

Eircom Chairman's Statement

“Setting the Record Straight”

October 13, 2004

I thought that I would change the pace of the normal Chairman's Statement today at our Annual General Meeting.

My feeling was that we should all try and share some history, in the sense that we are together the prisoners of our history, and that we should attempt to re-trace the path which brings us together here today.

The postal and telephone service on this island was, together with the Department of Agriculture, one of the first Departments of State initiated in this country.

The Department of Agriculture began in 1900 and the original Department of Post and Telecommunications began in 1922 with the appointment of James Walsh as the Postmaster-General. It became the familiar Post & Telegraphs Department in 1924 and those of us who are over 50 years of age (which excludes every woman in this room), will have grown up to the old P&T slogans of posts and telegraphs, a State monopoly like the ESB and, in our time, a good and efficient one.

To understand how it evolved requires, in degree, some knowledge of our history as an independent State, starting on that fateful day in 1921 with the signing of the Anglo-Irish Treaty on December 6th.

If you were to divide Ireland, unlike Caesars Gaul in *tres partem, in quaterm, dividem* in four parts, you would, I think, agree that the chronicle of Irish business development, starting in 1921, began with Warrior Politicians. The names of Cosgrave, Griffith and McGilligan, and DeValera and Lemass, Aiken and McEntre, Tom Johnson of the Labour Party, and the wonders of the 1926 Shannon scheme, are all connected with that first decade of Irish freedom in an unfriendly world. Ireland was almost without native capital and required the Keynesian commitment of the government to get things done.

This was largely effected through the second stage of our development which I call the Mandarin Civil Servants period of the 30's and 40's - people such as John Leyden, J. J. McElligott, J. G. B. McCartney, Jack Nagle and latterly, and most famously, Dr. Ken Whitaker.

These incorruptible, dedicated creators of the new Ireland navigated us through the rigors of supply in World War II and created the post-War phenomenon of the semi-State company.

And in this third reincarnation, we saw the emergence of Todd Andrews and Frank Lemass of CIE and Tim O'Driscoll at Bord Failte and Jerome Dempsey of Aer Lingus, and the redoubtable Lt. General Mickey Joe Costello of the Irish Sugar Company (story on Costello's trip to Abyssinia that was, Ethiopia, that is).

I was the beneficiary of this latter wave and at the early age of 25 was given the post of CEO of the Irish Dairy Board in 1962 and followed the mighty footsteps of Lt. General Costello in the Sugar Company in 1966, so that for a period of eight years, I had the opportunity to observe at first hand and participate in the running of two major State enterprises.

And with Aer Lingus very much in public eye at present - I cite “Kerrygold” and “Greencore” today as examples of what can be achieved through the fair marriage of State and private enterprise. It is a theme I will return to later.

Finally, and today, we have what I call the New Elizabethans--those people who

- (1) took the growing capital strength of the nation;
- (2) the increased awareness of international communications;
- (3) the beneficent and utterly critical tax structure we have developed in this country;
- (4) the literate, educated, computer-driven workforce; and both imported foreign capital **and** planted the flag of Ireland around the globe.

In this group I would instance the CEO of Cement Roadstone Liam O’Mahony, Michael Smurfit, Dennis Brosnan, Hugh Friel, John Magnier, Tim Mahony, the Ryan Group, Chris Horn, Richard Burroughs, Bill Cullen, Sean Fitzpatrick, Martin Naughton, Peter Sutherland, Bernard McNamara, and a host of other nascent leader and companies that owe their present prosperity to the building work and fabric created by those who went before us.

While the new Elizabethans have become the modern Irish missionary, our attractive tax regime ,well educated workforce and membership of the EU has also attracted foreign investment into Ireland. US investment in Ireland and its influence on the strength of our exports is especially evident.

The latest statistics available show that foreign direct investment in Ireland in 2003 had inflows of \$25bn; and that US owned companies accounted for 78% of Irish Industrial exports in 2001. In total, these enterprises account for 90,000 jobs, some 5% of total Irish employment.

