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Does AT&T need DISH Network?

Telephone, wireless and cable firms have all seized on the service bundle, spreading customer acquisition and maintenance costs across a larger revenue stream

As any discussion of these companies includes the full menu of VOD, IPTV, DBS, Broadband (fixed and wireless) and more that we consider our home turf, and with on again/off again rumors circulating about a potential business combination for these companies once again in the news, we couldn't resist weighing in with our view.

First, a little background on the players. AT&T is a wired and wireless phone company that has been experiencing the best of times and the worst of times, simultaneously. On the one hand, AT&T's wireless service has been growing nicely, fueled in no small part by data service revenues. On the other hand, at least partially through cannibalization, as well as competition from VOIP service from cable and standalone firms, voice revenues are in decline.

From an operational economics perspective, telephone, wireless and cable firms have all seized on the service bundle, which spreads customer acquisition and maintenance costs across a larger revenue stream for years – most notably through the “triple play” bundle of wireline voice, multichannel video and high speed data service. Initially offered by Cox and other cable operators, AT&T responded with a two pronged strategy: first bundling satellite television with its wireline services to complete the bundle, and then later with its own Fiber to the Node/IPTV based triple play offering.

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Each has its advantages, and disadvantages. Satellite provided an immediate bundle, and is obviously ubiquitous, but has required a somewhat clunky “marriage of convenience” with DISH Network. With the continued rollout of AT&T's U-Verse offering, the question arises, do they still need Echostar – and in the current climate of deal making, do they need them enough to buy them?

From a strategic point of view, being able to offer a full bundle throughout AT&T's wireline footprint offers the company the advantage of using the video technology that makes sense where it makes sense. While AT&T touts the ~\$300 cost to “pass” each home with the U-Verse infrastructure (as compared to cable and Verizon's FIOS offering), this number actually varies quite a bit based on the density of subscribers near each central office. Thus,



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there no doubt are many areas where DISH's space borne infrastructure is more efficient.

But, again, do you need to own it to use it? While the terms of AT&T's arrangements with DISH are private, as long as there are still two satellite providers AT&T can use the tension between them to make sure its satellite video comes at a reasonable cost. Consider alternatively a

combination of AT&T and EchoStar: under this scenario any premium AT&T pays for DISH (and we know Charlie Ergon isn't going to sell out cheap) can be amortized over their subscriber base. However, as AT&T lights up additional areas with U-verse, it winds up competing with itself, since there would presumably already be DISH subscribers there. Is this the best way to build value?

As you may have guessed, it all depends. At a rumored transaction value of \$30 billion, AT&T would acquire 13.5 million subscribers and an engine that acquires nearly 4 million new ones each year, (albeit mostly to replace churn, and at an annual cost exceeding two and a half billion dollars). While the synergies mentioned above are considerable, we note that they only apply in the AT&T geographic footprint – and elsewhere DISH is still going to face the full onslaught of telco and cable competition. And, at \$300 per address, that \$30 billion could fund the rollout of U-verse to 100 million households – nearly every home in America (of course, AT&T's infrastructure only passes a fraction of those, so in reality this is impossible). Given this alternate use of cash, we think this deal gets even harder to justify.

In our view, with its fast broadband pipe, AT&T doesn't need Echostar's satellites. Likewise, we note that no one is discussing combining satellite and cable firms, for example. We therefore think that, absent a significant price shift for the deal, combining DISH with a wireless ISP or a pure wireless carrier makes more sense, and that AT&T should keep to its knitting.

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