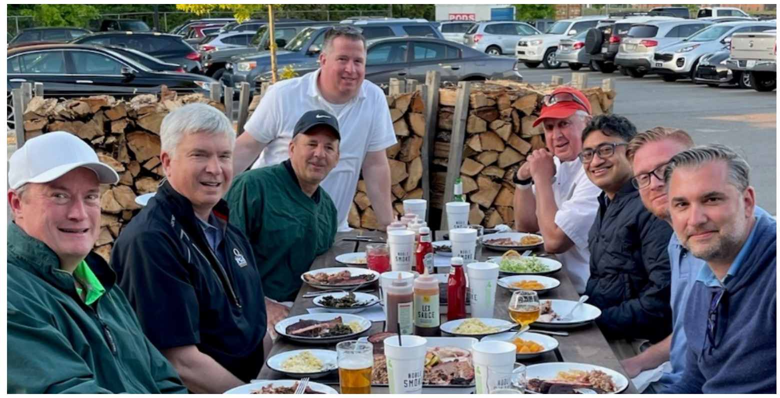
The Sunday Brief: T-Mobile's Pitchfork Strategy
May 9, 2021

Happy Mothers' Day and Wells Fargo Championship greetings from Charlotte and Davidson, NC. Pictured are several of us chowing down on some excellent Noble Smoke BBQ after taking in Friday's play. We also received a tour of their smoker facililty – quite an experience if you are into BBQ (see picture at the end). What a terrific time with telecom industry friends!



This week, after a brief market commentary, we will devote our time to T-Mobile's earnings analysis and what we call their "pitchfork strategy." We also recap earnings impacts for the Big 3 wireless providers.

The Week That Was

Ticker	Shares (millions)			Stock Price		Equity Value ($B)		Annual Change		2021 YTD PERFORMANCE		
Symbol	Dec-19	Dec-20	Mar-21	Dec-19	Dec-20	Dec-19	Dec-20	Amount	Percent	7-May	% change	Value Gained/ Lost ($B)
AAPL	17,493.9	16,788.0	16,687.6	$ 73.41	$ 131.97	$ 1,284	$ 2,216	$ 931	73%	$ 130.21	-1%	$ (29)
GOOG	689.7	674.1	670.2	$ 1,337.62	$ 1,751.88	$ 923	$ 1,181	$ 258	28%	$2,398.69	37%	$ 433
MSFT	7,665.0	7,542.2	7,531.6	$ 157.70	$ 222.42	$ 1,209	$ 1,678	$ 469	39%	$ 252.46	14%	$ 226
AMZN	497.8	503.6	504.3	$ 1,847.84	$ 3,256.93	$ 920	$ 1,640	$ 720	78%	$3,291.61	1%	$ 17
FB	2,850.5	2,847.6	2,835.5	$ 205.25	$ 273.16	$ 585	$ 778	$ 193	33%	$ 319.08	17%	$ 130
Totals						**$ 4,921**	**$ 7,492**	**$ 2,571**	**52%**			**$ 778**

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Symbol	Dec-19	Dec-20	Mar-21	Dec-19	Dec-20	Dec-19	Dec-20	Amount	Percent	7-May	% change	Value Gained/ Lost ($B)
T	7,170.0	7,126.0	7,140.0	$ 38.56	$ 28.75	$ 276	$ 205	$ (72)	-26%	$ 32.16	12%	$ 24
VZ	4,140.0	4,141.0	4,140.1	$ 60.77	$ 58.73	$ 252	$ 243	$ (8)	-3%	$ 58.72	0%	$ (0)
TMUS	855.6	1,241.6	1,246.9	$ 78.42	$ 134.85	$ 67	$ 167	$ 100	150%	$ 139.12	3%	$ 5
CMCSA	4,607.0	4,598.2	4,594.0	$ 44.76	$ 52.40	$ 206	$ 241	$ 35	17%	$ 58.11	11%	$ 26
CHTR	214.8	193.7	188.7	$ 485.08	$ 661.55	$ 104	$ 128	$ 24	23%	$ 693.44	5%	$ 6
Totals						**$ 906**	**$ 985**	**$ 79**	**9%**			**$ 62**

"Could have been worse" is probably the best headline to summarize this week's Fab Five market performance (-$135 billion or roughly one Charter for the week). Four of the five stocks lost market value (Amazon the largest -$89 billion), with Microsoft managing to eke out a $2 billion gain. The Fab Five are still up $778 billion as a group and well on track to add at least $1.5 trillion in market value in 2021. As we have mentioned before, we see the week ending April 9, the first full week of the second quarter, as pivotal – in that single week, the Fab Five added $785 billion. This is likely institutional buying. Using that same logic, the weeks of June 28 and July 5 should see gains for this group (last year, during the 2-week period straddling the Fourth holiday, the Fab Five added $724 billion).