And Ireland is categorised as one of the most open economies in the developed world, where we are second only to Luxembourg in the ranking of the former 15 EU nations. The US played a big part in Ireland achieving this status through its contribution to the five fold increase in our exports during the 1990's, as US companies used Ireland as a bridgehead to the eurozone market.

In the latter part of the 80's and through the 90's to today, the pace of change from a technical point of view accelerated exponentially with the advent of space travel and the capacity to instantly link the world televisually through the medium of space. The advent of the internet only accelerated this change in exciting, unpredictable and, at times, unforeseeable ways.

Propaganda being what it is, most proponents of the new technology overstated their case, often in the firm belief that theirs was the only way to the future. This led to the stock market implosion in the US particularly in 1999, of the internet bubble, and in many ways a minor but nevertheless similar observable bubble in telecoms in 1999-2000. This latter decline coincided with the first public offering in what had been a State or quasi-State company from its inception in Eircom.

Although it is only five years since the Government sold eircom, an historical perspective will, I believe, show eircom as a **pioneer** in the context of Ireland's new economy. The first major state privatisation; one of the first Irish utilities to access international equity markets; and one of the most vigorously re-structured and re-shaped Irish enterprises at the start of the 21st century. When the Government successfully sold eircom, then Telecom Eireann, at a price of three euro and ninety cent per share, in London, Dublin and New York (with the Minister Mary O'Rourke ringing the bell in the New York Stock Exchange) there were four reasons for the sale.

The first was ;

1. “To ensure that the company can grow through access to International equity markets”

Five years after the Government floated the company eircom is re-listed on the Dublin and London stock exchanges, having recently re-floated as the first major telecom IPO in Europe since the end of the telecoms bubble and it has accessed bond markets in what was at the time the largest ever euro-denominated bond financing. Before the recent IPO Eircom was restructured utilising international venture capital. The company today is entirely self-funding and viewed by the international markets as a well-run company.

In a speech which I gave nearly a decade ago in South Africa I noted that the chief characteristic of international capital was that it was hugely avaricious and demanding, going wherever it can get the highest return, but also that it was insecure. That eircom has been able to attract capital is testament to the quality of the company, but as seen with the de-listing of eircom in 2001 it is not a given that international capital will always be available (particularly with the risk of over-regulation). Management will focus on delivering a return, but it is vital that Government and Regulators are aware of their role in providing an attractive environment for investment.

In my assessment this first objective has been fully met, largely due to the good management of the company.

The second stated objective was;

2. “To develop competition in the telecoms market”

The Irish telecoms market is arguably, after Denmark, the most liberalised in Europe. There are over 40 authorised operators (many re-selling eircom’s network); eircom has only 44% in value terms of the total telecoms market including mobile, the lowest market share of any European incumbent other than BT (which must be a slight cause of alarm to you as shareholders or workers); and it continues to invest at above the European average in its network. The notion that eircom has dragged its heels and fought against liberalisation is belied by the fact that eircom has only once in the past three years launched a legal challenge against the regulator. Eircom has done a remarkable job to survive through de-regulation, and now it will vigorously resist over-regulation to ensure for you as stakeholders that the market really is free and liberal and competitive (I will return to this later).

The third objective was more controversial;

3. “To promote wider share ownership”

But again let me take the historical perspective which will show that five years after privatisation eircom’s shares are being traded daily by Irish and international investors whether big institutions looking after your pensions or the individual investor willing to take a risk to get a share of eircom’s success.

The controversy concerns the first flotation where 450,000 investors took a risk and as it turned out overpaid for their shares. That this was a consequence of the global telecoms bubble is cold comfort to those shareholders but as is clear from the chart

this was not an eircom or an Ireland phenomenon. A global perspective is necessary for the company's performance to be assessed objectively.

