

**The Sunday Brief: What Trends Do Telecom Carriers Face As We Head Into the Summer?**  
**29 April 2012**

Greetings from Kansas City, Dallas, and Paris. It was a week chock full of earnings results, and, in an attempt to keep the SB brief, this week's column will only highlight trends as opposed to going into specific earnings announcements.

The best indicator of specific company/ sector/ industry performance is the stock price. It's where attractiveness meets commitment. Nonetheless, as we have discussed in many previous editions of the SB, stock price is but one indicator of a particular company's performance and should be weighed against other elements of long-term performance.

Total Shareholder Returns Calculation					
Year-to-date 2012					
Stock Name	Ticker	12/30/2011	4/27/2012	Shares (millions)	Inc/(Dec) in \$billions
Amazon	AMZN	\$ 173.10	\$ 226.85	455	\$ 24.46
Microsoft	MSFT	\$ 25.96	\$ 31.98	8,400	\$ 50.57
Google	GOOG	\$ 645.90	\$ 614.98	325	\$ (10.06)
Apple	AAPL	\$ 405.00	\$ 603.00	935	\$ 185.13
<b>Four Horsemen Total</b>					<b>\$ 250.10</b>
Stock Name	Ticker	12/30/2011	4/27/2012	Shares (millions)	Inc/(Dec) in \$billions
Verizon	VZ	\$ 40.12	\$ 40.23	2,840	\$ 0.31
AT&T	T	\$ 30.24	\$ 32.67	5,930	\$ 14.41
Sprint	S	\$ 2.34	\$ 2.36	3,000	\$ 0.06
Metro PCS	PCS	\$ 8.68	\$ 7.01	363	\$ (0.61)
Leap/ Cricket	LEAP	\$ 9.29	\$ 5.84	79	\$ (0.27)
Clearwire	CLWR	\$ 1.94	\$ 1.42	452	\$ (0.24)
CenturyLink	CTL	\$ 37.20	\$ 38.60	620	\$ 0.87
Windstream	WIN	\$ 11.74	\$ 11.26	586	\$ (0.28)
Frontier	FTR	\$ 5.15	\$ 4.06	995	\$ (1.08)
Comcast	CMCSA	\$ 23.71	\$ 30.28	2,710	\$ 17.80
Time Warner Cable	TWC	\$ 63.57	\$ 80.65	314	\$ 5.36
Cablevision	CVC	\$ 14.22	\$ 14.56	274	\$ 0.09
Charter	CHTR	\$ 56.94	\$ 60.42	101	\$ 0.35
<b>Wireless/ Cable Total</b>					<b>\$ 36.78</b>
Dividend difference (est.)					\$ 3.57
<b>Return Advantage to Four Horsemen:</b>					<b>\$ 209.74</b>
Return multiple					6.20

The table shows the year-to-date returns and the total 2012 value created for shareholders (market value added, for all of you Stern Stewart disciples). In 2009, we coined the term "The Four Horsemen" to denote the largest threats to the telco and cable community, and at that time predicted they would use their global ambitions and scale to suck as much value out of the carriers as possible.

That hypothesis turned out to be more correct than any of us expected. Even with dividends included (although Apple's proposed dividend is not included in the offset), four companies – Apple, Google, Amazon, and Microsoft – have created \$200 billion more in shareholder value since the beginning of 2012 than the US-based telco universe. That's an entire AT&T + Sprint of difference created in four months. Since the "bottom" of the equity markets (January 1, 2009), the Four Horsemen have created more than \$782 billion of market value for their shareholders. And this figure does not

include the value created by Facebook. Including dividends (and glad to share the underlying data), the Four Horsemen have created more than six dollars of value year-to-date for every dollar created in the telecom universe.

With this information as a backdrop, there are several trends driving changes in the telecom universe. We will highlight three of them this week, and the remaining four next week.

**Trend #1: Voice and (in the near future) SMS drive diminishing value to the wireless customer.** If there is one thing that keeps the wireless carriers up at night, it's that the 4G future is less about voice and text and more about the applications and associated services that the carriers do not control (and whose traffic will

as likely be over unlicensed (Wi-Fi) as opposed to licensed spectrum). They wake up and find themselves in the middle of a firefight – Microsoft/ Skype vs. Google Voice (GV) vs. Apple iTalk (or however they combine iMessage with a voice service). It's not simply a race for free (which it will be), but additionally a race to establish the next dialing and messaging habits. Apple's Siri has already started this trend with voice-dictated messages. It's not impossible to see Apple's software doing a lookup to see if the contact also has an iMessage account and delivering the message through Apple's network, a kind of "least cost routing" for the Apple universe. Current and new "over the top" competitors will follow (or have already followed) with features and functionality that is developed in months, not quarters. Best of all, it will be transparent to the user and controlled through the smartphone/ tablet operating system (or through Skype or GV apps that run on competing operating systems). Apple, Microsoft, and Google will make voice and messaging more fun, productive, and device/ network indifferent. And, best of all, most of it will be free.

Note: most of this is already in place with Google's product suite today. Facebook also has many of the components available to preserve/ increase their value to their 900 million user base. All it takes is the first shot and the value destroying, multi-year fight to the finish will begin.