The Telco Top Five also had a strong week, with $29 billion in equity market gains. Every stock improved its value this week, with Comcast (+$9 billion) leading the way. On the back of strong earnings annoucned Tuesday evening, T-Mobile briefly reached $140/ share on Friday before giving some of it back. AT&T also had another decent week and is now up 12% in 2021.

Please note that we have added a new column outlining Q1 share count changes. The net effect of the changes to our previous value calculations for each group was -$3 billion for the Fab Five -- and was less than $1 billion for the Telco Top Five. Since these sums were spread across five stocks (in each group), the impact on any particular stock was negligible.

It is interesting to observe, however, the systematic use of excess cash for share buybacks (and, as we noted in last week's Brief, an occasional dividend increase).

While there has been a lot of talk about busting up big tech (see Steven Levy's conversation with Minnesota Senator Amy Klobuchar here), we think there should be a more intense focus on the word that big tech proabably hates more than any other – *interoperability*. LinkedIn and Facebook make it hard (Facebook especially after a 2018 software update) to interoperate with other applications – keeping users captive drives on-site engagement and corresponding advertising revenues. *What if the application/ website and the newsfeed layers were separated?* To do so, we would need a common aggregation portal, perhaps one that looks a lot like the Messages (or Messaging) function on smartphones today. No more going to the Facebook or LinkedIn apps – their news would come to a separate app/ portal. And, what if the aggregated news feed were searchable and curated for and perhaps even controlled by individuals? A user-defined algorithm sitting atop any Google or Facebook formula removes some of their influence.

If AT&T's breakup (and the follow-on 1996 Telecom Act legislation) is any indication, forced interoperability with any third-party app would bring tech to the table for a deeper discussion. It strikes at the heart of their profits – advertising. Providing alternate website/ apps for viewing and curating newsfeed would remove the eyeball from linkedin.com and facebook.com. Putting an algorithm atop Google to curate searches from multiple sources for certain topics would rebalance any bias (downside – it could potentially create narrower and more extreme newsfeeds).

It's worth thinking about tech regulation in a different manner than steel, oil, or even telephony. Separating value sources for consumer benefit might be the better solution, and telecommunications providers have the optimal platform to aggregate newsfeeds.

T-Mobile's Pitchfork Strategy

As mentioned earlier, T-Mobile capped off the Big Three Q1 2021 earnings with a surprisingly strong net additions and Sprint synergies picture (full earnings package here). What surprised us most out of the call was the quantity and magnitude of initiatives (and investments) that the company is making.

Because there are so many different initiatives, the best analogy to describe T-Mobile's 2021 is a pitchfork (specifically the hay variety shown nearby). More tines in the fork allow the company to pick up more of the market, yet none of the tines completely dominates the others. We like the strategy because each element stems from a single, new 5G network.

Here are the components, in our view, of T-Mobile's strategy.

a. **Accelerated Sprint Synergies.** This is more than SIM card swaps at your nearest T-Mobile store. Plan rationalizations need to take place; in some cases, phone swaps (especially low-end Android) will need to occur, and, as CEO Mike Sievert laid out, billing systems will eventually need to be consolidated. T-Mobile announced that they had converted 20% of Sprint customers and 50% of Sprint traffic to date. It did not appear that there were any major hiccups (including availabiliy of low-end Android devices), but there's a process that needs to take place. And the last 20-25% of Sprint customer conversions are going to be the toughest and take the longest. Our guess is that T-Mobile is cushioning for additional incentives to get the last customers moved over (which, by Mike Sievert's earnings call comments, may take until early 2022).

T-Mobile expects the total net present value of Merger synergies to be more than $70 billion – up more than 60 percent from the original Merger guidance of $43 billion.

Completed customer migrations lead to the largest synergies. This only occurs after deselected sites have been decommisioned, 1900 MHz (the original PCS spectrum) has been repurposed into the new T-Mobile network, and Dish has the opportunity to purchase fallow 800 MHz (the original iDEN) spectrum. When everyone is on the new network platform, supporting systems (e.g., billing) can get rationalized and further savings can be mined. But synergy "gold" comes from fewer towers and the elimination of the CDMA network.

