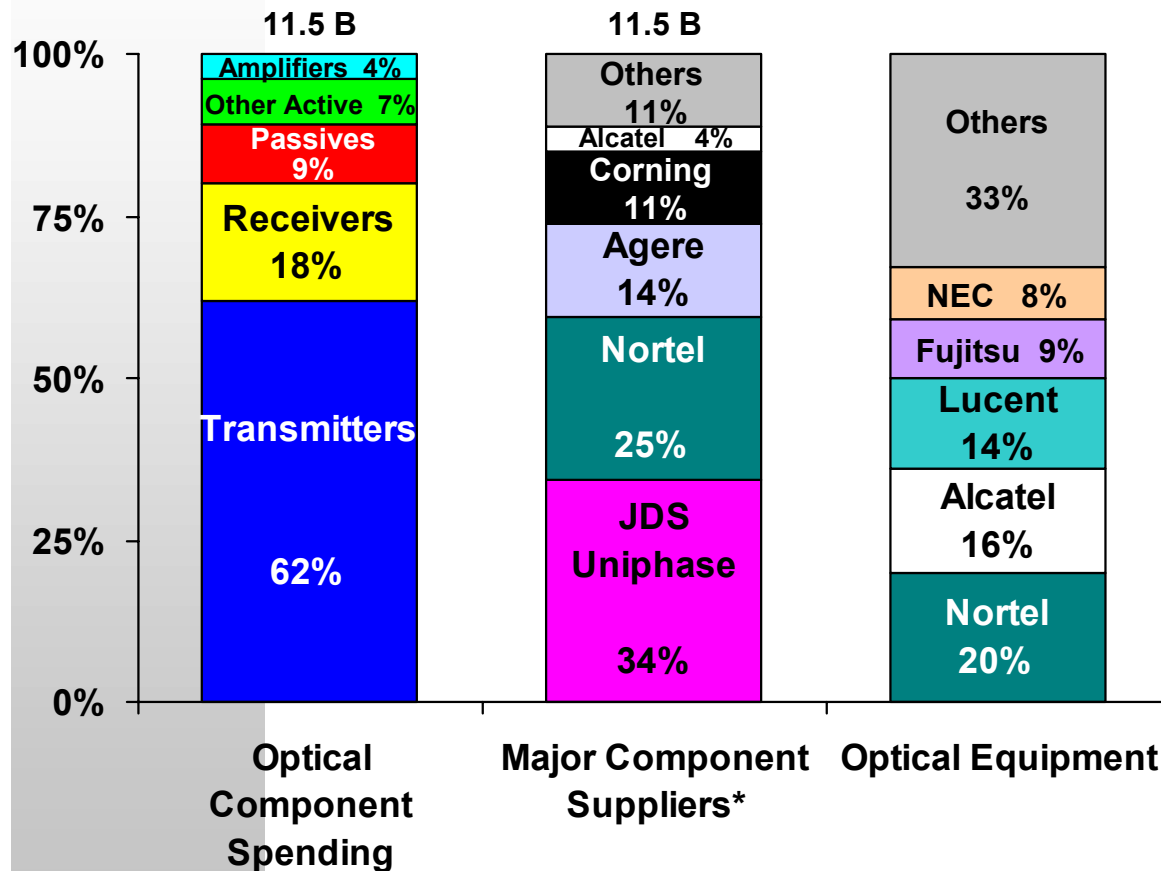
Fiber
Passive
Optical

Ethernet

Wireless

Significant Opportunities For MBE's In Optical Networking From Component Suppliers To Application Development