The shareholders in the first IPO actually outperformed the markets as is shown here

and through the combination of Vodafone shares and the Valentia buy-out, were returned 78% of their original investment. The truth is nobody in this period made money investing in telecoms. (and I would like to pay a tribute here to the Board and management of the then Telecom--and later Eircom-- for the way in which they courageously managed the decline in the face of great public unpopularity, and continued to invest in the future despite over-regulation. Within nine months of the first flotation the regulator imposed an extraordinary price-cap of CPI minus 8%; 'unbundling' of the network; and the re-seller regime, a triple-whammy which leads me to ask you "has any newly minted, and minted by the government, public company ever had such a baptism?").

In this environment of a boom to bust telecoms market and regulatory zealotry, the company cannot be faulted for securing the best price from, as it turned out, Valentia for their shareholders, and providing them, in Vodafone, with an outstanding long-term world-class stock. The fullest possible disclosure attended the auction which resulted in Valentia acquiring eircom and which was as transparent and fiercely competitive as any auction could possibly have been in the history of this country. As industry commentators at the time said.

"It is hard not to feel that Valentia is overpaying for the eircom rump. It remains to be seen whether O'Reilly's bid is the result of misplaced nationalism, the overheated bidding process, or an inspired business plan" (HSBC August 2001)

4. “To maximize the return for the Exchequer”

The final Government objective was outstandingly achieved.

The sale of eircom resulted in enormous enrichment for the Country (much of which has happily gone into the National Pension Reserve) to the tune of eight and a half billion euro, or approximately six thousand euro for each household in the state. So it is not lost to future of generations of our people, though perhaps the people will be different!

My assessment is that over the five year period eircom has achieved the objectives set by Government.

As we move into the present day I would also note that Eircom’s de-listing by Valentia was in my view, an outstanding exercise for the company. I have been involved, as a Chief Executive, a large shareholder and a director, in at least 15 major corporations throughout the world during my 40 years experience as a businessman, and I can assure you that Eircom could not have been more efficiently and effectively prepared for a return to public markets than through its experience with privatization.

The company returned to the market, recruited an outstanding Board of Directors and now stands poised, with your support, to expand dramatically through broadband, to re-enter the mobile market, and to make it a first-class, medium-sized company in the “tigerish” world of telecoms and in the dissemination of images and information through the internet.

I have commented on the history of telecommunications in this country in the past 85 years and attempted to present our company in a rational and reasonable competitive framework, vis-à-vis its domestic competition and its international rivals. I believe it is a company that on sober analysis has done extremely well for all its stakeholders within the parameters of pricing control and

investment obligation, but it remains a company that, in my view, is at times quite unfairly and deliberately over criticized.

Our critics cannot have it both ways.

They cannot criticize Eircom for being a monopoly, which it is not, in that it has now got less than 44 percent of the total telecoms market in the country and then lumber it with special universal service obligations which are not borne by our competitors, Vodafone and O₂.

They cannot call for a cost-driven price structure for connection to eircom's network while Vodafone and O₂'s networks remain tightly closed to other operators (and importantly are fifteen times more expensive for operators to connect to than eircom's network).

They cannot criticize eircom for refusing to sell its network at below cost to reseller operators, some of whom employ virtually nobody in Ireland and make no investment in the State's telecoms infrastructure, particularly when eircom has achieved a 48% reduction in real terms in the average telephone bill since 1997.

They cannot criticize eircom for being inefficient while it has made extraordinary efficiency gains through relentless headcount reduction (since privatization over three thousand jobs have been eliminated in the Fixed line business without a single day lost to industrial action).

They cannot criticize Eircom for under-investment, when eircom has, every year since privatisation, invested at above the EU average;

or for the delayed start in the rollout of broadband and not recognize the role of the regulator; nor realize (as many of them do but will not talk about) the overall inadequate return on capital allowed by the Regulator in regard to network prices charged to other operators.

The price of broadband in Ireland today is at mid-point in European levels which, considering the dispersed nature of much of our population, is entirely appropriate. And I might add that broadband gets daily more competitive -- which we welcome provided it is fair and not -- I repeat, not -- subsidized by our shareholders.