T-Mobile could have filled Tuesday's earnings call with synergy goodness (as the headline from their Fact Book above clearly shows). They didn't, and that's a very good sign.

b. **T-Mobile for Business (TFB) Growth**. Mike Katz, head of TFB, had a lot more airtime on this call – there's a reason for that. With the introduction of T-Mobile's Work From Anywhere (WFX) solutions, the salesforce has a differentiated offering – secure, nationwide, ~100/ 25 Mbps LTE/5G connectivity for $90/ mo. per connected site. Cable can achieve those speeds, but not cover the nation with one operations center/ service level. AT&T can achieve similar speeds in some/most of their footprint, but not in New York City, Denver, Chicago or Seattle. Verizon is getting closer to matching nationwide coverage with their 5G Ultra Wide Band network (see their C-Band + millimeter wave announcement with Ericsson here), but covering a suburb like Marietta, GA (Atlanta metro area) or Katy, TX (Houston) or Centennial, CO (Denver) could take several more years to deploy. T-Mobile has a differentiated offer ready now.

Then comes their relationship with Lumen/ Level(3) which we think could yield significant value. While the impacts to commercial offerings in key legacy US West (telco) states like Colorado, Washington, Minnesota, and Nevada are obvious, it's also important to note that Level (3) brought the former Time Warner Telecom (TWTC) and Telcove/ Adelphia Business Solutions local fiber to the table as well. This fills some of the additional gap versus AT&T and Verizon with enterprises – redundant fiber connectivity to data centers, enterprise locations, and key cell sites. While industry analysts debate the value of last mile connectivity, it's clear that having multiple fiber partnerships removes one additional incumbent advantage. Mike inticated that Lumen needs a "big, distributed, powerful 5G network." We agree, and hope that this is the first of many last mile/ data center relationships forged by T-Mobile.

c. **T-Mobile Home Internet Launch**. The pilot turned out to be more than 100,000 customers, and expectations of many (present company excluded) were that hundreds of thousands more would be signing up at launch in late March. T-Mobile's former head of Emerging Businesses (now head of all Product), Dow Draper, was tight lipped when a question was asked on the call about initial success (note – paraphrased quote):

"We are a little over three weeks in post-launch, and I would say we're as excited as we have ever been about this business…. We've seen two things which are very consistent with what we saw when we were piloting. One is that we have customers who are coming to us… particularly in suburban and rural neighborhoods… that are surprised at the speeds they can get in their area where they may only have one other choice. The other thing we are seeing is that we continue to attract customers who do not have a wireless relationship with T-Mobile…. This gives us the ability to establish a relationship with someone who isn't a [smartphone] customer, and that gives us a great opportunity to upsell."

While there was no discussion of the TVision decommission, any uptake on the YouTube TV product offering made to all existing T-Mobile customers (forewarned: you need to establish a new account with YouTube TV to get the $10/ mo. mobile subscriber discount), our initial take is that there is more Home Internet demand than T-Mobile capacity can handle in many of the 30 million homes passed. As reference, the non-phone device 8-quarter trend from T-Mobile's Fact Book is shown below (note: 2Q 2020 is the first quarter of the merged companies):

(in millions, except percentages)	Quarter							
	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
Devices sold or leased								
Phones	6.5	7.4	8.3	6.4	8.9	9.2	10.1	9.6
Mobile broadband and IoT devices	0.6	0.6	0.8	0.8	1.2	2.2	1.6	1.0
Total	**7.1**	**8.0**	**9.1**	**7.2**	**10.1**	**11.4**	**11.7**	**10.6**
Postpaid upgrade rate	4.5 %	4.7 %	5.6 %	3.8 %	4.5 %	4.3 %	5.7 %	4.8 %

While it's hard to separate COVID-related hotspot activity from Home Internet, we don't see (and didn't expect to see) a spike in non-phone devices in Q1 2021. We would not be surprised, however to see the impact of the Home Internet launch (and increased WFX sales) begin to show up in the remaining quarters of 2021.

As we spoke about in our April 11th Brief ("Is T-Mobile a Credible Home Internet Provider?"), we think the adressable market for their service is at least 25 million homes with a likely share of ~20% over time (likely $3-4 billion in incremental revenues with good margins). However, as we saw this week in Tesla's earnings announcement, Starlink is also attracting a lot of interest (500,000 preorders with some areas already sold out) and many rural providers (like Lumen) are waking up to fiber (we will cover their earnings comments in an upcoming Brief).

d. **Accelerated investments in the core wireless business.** T-Mobile, in their full year EBITDA guidance, all but indicated that there were going to be "switching events" in the second half of 2021. Some of those will be driven by the Sprint to T-Mobile conversion (and we strongly believe that the last 15-20% will definitely be the hardest and costliest). This is probably one of the factors driving the $100 million in increased investment in merger-related costs.

