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XM and Sirius and our cracked crystal ball

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For a while now, XM Satellite Radio and Sirius Satellite Radio have been perfect case studies for the rapid evolution and convergence in media and telecommunications. Part satellite operators, part radio broadcasters, part content producers, part technology companies, these two are the prototypical illustration of the cross-disciplinary art which the industry has become. So, when XM and Sirius announce plans to combine, it is by definition one of the more interesting events in media and telecommunications, giving rise to competitive, regulatory, technical, and marketing issues that sector observers will undoubtedly want to monitor closely. We list some of the key implications of the proposed transaction, noting that nobody, not even the two companies' executives and advisors, is likely to have a strong sense of the outcome at this time.

- Symbolic. Despite significant hurdles to a successful combination (that will be elaborated upon below), the two sides had reportedly chosen to accelerate their merger effort in the past couple of months. Two reasons that may explain this increased vigor are (a) fear that a change in the currently Republican administration after 2008 would further jeopardize the already treacherous FCC and Justice Department approval process, and (b) a competitive environment that adds to each of the two companies' struggles as it seeks to become sufficiently profitable to justify the amounts of capital raised to date. The suggestion has indeed been made that a merger of the two may be the most viable alternative for them to survive. Given the existing market presence – in terms of subscribers, distribution relationships, high-profile proprietary content – of both XM and Sirius, it may be a sobering thought for many in the evolving media and telecom sector that these companies could be too small to succeed on a stand-alone basis in the longer term. That the federal regulators may not agree with such market realities could be even more disconcerting.
- Regulatory. The crux of the anticipated regulatory debate seems, as is often the case, to be based on definition. If the emphasis is on “satellite” rather than “radio” (or even “audio”) so that satellite radio is a unique service and the satellite radio sector is one that competes within itself, then the proposed merger would result in a monopoly. If on the other hand XM and Sirius are merely another “radio” (or “audio”) service among a growing number, which now includes not only terrestrial radio turning digital but cellular phones enabled for music and Internet radio that will increasingly benefit from the growth of wireless broadband networks, then you can sort of see why XM and Sirius have become anxious to combine. Regardless of perspective, however, the issue of rural coverage

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could prove to be an insurmountable obstacle. Due to the absence of wireless broadband networks and the relatively few terrestrial radio alternatives in remote areas, any argument with respect to competitive alternatives in such locations will be weak. How the regulators will see it is yet uncertain, but the decision will be precedent setting (note, for example, DirecTv and EchoStar), and that it will not be taken lightly explains the more than 12-month “drop-dead” date (without a breakup fee) the two sides have reportedly set.

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- Marketing. The two services are incompatible, although engineers from both sides have been working on the development of a receiver that could pull in both signals. If this can be accomplished, and assuming that the consumer offering is price competitive, then the combined channel lineup will be truly formidable in terms of both magnitude and content. Alternatively, the two services could be tiered and separated, in a manner comparable to cable television offerings – with one tier, for example, providing the premium Howard Stern and Oprah type content, while the other focuses on, say, popular music genres. Conversely, there is already talk about the elimination of redundant programming on the two sides, and one may for that matter also see a significant redundancy in the separate but substantial Internet radio presence of each. In all of the above, and depending on how the strategy would play out, the competitive impact and ripple effects on digital music could be huge – influencing the entire competitive landscape from Internet radio all the way to the wireless carriers now beginning to offer musical content to their cellular service subscribers (as a potential satellite radio alternative). In addition to any precedent setting impact, therefore, regulators will undoubtedly also be mindful of the industry-wide landscape that could be shaken up – an entirely different sort of impact from allowing, say, AT&T to essentially recreate itself long after the telecom sector has more or less gone wireless anyway.

Reflecting the uncertainty described, the two sides purposefully abstained from announcing a post-merger brand, not wanting to risk the embarrassment of a new name that will never exist, or one that will be a taint on the old. So, in this too, the XM and Sirius case study is emblematic of the media and telecommunications sector more broadly: their crystal balls are just as vague and foggy as the rest of ours. Notwithstanding, the markets traded both stocks up by 5-10% the day after XM and Sirius announced their merger plans. Apparently some crystal balls got polished in a hurry. Stay tuned.