Might I also nail a particular lie used by some journalists that the slow investment in broadband inhibited foreign investment in Ireland. In the last ten years foreign direct investment into Ireland as a % of GNP has exceeded every major country in Europe. The trend on inward investment continues to be strong. The latest World Investment Report from the United Nations Conference on Trade and Development showing that the state was the seventh most significant recipient of foreign direct investment in 2003. In a year when investment in EU member states fell by 11%, foreign direct investment to Ireland rose by 4%.

So, clearly, either broadband was not a condition precedent to investment or supply was adequate.

And finally, they cannot clamour for a competitive market (by which they mean the open access to eircom's network) while ignoring the restrictions on eircom that prevent it from competing. It is time for the over-regulation of eircom's retailing activities to be lifted.

As shareholders, you all have a tremendous interest and personal investment in ensuring that Eircom is not put at a disadvantage by the Regulator in regard to other forms of competition.

Let me leave the last word with Robert Cole in his column, "Business Commentary" in The London Times, commenting on British Telecom and its relationship with Ofcom, the British Regulator:

"In reality, people have switched massively to mobile phones even though this service is hugely more expensive for most purposes than the traditional telephone....If people are allowed to exercise a free choice, most seem to put convenience, range of services and quality above price.

There appears to be a different climate of criticism in the media applied to matters that relate to Eircom than those that relate to Eircom's competition. Every shareholder in this room and in the company has a direct interest in ensuring that fairness and equity obtain in all of these matters. If an unfair representation is made of the activities of Eircom, as has been the case by many of our critics, then the only sufferer in the long term will be you, as workers and shareholders in this very enterprise. A recent example was the National Competitiveness Council report which said that Fixed Line Telecoms was competitive (indeed the only major utility sector noted as such) but in the summary continued to call for more regulation on the sector.

But I would also say that eircom is its own harshest critic. Yes, the broadband take-up rate is among the fastest in Europe, but we need to grow even faster to climb the European league table. Currently the rate is nearly the highest in the EU, is accelerating and soon will see Ireland catch up on our European neighbours. When the 100,000 target is achieved, ahead of schedule, management will announce a new ambitious target.

Yes the cost of telecoms has fallen dramatically due to eircom's price reductions, but eircom can continue to add value and is hugely frustrated that it continues to be prevented from applying eircom's lower prices in mobile telephony. Eircom must get back into mobile and we are building the commercial case for re-entry. And yes eircom can boast of a strong record in driving efficiency reducing headcount from 10,800 (excluding Eircell) at the time of its privatisation to 7,500 today. But as the network becomes more efficient the company must and will reduce headcount further.

Eircom endures endless criticism and analysis but when it is objective, the company wouldn't have it any other way. Change is never easy and rarely perfectly executed but a changing eircom, one whose focus is customers and shareholders, competing in a liberalised telecoms market is what you see today.

So, in summary, I say, "Here is a company superbly lead by Phil Nolan and the senior management, structured through the participation of the ESOT and its other major shareholders in a sensible way, investing capital at a rate which is at or above the European average serving the consumer well with fixed line and broadband, and that hopes to get back into mobile, requiring the assistance of the consumer, the Regulator and the Government in achieving this end if we are going to get a real reduction in the cost of mobile calls.

“Its fixed-line calls are one-fifth the cost of mobile calls. Its broadband is at a median price for all Europe. It will achieve its target of 100,000 broadband customers early. Internet usage in Ireland is at an average level for all countries in Europe. It aims increasingly to provide service with efficiency and with a smile. Its tariffs are, today, 48 percent in real terms below those of 1997, something which almost no other company in Ireland can claim, and it stands ready to go forward with its shareholders, its management and its workers in providing an essential and exciting service, or series of services in Europe’s most rapidly expanding economy.

“It is a company, therefore, I commend to you for the future.”

Sir Anthony O’Reilly

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