2021 Outlook

Metric	Previous	Revised	Change at Midpoint
Postpaid net customer additions	4.0 to 4.7 million	4.4 to 4.9 million	300 thousand
Net income (1)	N/A	N/A	N/A
Core Adjusted EBITDA (2)	$22.6 to $23.1 billion	$22.8 to $23.2 billion	$150 million
Capital expenditures (3)	$11.7 to $12.0 billion	$11.7 to $12.0 billion	No change
Merger-related costs (4)	$2.5 to $3.0 billion	$2.7 to $3.0 billion	$100 million
Net cash provided by operating activities	$13.0 to $13.5 billion	$13.2 to $13.6 billion	$150 million
Free Cash Flow (5)	$4.9 to $5.4 billion	$5.1 to $5.5 billion	$150 million

We also think, however, that T-Mobile has something else planned – it could be content-related, or Apple iPhone launch-related, or rural expansion-related, or something completely different, that will impact the trajectory of their business. Based on comments that they made about Q1 postpaid ARPU being the "low point" for the year, we don't think it's a redux of last year's "Four lines for $100" offer, but rather something directly related to device transition and 5G. All speculation at this point, but we think that the EBITDA guide was intentional, not merely conservative. T-Mobile wants more market share growth.

Where does this leave the wireless industry? It's pretty clear that T-Mobile is not desperate for a content partner outside of their existing relationship with Netflix (although we would not be surprised to see a promotional offer with Apple+ or Paramount+ or another content partner in the future). We remain perplexed that Metro has the only promotion with Amazon Prime (a true head-turner if Prime were included with every Magenta MAX plan), but again, T-Mobile may not need a content partner to continue to take market share.

It's also clear that postpaid retail wireless service revenues are going to be challenged at Verizon for the foreseeable future. Here's Verizon's service revenue line, as well as their 10-Q commentary on what drove revenues in the quarter (emphasis added):

Consumer - Selected Operating Statistics

Unaudited	2020 1Q	2020 2Q	2020 3Q	2020 4Q	2021 1Q
Revenue Statistics (in millions):					
Wireless service revenue	$ 13,476	$ 13,087	$ 13,442	$ 13,600	**$ 13,684**
Fios revenues	$ 2,799	$ 2,754	$ 2,773	$ 2,756	**$ 2,860**

"Wireless service revenue increased $208 million, or 1.5%, during the three months ended March 31, 2021, compared to the similar period in 2020. *This increase was primarily due to growth from reseller accounts, growth in mobile security products included in certain protection packages, growth in revenues related to content offerings and growth in access revenues related to our postpaid plans*. These increases were partially offset by a decrease in TravelPass revenues driven by a continued decrease in international travel due to the COVID-19 pandemic."

As we continue to dig into the sources of Verizon's growth, we find that retail postpaid access growth makes up far less than we originally expected. Our educated guess is that ~40% of the $208 million comes directly from the wholesale cable vector, and that their launch of their Verizon Protect product (description here) will have minimal service growth impact after 2Q 2021 (the conversion deadline was last Thursday). And, while we think that serving as a "bill on behalf of" solution for Disney+ (and likely Discovery+) is great for customers and, at the margins, for churn levels (Hans Vestberg, Verizon's CEO, described the process and revenue opportunity in their 4Q 2020 earnings call – transcript here), it's likely less profitable revenue than EBITDA from additional smartphone lines. Verizon can do better – a lot better – in 2022 but needs to stem account losses now (-71K Q4/ Q1 vs. +260K for T-Mobile).

Finally, we think strong content and streaming revenues from AT&T will overshadow sagging profitability. Frankly, we aren't sure if the surge in HBO and WarnerMedia (already underway) is going to help AT&T Business, but we are highly confident that if there's a blockbuster this summer, AT&T's Consumer division will leverage it to the hilt. We are also more positive than ever that AT&T will not only meet but perhaps slightly exceed their three million new homes passed in 2021 given the focus it's receiving in the company.

That's it for this week. Next week, we'll talk more about Fab Five cash generation, and assess the state of local broadband in light of Federal infrastructure plans. Until then, if you have friends who would like to be on the email distribution, please have them send an email to sundaybrief@gmail.com and we will include them on the list (or they can sign up directly through the new website). Thanks again for the referrals.

As promised, here's the smoker pic from our tour (scratch and sniff not available). Have a great week, Happy Birthday Pops, and congratulations to the Davidson Class of 2021 who will graduate this Tuesday!