

## The Sunday Brief: The Fourth Quarter Results Are In – And The Winner Is....



Greetings from Kansas City, where, after spending nine days in India, I have learned never to complain about traffic (and other life gripes) again. Several of you asked about my observations of India as it relates to this column, and I will keep them brief: a) Pre-paid service dominates and expands the addressable market; b) With number portability just being introduced in India, it's a "Wild West" mentality for challengers which means US-levels of advertising; c) Blackberry and Android (not Apple) are the aspirational devices that the middle class can afford (all of the Blackberry devices being turned in for Verizon iPhones have to go somewhere); and d) the expansion of 3G and soon 4G data in India represents the next \$10 billion opportunity in the telecom

industry.

All in a country of 1.2 billion, with an addressable market of 400-500 million and an economy growing at 8-9% per year. Lots of opportunity to grow, especially for smartphones and the applications that make them great.

While I was away, the rest of the telecom crowd (except for Charter Communications) announced fourth quarter and full year earnings. As the faithful readers know from previous Sunday Briefs, this is the "quant" edition, so be prepared.

**OIBDA/ EBITDA expansion.** As we discussed with the third quarter earnings review, the best measure of health in the wireless industry (and a good gauge of future capital expansion) for any company is EBITDA growth. This growth is very hard to come by right now, unless carriers can a) raise prices, or b) change their cost structure. Contract or post-paid carriers also have a disproportionate increase in data costs (meaning access and transport from the cell tower to the IP backbone network), and smartphone subsidies. Here's the look at the wireless industry EBITDA for each of the major US wireless players for 4Q:

Description	4Q 2009	4Q 2010	change	% of industry OIBDA	
				4Q 2009	4Q 2010
Verizon	\$ 5,878	\$ 6,735	\$ 857	42%	45%
AT&T	\$ 5,131	\$ 5,188	\$ 57	36%	35%
Sprint	\$ 1,152	\$ 1,046	\$ (106)	8%	7%
T-Mobile	\$ 1,375	\$ 1,342	\$ (33)	10%	9%
MetroPCS	\$ 251	\$ 315	\$ 64	2%	2%
US Cellular	\$ 173	\$ 141	\$ (31)	1%	1%
Leap (Cricket)	\$ 107	\$ 130	\$ 23	1%	1%
Total	\$ 14,067	\$ 14,897	\$ 831	100%	100%
<i>y-o-y growth</i>			5.9%		

There has been a lot of discussion as to whether we are already in a duopoly state in the US wireless industry, and this table clearly makes the case that we are (and

have been there since 2009). Verizon and AT&T made up 78% of the free cash flow at the end of 2009, and it's now 80%. Even if the rest of the industry combined in a show of CDMA-to-LTE force (or, in T-Mobile's case, HSPA+ to LTE), they would only generate 20% of the industry profits. To the extent that a

duopoly is the ideal economic structure for AT&T and Verizon (less government oversight, more pricing power), they should be headed into a period of sustained profitability.

The clear winner in the fourth quarter is Verizon. They eclipsed all of the other players in profit growth while upgrading their network to LTE and paying down debt.

The seeds of this growth began in January, 2009 with their announcement to impose a minimum data plan on all but a few feature phones. This, combined with overall smartphone plan adoption, has helped drive service revenue growth of \$1 billion from 4Q 2009 to 4Q 2010. Also, about \$100 of the \$857 million growth comes from the full year benefits of their wholesale relationship with Wal-Mart (Straight Talk product). This relationship is waning as Wal-Mart has expanded the number of carriers providing telecommunications services.

The runner up for the wireless space is AT&T. They also get the award for best actor in a wireless drama, as they have survived a withering assault on their network's quality in both 2009 and 2010. If the predominance of defections to Verizon come from disproportionately high-end data users (and they don't bring Mom & Dad over to the new family plan), then happy days are here again at AT&T. However, if \$300 device subsidies become the norm, and service costs rise as customers begin to move into the \$25 2 GB rate plans (we just moved our Mobile Symmetry test phone into the 2GB tier – 15 minute call to customer service), trading water will be the status quo. AT&T wins "Survivor of the Year" and, with \$20 billion in annualized wireless cash flow, they can now focus on their wireline headache.

**Continued access line losses are the elephant in the room.** The table below clearly shows that losses are not abating, and that Comcast and Time Warner Cable are not the ones to blame.

