

The Sunday Brief: Sprint's Four Year Winter



Greetings from Kansas City, where we are all smiles that the temperatures are finally staying above freezing (there's plenty of melting left to do). Speaking of a thaw, the home town company (and my former employer) Sprint reported earnings this week, and it looks like the four year winter of subscriber and revenue losses might have started to abate. While all of the figures reported exclude the effect of the Verizon iPhone and 4G introduction (which Sprint, on their earnings call, acknowledged impact the trajectory of

net additions in Q1), they provide a snapshot of the difficulty of operating as the #3 player in what has effectively become a duopoly.

Sprint - Four Year View					
(Source: Earnings Announcements)					
Note: Not adjusted for iPCS and Virgin Mobile USA Acquisitions					
					2007-10
Description	2007	2008	2009	2010	Change
Net Revenues	\$ 40,146	\$ 35,635	\$ 32,260	\$ 32,563	-18.9%
Adjusted OIBDA	\$ 10,800	\$ 7,664	\$ 6,407	\$ 5,633	-47.8%
Interest expense	\$ 1,433	\$ 1,362	\$ 1,416	\$ 1,429	-0.3%
Capital expenditures	\$ 6,458	\$ 3,039	\$ 1,597	\$ 1,926	-70.2%
Free Cash Flow	\$ 2,182	\$ 1,776	\$ 2,802	\$ 2,512	15.1%
Net Debt	\$ 19,690	\$ 17,891	\$ 17,137	\$ 14,718	-25.3%
Net PP&E	\$ 26,636	\$ 22,373	\$ 18,280	\$ 15,214	-42.9%
Wireless margin (%)	30.9%	23.8%	20.1%	17.5%	1340 b.p.
Postpaid net adds (000s)	(1,224)	(4,073)	(3,546)	(855)	(9,698)
Prepaid net adds (000s)	566	(981)	2,552	1,638	3,775

First, the good news: Post-paid growth has returned to the business. We saw lower churn and better gross adds coming, but Sprint's 58,000 post-paid subscriber gain (at a \$55 ARPU) provided more than an emotional lift – there's \$10 million more in sequential quarterly revenues to celebrate (compare this to Verizon's \$25 million and AT&T's \$124 million increase in service revenues from 3Q to 4Q). Sprint also reported that their post-paid business was "net port positive" which means that in aggregate, more customers came to Sprint than left Sprint for other carriers. Across the entire Sprint brand (pre and post-paid), Sprint was net port positive against Verizon, AT&T, T-Mobile, Leap, and Metro PCS.

This is an achievement for several reasons. First, it's not the second quarter. Sprint has historically enjoyed its best churn and net adds in 2Q, and some analysts discounted the positive net add performance in 2007 as a temporary fix (which it was). To do this in the fourth quarter is significant. It

shows that Sprint still has retail muscle, and can use that strength to differentiate its device lineup in the marketplace.

Second, while growth is coming at the expense of near-term profitability, it's not coming at the expense of long-term ARPU. Sprint is wisely implementing a \$10 price increase on smartphone service plans. Dan Hesse revealed on the conference call that 50% of the CDMA customer base is now on smartphone plans – this equates to 13.5 million opportunities to raise rates over the next 24 months. Assuming that even five million customers are upgraded to the new plan in 2011, the full year impact to 2012 is \$600 million, with most of this falling to the bottom line. It justifies at least \$240 million in additional capital expenditures for either the current or the new network. Price increases are tough, and, as we examined Verizon's decision to implement a mandatory minimum level for new smartphones in 2010, they require fulfilling a promise. Sprint needs a lot more money to keep its promises.

Finally, prepaid churn was below 5 percent for the first time in a while (Sprint is still churning over 60% of its base each year, however, compared to 22% in post-paid). Many wrote off Sprint's growth in pre-paid as a fad, and several criticized the "brand of brands" strategy laid out by Sprint's former Prepaid president, Dan Schulman, at the beginning of 2010. Assurance Wireless was regarded as a low-ARPU/ low-income gimmick to make the subscribers numbers more positive. Boost was largely ignored as a teens/ urban-only brand: not business, not family, therefore not profitable and not important. While many arguments can be made about the sustainability of any pre-paid revenue stream, Sprint derived at least \$80 million in quarterly service and \$20 million in equipment revenue growth from retail prepaid services. \$100M million in sequential revenue growth is nothing to sneeze at.

So Sprint's back in the black as least as far as subscribers go. **That thaw is well underway.** Is this freeze temporary? **What could cause it to refreeze? Four things:**

1. **Clearwire.** Post-paid turned positive because of the EVO. The EVO experience is worth the extra money in most markets because of 4G speeds. Battery and occasional application integration issues aside, it may be the best combination of processor/ bandwidth/ applications in the market. But a 3G only EVO? Nope. Sprint cannot sustain positive post-paid net adds in 2011 without Clearwire. And a weaker 4G experience, driven by a starved partner, reflects poorly on the Sprint brand that took billions to restore. It's a real pickle, and every month that goes by it gets worse. Clearwire finally seemed to show signs of backing off its retail ambitions with comments made by their CEO, Bill Morrow, this week.
2. **iPhone.** Despite the reports this week that the iPhone was a ho-hum event for Verizon (it wasn't), not having the iPhone hurts Sprint and T-Mobile. As the iPhone line broadens, with cheaper varieties on the way, Sprint needs the iPhone in their lineup. To everything there is a season, and this is the season for drafting on the "we're not AT&T" momentum. Sprint also has a head start in its approach to open applications, which will be terrific for an integrated Face Time/ QiK/ Fring network. Note: If Sprint does not embrace the iPhone, they need more marketing heft from Google – exclusive applications, marketing/ Ad word preference, etc.

