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Market Analysis

Canadian space companies have developed impressive and globally competitive competencies in some niche areas of satellite communications. This has allowed them to be very successful in domestic and export markets. In fact, 63% of total 2000 revenues of \$1.4 billion were from Telecommunications. Satellite communications can be considered the cornerstone of the Canadian space industry at large.

In recent years, there has been recognition at senior levels of the Federal government of the importance of an advanced telecommunications infrastructure to drive the knowledge-based economy. Satellites can and do play a major role.

Canada can only achieve its goal of becoming the most connected nation by exploiting space-based technology. All these factors argue in favor of a sustained partnership between the Government and industry, involving the development of advanced communications technologies and Government acting, where possible, as anchor tenant for new services.

This government/industry partnership is appropriate and timely. This has been a difficult year for the global telecommunications sector, and the space component of this sector has been no exception. Large projects have faltered, and some operators have gone under. This has had a significant negative impact on the Canadian satellite communications industry. Several suppliers have seen their order books shrink as a result of reduced demand from large global prime contractors, leading to reduced turnovers and some job losses.

The telecommunications sector's difficulties were due, in part, to significant overcapacity in terrestrial networks as well as questionable management (unworkable debt loads) at several carriers and Internet companies. These combined events led to a loss of confidence in the investment community at large, affecting the profitability and viability of telecommunications companies, with a spill-over effect on satellite communications companies. This in turn soured the investment climate for most other space companies.

The events of September 11, 2001, and the recession which followed in North America and elsewhere, contributed to further weakening investors' confidence. Now, and for the next 1-2 years at least, would-be lenders are especially stringent in their requirements for new loans and the stock markets are inhospitable to new public offerings. Less financing means fewer projects, and reduced opportunities for Canadian space companies.

These problems in the commercial satellite communications industry affect all satellite prime contractors, and by extension their suppliers in Canada and elsewhere. US prime contractors, however, enjoy an edge because of their access to large and increasing military programs (such as those related to GPS

Modernization, or Homeland Security). European prime contractors do not enjoy this benefit, since Europe has no supra-national military space program of significance. It is generally difficult for Canadian space suppliers to access defense space contracts in the US and other foreign countries, although there are exceptions.

In the US, the effects of the 1999 transfer of export licensing authority for commercial satellites from the Commerce to the State Department, and the applications of the International Traffic in Arms Regulations (ITARs), continued to be felt in 2001 and 2002. Even though during this period the US government and US companies beefed up their licensing staff and some regulations were streamlined, and despite the fact that the Canadian government was successful in getting the previous Canadian ITARs exemption partially restored, satellites (even commercial communications satellites) remain generally subject to ITARs and TAAs are required for almost all technology exchanges and discussions with US space manufacturers.

Notwithstanding the above, an examination of prevailing trends provides cause for optimism for a rebound in the near future. This cyclical downturn is expected to be over in 1-2 years, with Canadian industry continuing to reap the benefits of past and on-going investments in technological excellence. This will require a continuation of the strategic partnership between the industry and the Canadian government. Consequently and based on our analysis, the following trends are expected over the next few years:

- North America will continue to lead world demand for communications services.
- The US market for telecommunications services and equipment will remain predominant.
- Television will remain the dominant application.
- DBS will continue to gain ground on cable systems.
- In-flight multimedia services should be deployed widely by 2005.
- Roll out of Ka band services on a regional basis will be gradual and cautious.
- High volume data transmissions will become a niche market.
- Demand for GEO transponders is increasing slowly, requiring new satellites in the 2004-2010 period.
- The lifetime of GEO satellites will continue to increase.
- US prime contractors will continue to dominate the market.
- Consolidation and vertical integration will continue among satellite operators.
- Manufacturing overcapacity in US and Europe will remain a problem.
- ITARs will remain an irritant in dealing with US manufacturers.
- The financing outlook will improve for some satellite communications operators.