Access line tracking	2009				2010			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
VZ - residential	17,199	16,677	16,105	15,618	15,201	14,828	14,465	14,135
<i>Annual % change</i>					-11.6%	-11.1%	-10.2%	-9.5%
VZ - small business	13,139	12,924	12,719	12,540	12,365	12,172	11,953	11,755
<b>Total retail access lines - VZ</b>	<b>30,338</b>	<b>29,601</b>	<b>28,824</b>	<b>28,158</b>	<b>27,566</b>	<b>27,000</b>	<b>26,418</b>	<b>25,890</b>
<i>Annual % change</i>					-9.1%	-8.8%	-8.3%	-8.1%
AT&T Consumer Lines	29,969	29,047	28,098	27,332	26,633	25,780	24,908	24,195
<i>Annual % change</i>					-11.1%	-11.2%	-11.4%	-11.5%
Qwest - consumer	6,290	6,069	5,842	5,675	5,509	5,315	5,119	4,919
<i>Annual % change</i>					-12.4%	-12.4%	-12.4%	-13.3%
Qwest - small business	1,268	1,241	1,216	1,190	1,164	1,142	1,119	1,078
<b>Qwest - total</b>	<b>7,558</b>	<b>7,310</b>	<b>7,058</b>	<b>6,865</b>	<b>6,673</b>	<b>6,457</b>	<b>6,238</b>	<b>5,997</b>
<i>Annual % change</i>					-11.7%	-11.7%	-11.6%	-12.6%
<b>Big 3 total lines</b>	<b>67,865</b>	<b>65,958</b>	<b>63,980</b>	<b>62,355</b>	<b>60,872</b>	<b>59,237</b>	<b>57,564</b>	<b>56,082</b>
<b>Comcast</b>	<b>6,769</b>	<b>7,002</b>	<b>7,377</b>	<b>7,620</b>	<b>7,894</b>	<b>8,125</b>	<b>8,353</b>	<b>8,610</b>
<i>Annual % change</i>					16.6%	16.0%	13.2%	13.0%
Time Warner Cable - Res	3,913	4,016	4,078	4,153	4,239	4,302	4,324	4,385
<i>Annual % change</i>					8.3%	7.1%	6.0%	5.6%
Time Warner Business Class	38	48	58	67	78	90	102	111
<b>Total TWC</b>	<b>3,951</b>	<b>4,064</b>	<b>4,136</b>	<b>4,220</b>	<b>4,317</b>	<b>4,392</b>	<b>4,426</b>	<b>4,496</b>
<i>Annual % change</i>					9.3%	8.1%	7.0%	6.5%
TWC sequential growth		113	72	84	97	75	34	70
Comcast sequential growth		233	375	243	274	231	228	257

Verizon has lost more than 5 million access lines in the last eight quarters. To use a cable metric, that's 5 million fewer revenue generating units at \$35 in monthly revenue per unit or \$175 million each month (\$2.1 billion annualized) that must be covered by FiOS growth. Remember, the figures in the table exclude the Frontier properties which were the ones generating disproportionate profits.

An interesting sub-trend is the line loss in Verizon's small business unit, which comprises about 30% of the 5 million loss noted above. As the economy recovers (2010 should be a recover year – right?), line losses should turn into gains. Instead, year-over-year line losses are 6% for Verizon.

Where is the small growth going? To wireless, over-the-top VoIP, and to cable (although not to Time Warner Business Class as the chart below shows). This is why triangulation of wireline and wireless matters – expectations from a recovery will disproportionately benefit wireless for voice and cable (if available) for data.

The access line situation is even worse at AT&T and Qwest. AT&T's access lines are down more than 20% over the past two years (\$2.5 billion in annualized revenues for U-Verse to make up). Qwest's consumer access lines are down more than 24% in the past two years, and small business is down 16%.

As we have discussed in several Sunday Briefs, the loss of access lines is not uniform in the local network, and creates a "Swiss cheese" result – some here, others there. As a result, costs to maintain that network do not come down in a linear manner. With six years of cheese creation (cable voice started in earnest in 2004 and 2005, later for Comcast), the ILEC network is full of holes.

Contrast that with the situation for cable. 99%+ of the voice customer gains for Comcast and Time Warner Cable (and Cablevision, Mediacom, and Cox) are part of a bundle, meaning that they represent incremental cash flow to another revenue generating unit. The 2 million access lines added by Comcast and the 600 thousand lines added by Time Warner Cable over the past two years yield high incremental cash returns. These returns will grow for Time Warner Cable as they migrate to their in-house network.

The elephant in the room for Verizon, AT&T, and Frontier is wireline, specifically the long-term cost structure in light of a decreasing customer base. We are about to enter a geographical re-clustering of the Swiss cheese networks, with AT&T and Qwest selling and Frontier/ Windstream/ private equity buying. The problem is that Swiss cheese left in the open begins to mold after a while, and 11% annual losses into perpetuity equate to mold.

Next week, we'll deal with the other side of the access line losses – High Speed Internet gains, which bounced back for cable, but continue to languish for the traditional telcos. Also, we'll dive into ARPU and other gems the carriers have disclosed in their 10-K filings.

Now for five you may have missed:

1. [The Google/ Facebook relationship is starting to fray](#), with Google starting to limit synching of Facebook friends into the new Google phone. Good news for Mobile Symmetry.
2. [Verizon's wireline E-911 network failures are undergoing FCC review](#). Looks like they need to use some of that EBITDA for selective router capacity.
3. Verizon was also dealt a blow this week when [Consumer Reports stated](#) that there are similar antenna issues for Verizon iPhone customers as AT&T.
4. [Sprint introduced a Windows 7 phone from HTC with a Snapdragon processor](#) (guessing many of you really missed that one). Will the Touch Pro 2 user community move? Will anyone care?
5. After abandoning their 3Leaf acquisition, [Huawei hits back at the US government](#). Will any senator pick up the cause of the Chinese?

Have a great week, and don't forget to sign up and form a group at Mobile Symmetry ([www.mobsym.com](http://www.mobsym.com))!