



Reducing Service Provider Expenses

The twenty-first century has not been kind to telecommunications service providers. When the “internet and telecom bubbles” burst, so did the promises of compounded double digit growth in revenues and profits. In fact, today’s economy is marked by cutthroat price competition, falling prices, and technology substitution. Rather than watching revenues increase, service providers are hard pressed to maintain sales levels at the prior quarter benchmark. Yet funding in the form of operating profits is still needed to replace equipment, service debt, and provide a return to investors. The simple equation is:

$$\text{Revenues} - \text{Expenses} = \text{Profits}$$

Given this, the math says that if revenues are not being increased, expenses must be decreased to improve profitability and generate needed free cash flow.

On the operating side of the business, there are two basic types of expenses. The first is Cost of Goods Sold (COGS). These are the direct costs associated with building and maintaining a product. In telecommunications, COGS includes the cost of running the network including right of way/way leave charges, expenses associated with transmission and switching facilities, network repair, direct customer support, engineering, provisioning, and the rental costs of capacity obtained from other service providers. The second major category is Sales, General, and Administrative expense (SG&A). SG&A covers the salaries of people not directly associated with service delivery for sold products (accounting, sales, pre-sales support, marketing, advertising, human resources, etc.). While the accountants will talk about other types of expenses including depreciation, taxes, interest, and so forth, for the purposes of this discussion we will stick with COGS and SG&A.

Looking at recent carrier financials, two things stand out. The first is that there is a wide disparity between carrier expense proportions as a percentage of revenues. The second is that almost every carrier needs to be doing better in order to provide the profitability needed to reward investors, fund expansion, and pay debt holders.

Recent Interim Financial Results Reported by Selected Carriers*

Carrier	Revenue	Cost of Revenue	Gross Margin	SG&A	EBITDA***
AT&T	\$7,638.00	\$4,194.00	\$3,444.00 45.09%	\$1,603.00 20.99%	\$1,841.00 24.10%
Broadwing	\$163.40	\$111.49	\$51.91 31.77%	\$64.30 39.35%	(\$12.39) -7.58%
Cable & Wireless	£1,618.00	£892.00	£726.00 44.87%	£470.00 29.05%	£256.00 15.82%
COLT	£303.70	£207.80	£95.90 31.58%	£62.50 20.58%	£33.40 11.00%
Complete1	39.40 €	18.10 €	21.30 € 54.06%	12.30 € 31.22%	9.00 € 22.84%
Fibernet (US)	\$26.38	\$10.00	\$16.38 62.10%	\$11.70 44.35%	\$4.68 17.74%
Global Crossing	\$569.00	\$470.00	\$99.00 17.40%	\$118.00 20.74%	(\$19.00) -3.34%
Level3**	\$423.00	\$116.00	\$307.00 72.58%	\$204.00 48.23%	\$103.00 24.35%
MCI	\$5,076.00	\$3,209.00	\$1,867.00 36.78%	\$1,246.00 24.55%	\$621.00 12.23%
Time Warner Telecom	\$160.59	\$65.55	\$95.04 59.18%	\$43.43 27.04%	\$51.61 32.14%
XO	\$391.90	\$162.00	\$229.90 58.66%	\$209.40 53.43%	\$20.50 5.23%
			42.37%	24.65%	17.73%

*based on public reports for the then most recent reporting period released prior to 1 December 2004

** results are for telecommunications line of business only

*** does not reflect extraordinary items or other classified expenses beyond SG&A and COGS

Carriers can receive significant assistance in their expense reduction efforts through the products and services of Magenta netLogic. We can help reduce both COGS and SG&A through the Magenta netSystems and Magenta netSolutions lines of business. By improving the ways in which outsourced network capacity is identified and purchased, both the direct (facility rental) and indirect (internal salaries and coordination) costs can be reduced. This cost reduction can in turn be used to provide greater profitability, or, where circumstances demand, lower prices at a comparable margin.

Magenta netLogic is able to provide this assistance by leveraging the power of information. The Magenta Connectivity Lifecycle Manager (CLM) database includes up-to-date pricing and network location information from incumbent providers and leading alternative carriers. Our geographic mapping and information capability plots customer addresses against serving exchanges and inter-city carrier points of presence, ensuring that distance is calculated accurately. Finally, our skilled analysts continuously review pricing algorithms, rates, and tariffs to identify the right solution for an application, often reducing costs significantly by applying the most favorable terms to a purchase. While carrier data is available from multiple sources, both public and private, the transformation of this disparate data into actionable information by the Magenta netLogic team differentiates our offerings and creates the value our clients require.

Magenta netSolutions has the most immediate and dramatic impact on the COGS picture as it analyzes actual spending on purchased network services and provides recommendations to optimize expenditure levels. Past experience indicates these savings can range from 15 to 30% of outsourced networking monthly expenses. Magenta netSolutions identifies opportunities by reviewing historical network data. We can review invoice accuracy, apply accurate and appropriate pricing rules, properly compute and apply distance measurements, identify available alternative provider offerings, and develop recommendations for reconfiguring the network to utilize more cost effective PoP locations and data homing arrangements. While service providers could provide similar analysis on their own, should they desire, the Magenta netLogic differentiator lies in the depth and breadth of the information in the CLM. Should the carrier undertake this analysis without these resources, the sheer costs of duplicating the levels of actionable information within CLM could potentially eclipse immediately available savings.

While Magenta netSolutions looks at historical COGS, Magenta netSystems helps control future COGS. Magenta netSystems allows a circuit to be priced and designed utilizing the best rates and configurations available, providing a benchmark price for purchasing services

The true impact of Magenta netSystems though is on SG&A expenses, particularly those associated with the pre-sales process. Magenta netSystems can reduce costs associated with preparing and presenting proposals for services. With capabilities that include providing multiple quotes (term, bandwidth, and technology) between locations; management reporting and tracking capabilities; and business rule driven automated pricing development without extensive back-office intervention, Magenta netSystems can reduce the costs of preparing and managing customer quotations. For clients with their own internal pricing systems, the Magenta netLogic team can develop interfaces between netSystems and the clients own sales support systems, bringing the power of CLM within the client's own business processes.

The pricing and quotation management capabilities within Magenta netSystems can free up service provider resources for other functions through the delivery of an efficient, timely, and cost effective means to develop, revise, and track quotations for off-net capability. By providing quotations to the sales staff quickly and efficiently, Sales Team efforts can be focused on being in front of customers and closing deals, not on preparing and tracking internal requests and reports related to price calculation and quotation management.

Coupling Magenta netSolutions and Magenta netSystems gives our clients the capability to reduce historical costs while improving on the cost base for the future. This flows directly to the client bottom line, improving financial performance and generating available resources for other necessary activities. For more information on how Magenta netLogic can reduce your costs of doing business, contact us at sales@magenta-netlogic.com

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