Even with the terrific performance of 3Q and 4Q, Sprint still lost 855 thousand post-paid customers in 2010. That's still an annualized run rate of \$560 million of revenue to make up just to get back to a "no growth" level. Assuming 6% of the current CDMA smartphone base leaves for the Verizon iPhone (a very conservative assumption), that still leaves more than 1.6 million net adds just to get back to 2009 post-paid customer levels (855 thousand from 2010 + 6% of 13.5 million CDMA smartphone users = 810 thousand equals 1.665 million gap).

3. **A combined Leap/ Metro PCS.** It's a question of when, not if, for Leap and Metro PCS to resolve their differences and combine. They both have advantages when it comes to local network coverage, and together could bring a sizeable change to smartphone lineups for the prepaid market (Sprint clearly got out to an early lead here with Boost, but with 60% annual churn, things can change quickly). When they combine, look for changes in Sprint's prepaid performance. The cold wind turns frigid when TracFone (America Movil) is added to the Leap/ Metro mix with additional distribution help from Wal-Mart. Sprint has invested heavily in prepaid distribution (it's a terrific asset) and Wal-Mart is one of the few companies (maybe the only one) that can deflate the value of that asset – quickly.
4. **Network Vision spending and focus blinds extending the customer experience improvements.** To go with the sports analogy used by Dan Hesse on the earnings call, Sprint has put together a terrific drive. They started inside the 10-yard line, and have put together some impressive third and fourth down conversions to keep the drive alive. The problem: It's only the start of the second half, and Sprint's trailing by four touchdowns. Sprint has a "Wildcat" offense (that's Network Vision, the network upgrade project), and it's execution is critical. However, only a few plays use the Wildcat, and the opposition will quickly learn how to defend against the formation.

The customer experience consists of solving today's issues (which Sprint has remedied through simplifying plans), as well as tomorrow's. Unfortunately, tomorrow's issues consist of questions like "How do I get QiK to work on my EVO?" or "Why do I receive so many forced resets for applications on my Epic?" or "How do I transfer my (iPhone, Palm or even my current Android) apps to my newly purchased Android phone?" These customer experience improvements also require investment – different rep skills, both in-store and on the phone; an accelerated embrace of applications as Sprint's differentiator; owning the Vo4G (Voice over 4G) space.

It's been a four-year long winter. Compared to the end of 2007, Sprint has nearly 10 million fewer post-paid subscribers (driving \$6.5 billion+ in lower service revenues), \$5 billion+ in lower annualized OIBDA, 40% fewer assets (as measured by net PP&E), and wireless margins that resemble those of a wholesale operator using Sprint's network. However, they have reestablished trust in their base, have a terrific flagship product with the EVO/ Shift/ Epic/ Overdrive 4G lineup, greater financial flexibility thanks to 25% less net debt, and have the pole position in prepaid. Is this Sprint's spring?

Now for five you may have missed:

1. Speaking of turmoil, [Nokia and Microsoft connect for some cooperative efforts](#). The link is to the full coverage from Engadget. Here's another interesting take from Gizmodo on [why Nokia did not pick Android](#). Good move for both of them, and a bad move for Blackberry.
2. [Samsung 10.1 inch tablet around the corner](#). It's a big one, and starts to link the device to the application (see last week's post for the thesis). Who said all of the news was made at CES?
3. In a completely different direction, we have the rise of government-mandated privacy with the release of the ["Do Not Track Me" bill](#). Mobile Symmetry is out in front on protecting privacy, especially for individuals under 18. More to come on this in a special "privacy" brief in March.
4. We couldn't go a week without mentioning the demise of Borders. Read the comments from this [New York Times article](#). Rest in Peace.
5. Twitter's worth \$10 billion? Really? A comical look at valuations from our friends at the [Wall Street Journal](#) (includes link to the original article).

And two: I failed to mention some significant achievements in the lives of two of the Sunday Brief faithful who allowed their names to be mentioned. First, in December (sorry, I really missed this one), [Duke Net was spun out from Duke Energy](#), and a long-time colleague and one of the devoted faithful, Brad Davis, was made CEO. Congrats to Brad, and my apologies for missing this one. Second, Dallas Clement shifted his role within the Cox family to be the [CFO of the Auto Trader franchise](#) (part of Cox Enterprises). Terrific achievements all around.

One final note – next week's Sunday Brief will at best be awkwardly timed as I will be posting it from India as the entire Patterson family heads out for some missions work with [Project Rescue](#). Yes, I'll also be conducting some business and be available, but this is truly a once in a lifetime experience.

Enjoy the week, especially if you are in Barcelona at MWC. And don't forget to sign up for Mobile Symmetry (www.mobsym.com)!

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