

FINALLY, the FCC approves the XM / Sirius merger!!!!

Back on February 19, 2007, the Boards of XM Radio and Sirius Satellite Radio approved a plan of merger and began what would become a long, combative and historic regulatory drama. On March 29, 2007, they submitted an application with the FCC to combine their spectrum into a new merged entity. On June 8, 2007 (the FCC's Day 0), the pleading cycle was officially established. This last Friday, July 25, 2008 (FCC Day 412) the approval was finally granted. XM shareholders will receive 4.6 shares of Sirius stock in the merger. The new company will be named Sirius XM and will trade under the ticker "SIRI".

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The approval undoes a well intentioned FCC created duopoly that seemed to make sense last century. After all, the FCC had watched an initial five or six satellite TV competitors bludgeon each other down to a sustainable two survivors, DIRECTV and Echostar. Perhaps consumer space businesses were just too hard to expect more than a couple players to survive. When it came to satellite radio it turned out that even two was a big number and, unlike satellite TV in rural America, there is already ample evidence of serious alternative competition in the radio market. Last Friday, this reality was finally acknowledged. The FCC's approval will now allow for the formation of a stronger combined satellite radio competitor with 18.5 million subscribers, comparable in scale to DIRECTV's 17 million subscribers.

The approval is rumored to have come with several material concessions and conditions, including:

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- Payment of \$19 million in fines for terrestrial repeaters operating out of compliance, of which approximately 100 of XM's and 11 of Sirius' will be shut down or brought into compliance;
- A 3 year freeze on subscription fees with a relook feature six months before the freeze expires allowing for public comment and a potential continuation of the price freeze;
- The addition of smaller lower cost programming packages in a more a la carte service offering;



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- A one year deadline to establish a dual mode radio and the establishment of an open standard for manufacturing; and
- A spectrum set aside of roughly 8% amounting to 24 channels to be allocated for 12 public service channels and 12 minority programming channels.

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These conditions while material do not seem unreasonable and should not prevent a vigorous and intelligent management team from making a go of the new combined venture. Looking at the final result, our hats go off to the three brave FCC commissioners who were able to set aside the self interested lobbying of the powerful NAB to make this long overdue common sense decision. These three commissioners got it. Satellite radio does not merely compete with itself. It can not through a merger become a monopoly in any economic sense of the word. It will continue to compete with the legacy AM/FM services trying mightily to convert free-to-air listeners into paid subscribers. Perhaps, more importantly, it faces an ever growing and powerful array of digital, wireless, iPod/MP3 and internet music and audio distribution alternatives that threaten to capture much of those premium, technology sophisticated, young and audiophile sectors of the market more likely to pay subscriptions. Many of these newer alternatives provide 1000's of channels of content, offer significant individual customization of channels and come with special features allowing listeners to skip, ban or even "love" songs to teach their service how to better serve them in the future.

For satellite radio to compete effectively and better serve consumers, it first needed a saner cost structure, improved access to capital and greater channel capacity. The approved merger offers a chance at all of these, but not a guarantee that the new entity will achieve the level of sustained profitability that has eluded these companies since their creation over a decade ago. So far, the market's response has been underwhelming. Clearly investors think the FCC approval is just one step in what will still be a challenging business plan execution for the merged entity. Here are a few comments taken at random from the financial blogs:

The market understands this fact...

"Awesome, the merger is finally approved and the stock is still going down."

"Is anyone else watching this stock today in disbelief, thinking how can these stocks still go down after FCC approval."



“I do not understand why this is going down, it makes no sense, it should at least go back to the stock price of when the deal was announced.”

Surprising that a “monopoly” should be treated thus, but of course it is not a monopoly and will face many competitors and many obstacles to success. The market understands this fact. Thankfully, however, through the wisdom and courage of three FCC commissioners, consumers may one day soon experience a more vibrant and competitive satellite radio alternative, one that can better realize the full potential of this still emerging technology. Chairman Kevin Martin said it best, “The merger is in the public interest and will provide consumers with greater flexibility and choices. Consumers will enjoy a variety of programming at reduced prices and more diversified programming choices. It will also spur innovation and advance the development and use of interoperable radios, bringing more flexible programming options to all subscribers.”

Alas, the NAB (and Internet radio) will now have one strengthened competitor versus two weaker ones. We believe this will spur more innovation and provide consumers with more and better options, but it may also help accelerate the slow secular decline of AM/FM listenership. In the final analysis, however, it is not the purpose of the FCC or any part of our government to protect old technologies from new ones. No technology is guaranteed an audience forever. If AM/FM wants to fight back it has only to ditch its analog roots, join the digital revolution and switch more aggressively to HD technology.

Lastly, there are also the natural cogitations, murmurs and predictions as to what this approval might mean for a future combination of DIRECTV and DISH. By all we can tell, the consensus is that such a merger is still years away from making a similar case for alternative competition in its core markets. But, if Telcos increase their video efforts, IPTV continues to proliferate and mobile video finds a workable business model, we may face a new regulatory drama for satellite TV in the not too distant future. That one should make this one seem like child’s play.

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