



## AT&T's "Triple Win" Isn't Much of a Trifecta

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While most of us were enjoying Presidents' Weekend, the best and greediest investment bankers were hard at work auctioning off the carcass of AT&T Wireless. Cingular Wireless, a joint venture of SBC and Bell South, two former "Baby Bells," was busy ratcheting up its daily bid to make sure it trumped Vodafone to emerge as the winner of these assets. Cingular started the bidding at \$30 billion but ended up agreeing to overpay \$41 billion, or \$15 per share, to become the largest U.S. cellular carrier. The logic seemed to be: "The more the merrier." Not clear if that applied to: the more you paid, the more customers you controlled, or having the highest "churn" (customer loss) in the industry. NTT DoCoMo, which already owned 17% of ATT (for which it had overpaid a ridiculous \$24.15 per share in November 2000 (with additional, now worthless, options at \$35) apparently decided not to throw more good money after bad. The CEO of Nextel, another rumored bidder, was only seen on TV over the weekend presiding at the Daytona 500 armed with a broadcasting headset but no checkbook! (Nextel has recently taken over from Winston as the official sponsor of NASCAR.)

### A Triple Win for Whom?

John Zeglis, the Chairman and CEO of AT&T Wireless said: *"Today's announcement is a triple win for AT&T Wireless shareowners, customers and employees. For shareholders the transaction provides a handsome return on investment. For customers, this means all the advantages only the nation's largest wireless company can provide. For employees **who become part of the combined company**, this means more opportunities than they otherwise would have had with AT&T Wireless as a stand-alone company."*



### **Just exactly who does Mr. Zeglis think he is kidding?**

One look at the chart above will tell you that almost nobody made any money in this stock from the day it was spun out of AT&T as a tracking stock. Try telling that to NTT DoCoMo that lost a third of its \$9.8 billion investment. Try putting that one over on the poor AWE employees for whom a significant amount of stock was set-aside on the initial offering. Remember, this IPO occurred at the height of the investment bubble. It came public at \$29.50 and traded ever so briefly to 36. By the end of its second week of trading, it was at 28.25 and headed south for the next 2 ½ years. The week the IPO was offered, the Wall Street Journal ran an article about one AT&T employee who was mortgaging his home so that he could afford to pay for as much stock as they would let him have on this deal. I have often wondered if that poor man lost his house when AWE collapsed to a low of 3.86 eighteen months later. So exactly of whom is Mr. Zeglis speaking when he talks of a handsome return on investment? He can only mean those who invested in late 2003 when the first rumors started swirling that a deal was imminent. No professional investors believed that anyone would foolishly pay this much for this ill-run hodgepodge of assets. That's why just days before the deal was finalized, the stock was trading at only 11. AWE fooled NTT DoCoMo into overbidding in 2000. Maybe they have pulled off the same trick again on Cingular!

### **How About the Customers?**

Churn is the monthly number of subscribers lost by a provider each month. People move, customers don't pay their bills, some become unhappy with the service due to dropped calls, etc. I attended the AWE initial public offering road show at the Waldorf Astoria. The Empire Room was packed like a can of sardines yet nobody asked any meaningful questions. I raised my hand: "Mr. Zeglis, you referred in your prepared remarks to your hope that you will get your churn down below 3%. Exactly where is your churn now?" There was a gasp in the room as Mr. Zeglis admitted that AT&T's churn exceeded 4% but was definitely getting better. Think about it. If 4% of your customers churn off your system every month, you are losing 48% or almost half of your customers every year. It's tough to overcome that obstacle and grow your business. Once number portability became the law last fall, AT&T lost more customers than any of its competitors. While Nextel was adding more than a half million new subscribers (553,000) in the fourth quarter, AWE was busy writing off \$100 million due to problems with its new IT system and adding only 128,000 net new subscribers.

### **Would You Like to Be an AT&T Wireless Employee Now?**

Reread the wording of Mr. Zeglis' quote above. How many AT&T folks will get to keep their jobs? Take a guess. Do you think half of these people will be furloughed? My bet is the lion's share of them will be employed elsewhere a year after this deal closes.

### **How did This Mess Happen?**

Just like Comcast's acquisition last year of AT&T Broadband, the acquirer of these assets is likely to run them far better than did the folks at AT&T Wireless. The core of this operation was formerly McCaw Cellular. It was acquired more than a decade ago when

AT&T tried to map a communications survival strategy to keep itself alive after it lost its long distance monopoly. The insurmountable problem at AT&T Wireless was to get business people who grew up in a monopoly environment to think like aggressive, competitive entrepreneurs. They couldn't do it in the cable business, a quasi monopoly, and they were even less capable of doing it in wireless with multiple competitors.

### **Nextel, the Real Trifecta**

About a decade ago, Craig McCaw had taken the money he made from selling his cellular business to AT&T and invested it in Nextel to save it from bankruptcy. Nextel's business had evolved from the old two-way radio dispatch business channels it had accumulated at a low entry price. Utilizing Motorola's push-to-talk IDEN system, McCaw had the vision to take Nextel's "Direct Connect" feature, turn it into an advantage, and repackage Nextel as a differentiated provider. Unlike the true cellular operators, Nextel didn't initially have a large block of contiguous frequency with which to build its business. By necessity, frequency-starved Nextel learned to optimize whatever bandwidth it had and to maximize every revenue opportunity. It acquired bits and pieces and then large chunks of frequency at low-ball prices to use for trading or for future expansion. Also, Motorola kept improving IDEN and migrating it toward a full-fledged cellular competitor. Because it had no choice, Nextel learned how to make a silk's purse out of a sow's ear. AT&T had both bandwidth and money. It never had to be innovative or clever to survive.

A few years ago, merger conversations were rumored between Nextel and AWE. The buzz at the time was that the talks collapsed over who would run the merged company. AWE's top managers didn't want to relinquish control to the hard-working innovators at the smaller upstart. In the end, Zeglis and friends lost control anyway, not just of their jobs, but also of their company. By contrast, Nextel has accumulated over 13 million happy customers, paying the largest monthly fees in the industry. We know they are happy because the churn is very low at an industry leading 1.5%.

In mid-2002, WorldCom was going bankrupt and Telecom was a very bad word. Wall Street was worried about Nextel, too. Since then, Nextel has bought back debt, watched its credit ratings rise, gone from a loss to earnings (expected to top \$2 per share in 2004) and really cleaned up its act. That combination is why Nextel stock went from \$3 in June 2002 to \$28 at 2003 year-end, a gain of more than 900%. In the same time period, AWE went from 5.85 to 7.99, a gain of 37%. As further consolidation occurs in the cellular industry, I expect Nextel to maintain restraint in what it will bid for others. I also expect it to continue to show its competitors how to maximize revenues, profits and customer satisfaction. Now that's my idea of a trifecta! Guess which one we've owned for twenty months?

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