**Trend #2: Microsoft will (continue to) disrupt mobile phone pricing. Others will follow. Postpaid carriers will cheer.** As evidence of this, have a look at today's "Deal of the Day" on Amazon Wireless:



Yes, Verizon 4G phones with very fast processors, Corning's Gorilla Glass, and 16GB of memory are on sale for free (and also include a "double your data" promotion). We aren't even close to "back to school" promotions yet – imagine what the deals will be in July and August!

Microsoft started the latest battle with the launch of the Nokia Lumia 900 on Easter Sunday, effectively offering their flagship product for free through most of the month of April. T-Mobile has already taken the slightly less powerful Lumia 710 to free on Amazon and Walmart.com. In the process of high-end smartphone price compression, the Verizon Samsung Galaxy Nexus S 4G is now \$50 at Amazon, the Sprint Samsung Galaxy S II Epic Touch 4G is free at Amazon, and the AT&T HTC Vivid (an LTE phone) is free at Amazon. Meanwhile, the iPhone continues its price leadership, and "take or pay" commitments loom large.

Let's assume for a moment that 1.2-1.5 GHz processor devices running on 4G (LTE, HSPA+, Wi-Max) networks head into the back-to-school season for free with a new 2-year contract. And let's assume that the monthly rate for this smartphone is \$60 (using a mix of family plan and business discounts). It's still an outlay of \$1440 over two years, but that total would be equal to or slightly less than purchasing a similar device from MetroPCS at \$199-\$299 with a \$50 unlimited data plan (which includes 2.5 Gigabytes of 4G data per month). With powerful and popular devices at free, and family plans structures continuing to be very attractive, who needs a prepaid smartphone? (Note: all of this is before expected economic improvements in family data plans that Verizon will introduce in 90 days).

This is why Metro PCS is struggling (and Leap/ Cricket will struggle) in the high end – voice is not the reason for these smartphone (plan) purchases (see Trend #1 above). Data coverage and speed are the more important buying behaviors for new smartphone purchasers. With the low end of the market quickly shrinking (with free RAZRs, who can blame them?), free fast smartphones is the headline.

As the large operating systems fight for consumer market share, handset prices will decrease, and expectations that today's fast phone will be tomorrow's free phone will be established and met. While it might take a bit longer to get to free, the iPhone is not excluded from this trend.

***Trend #3: Social networks also battle for time and attention. Facebook still wins, but does not dominate.***

Now that we have stopped voicing each other, and our texting has quickly moved to application-based messaging, what will we do with our data? Facebook has and will continue to dominate, and, as mentioned earlier, will establish themselves as a communications services provider on par with any of the carriers.

But Facebook will not be the only game in town. Its broad-based approach will be challenged by more focused competitors that concentrate on one element of the social experience. For example, Twitter enables both broadcast messaging and individual text-based responses with ease. The relationship between the communicating parties as already been established. How long will it take for Twitter to include a "call me" button which will not use ten digits but rather your Twitter handle as your address? Yes, it would all come through the data channel and completely bypass the carriers. As long as the user decides which Tweets to include for this extra personal level of service, and as a result can opt in/ opt out at any time, would there be any privacy concerns? Nope. With Twitter being a highly mobile social application, the implications to carriers are nearly immediate (and all Apple had to do was fuse Twitter to the iPhone 4S – brilliant!).



The real threat to Facebook is Pinterest. As a 44-year old male, I am not the demographic for Pinterest, but go to the site (you need to be invited – if you have no Pinterest friends, I'll invite you if you let me know at [sundaybrief@gmail.com](mailto:sundaybrief@gmail.com)) and enter some innocent term like "limeade." Now you will understand why people get happily "lost" in the site. Businesses have not moved to Pinterest en masse – yet – but look at Pottery Barn Kids, or Kate Spade, or Lowe's and you will see why it's much different than Facebook.

Pinterest is stealing viewing time from Facebook in hours, not minutes. No one talks about "losing themselves" in Facebook or says "I have to stop spending so much time on Facebook" the same way they say it about Pinterest anymore. Why? Because Pinterest is about shared interests, not shared relationships. It's a fundamentally different part of our social nature. When those interests run deep, our commitments are strong. When those commitments are strong and lead to purchases, either on site or through participating Pinterest merchants, the strength of their challenge to Facebook becomes significant.

According to recent data, Pinterest ranks third behind Facebook and Twitter as a social network as measured by unique visitors. However, when time spent per user is evaluated, recent data shows that Pinterest and blogging site Tumblr rank second (in a tie) to Facebook.



Minutes per Average User (MAU) drives Facebook's value. Could Pinterest, Tumblr, and their successors impact Facebook's earnings growth? Absolutely. This threat will also drive Pinterest's valuation to the stratosphere, making the Instagram valuation look puny in comparison.

It's still a battle for eyeballs, with billions of dollars of valuation at risk. Mobile is the field, and the telecommunications providers are the groundskeepers. Unfortunately, the caretakers get paid a fraction of the players.

If you are headed to CTIA next week, I wouldn't mind connecting. Send an email to [sundaybrief@gmail.com](mailto:sundaybrief@gmail.com) and we'll arrange a time. Have a terrific week!

Jim Patterson  
Patterson Advisory Group  
816.210.0296 mobile  
[Jim.patterson64113@gmail.com](mailto:Jim.patterson64113@gmail.com)