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Vodacom's R500m plan to plug the interconnect hole

And why tower sharing isn't, but should be, the start...

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The deadline of July is unrealistic, considering the authority is only receiving written submissions from the operators in early June. A series of public hearings will then be held, making that July deadline overly ambitious.

In its results presentation for the year to March 31, Vodacom offered a projection on the "impact of mobile termination rates".

Firstly, fixed-line to mobile voice traffic is already declining because of VoIP and fixed-mobile substitution. This translated into a drop of 8.7% in incoming interconnect minutes from fixed-lines (calls from a Telkom (JSE:TKG) phone to a Vodacom number).

There is one month of the reduced peak interconnect rate (R1.25 to 89c) in Vodacom's numbers, and the lowered level of profitability is evident. Interconnect revenue grew by 1.1% (to R8.07bn), but net interconnect revenue decreased by 14.7% (R1.75bn from R2.05bn). This means that interconnect as a percentage of EBITDA dropped to 9.4% (from 12.6%).

Vodacom's chief financial officer Rob Shuter quantified the potential loss: for every 10% reduction in peak mobile termination rates, Vodacom will see an estimated R200m loss in annualised EBITDA.

It has stated its intention to "preserve" its EBITDA margin, and in the face of potentially steep drops in net interconnect revenue, Vodacom aims to save R500m during the 2011 financial year through a "cost-efficiency programme". When you're spending R1.7bn on marketing and advertising alone, there's scope for some pruning.

Shuter is confident this will allow the operator to absorb the "first round effects" of the interconnect changes. It's an ambitious plan, with 200 projects scoped and underway. The cuts will impact every part of the business, from direct costs (distribution partners), network operating costs, employee costs as well as marketing and advertising.

But, Vodacom hasn't announced any plans to share its network infrastructure. There are rumours that Cell C is planning to sell its base stations to a third-party operator and lease them back - this will provide it with the chunk of capital needed to build out its high-speed "3.9G" network (its not a 4G network, no matter what they say).

There are also murmurs that MTN Group (JSE:MTN) and Telkom will work together and share sites as part of the fixed-line operator's roaming agreement with MTN.

Delta Partners, in its "SA Telecoms in 2010" white paper, says that "operators need to move from rhetoric to reality regarding infrastructure sharing and optimised sourcing. Tower sharing has been a popular and well understood topic of debate for some time but the market is yet to fully exploit the opportunities".

"... It is not clear that enough is being done to fully exploit the potential benefits at a time when the upside could be at its greatest."

Andrew Snead, partner at Delta Partners, says that we're seeing capex at its peak and surely infrastructure sharing makes sense. This could take many forms: tower sharing, fibre sharing, and active network sharing.

We're already seeing Vodacom, MTN and Neotel working together to build a 5 000km national fibre network, but the only sharing will be on the trenching and ducting. Each of the operators will deploy their own fibre.

Snead points to the pervasiveness of infrastructure sharing globally. This is an obvious way to save on both capital and operational expenditure. Historically, though, local operators have been very protective over their network infrastructure. The fierce competition between Vodacom and MTN has seen them actively avoid sharing sites for base stations, no matter how tough it is to get environmental approval in certain areas.

Despite the proposed cuts in interconnect, Vodacom still expects to grow service revenue (in the low single digits) and improve its EBITDA margin in the next three years.

Maybe it knows something we don't.

Then again, maybe infrastructure sharing is the next trick up its sleeve to preserve its margin after the first round of cuts.