Optical Components and Suppliers



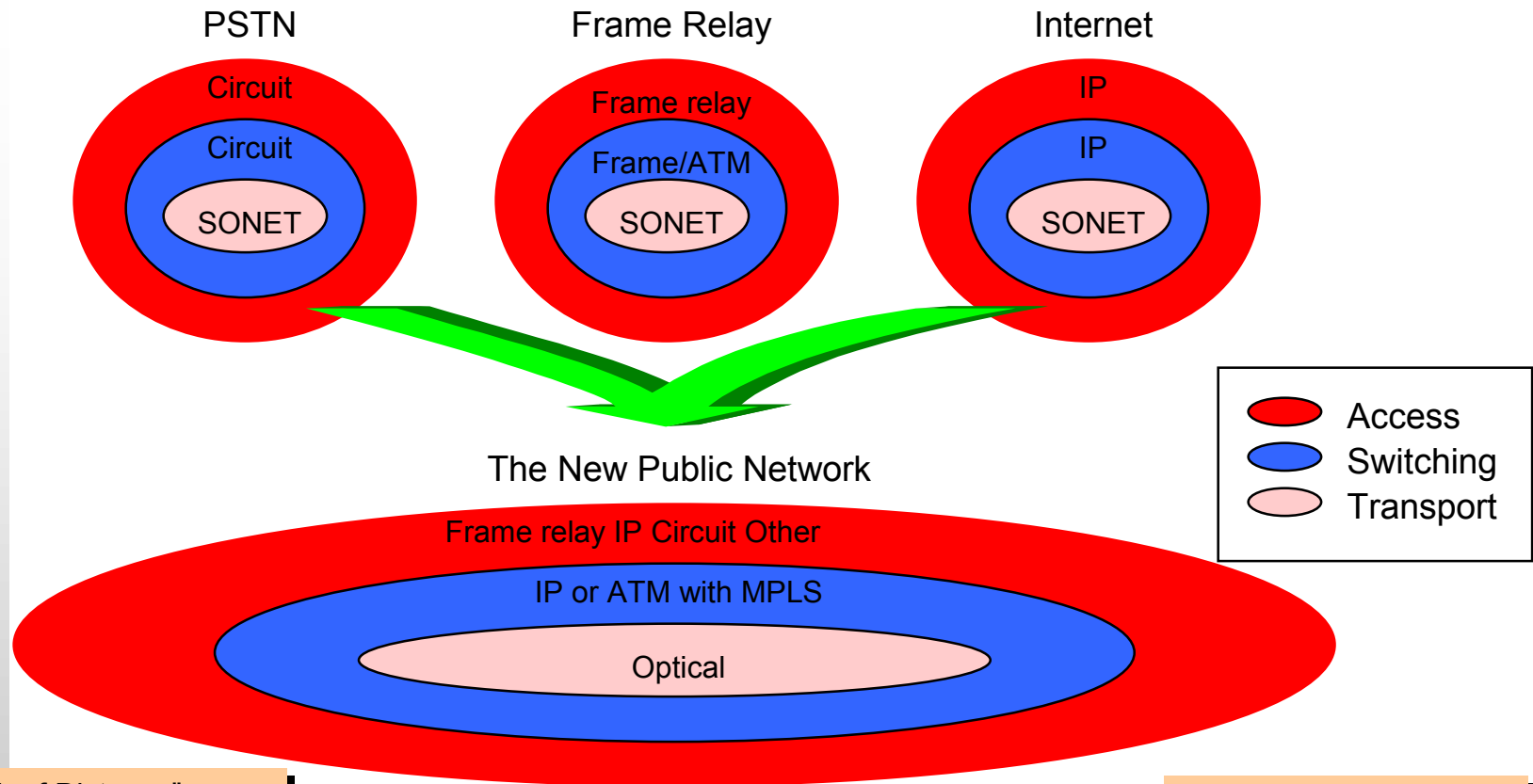
Opportunities

- Service providers will seek partners with "Turf Vendors"
 - Manage complexity
 - Quality and manageability
- Customization of equipment and deployment with OEMS
 - Rapid deployment and tune-up
- Component and technology providers to optical component suppliers
 - Software development and testing
 - Passive and active component supply
- Application development
 - Rich feature sets comparable to PC-based applications

* 2000 Market Share

SOURCE: Industry Standard, Insight Corporation, Dell Oro Group, Wall Street Journal, Merrill Lynch

Optical Networking Growth Will Lead to Network Convergence



"Death of Distance"

Anytime, any-to-any connectivity

Old infrastructure does not disappear

Network optimized for IP

Intelligence at the edge of the network

Carriers must merge billing and provisioning systems

The Asaba Group

www.asabagroup.com