

## T-Mobile

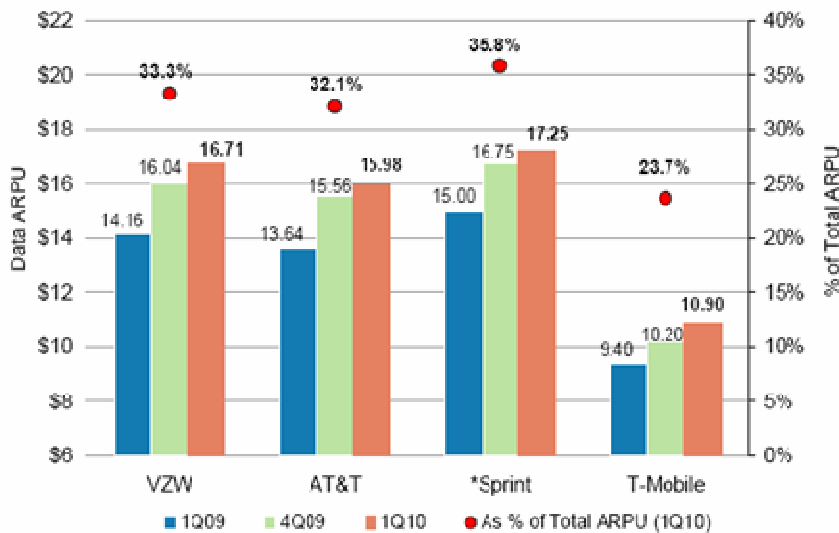
### T-Mobile Fails to Produce Roadmap for Wireless Data

### T-Mobile Missing Out On Data Revenue

T-Mobile USA (“T-Mobile”) has acknowledged that future growth in the wireless business would come from data. T-Mobile’s reluctance to select and aggressively pursue a 3G strategy puts the company at a significant disadvantage in the early stages of the data business.

While all three of T-Mobile’s major competitors derive more than 30% of the average revenue per unit (“ARPU”) from data, T-Mobile continues to drastically underperform this key metric. Although Deutsche Telekom (“DT”) claims that T-Mobile has achieved “strong data ARPU” growth for the first quarter 2010, T-Mobile’s actual data revenues were significantly below its major competitors.

**Data Above 30% of Total ARPU for Most**

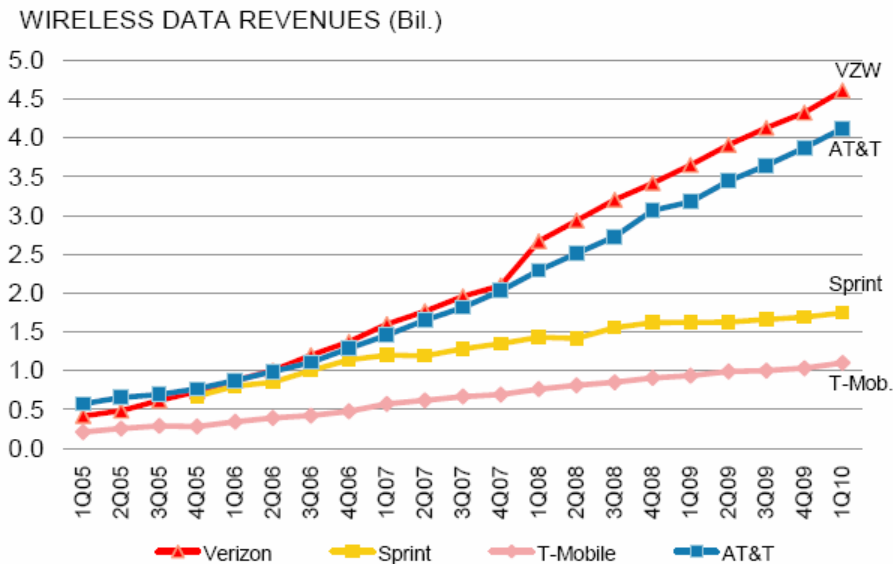


Source: Company data, Morgan Stanley Research. \*Sprint data ARPU is for postpaid only.

In a June 1, 2010 report, Morgan Stanley analyst Simon Flannery argues that “[t]he once voice-dominated wireless world is no more as maturation and commoditization have resulted in negative voice revenue growth. Instead, *data has become the key driver* offsetting the deflationary impact from voice.”<sup>1</sup>(Emphasis added). The prospect of declining voice revenue growth underscores the critical nature of growing wireless data business.

<sup>1</sup> Simon Flannery, Morgan Stanley, "Wireless Data: The Torch Passes from Voice to Data," June 1, 2010.

Even more troubling for T-Mobile's future is how quickly the wireless data gap with competitors has grown. As recently as the beginning of 2005, all four major carriers had relatively similar data revenues. As the chart below illustrates, T-Mobile lags far behind other carriers in wireless data revenue and the growth of data has been much slower at T-Mobile.



### T-Mobile's HSPA+ Rollout –3G Mistakes Being Made Again?

T-Mobile has decided to put plans for a next-generation wireless network on hold while it pursues a rollout of an enhanced 3G network using HSPA+ technology.<sup>2</sup> While the HSPA+ technology compares well to 4G speeds (and provides superior speeds to 3G networks), HSPA+ is not a solution to T-Mobile's long term need to be more competitive in the wireless data market. In order to take advantage of the increased speeds, T-Mobile customers must have an HSPA+ enabled device. The only device T-Mobile currently offers that is HSPA+ capable is a USB dongle for laptops, although it plans to offer HSPA+ handsets by the end of the year. Additionally, T-Mobile competitors will have significant operational advantages from their 4G networks that will provide far greater overall network capacities.<sup>3</sup>

In an effort to leapfrog its competitors after having been very late deploying a 3G network, T-Mobile appears content to gamble its future on the brief advantage HSPA+ has over its competitors' 3G networks. AT&T is also upgrading its 3G network to HSPA+ in advance of developing a 4G network in order to provide customers with the best possible experience. AT&T has said the HSPA+ upgrade will cost approximately \$10 billion, compared to the \$18 to \$19 billion dollar price tag of the 4G network. T-Mobile's reliance on a HSPA+ network in lieu

<sup>2</sup> See <http://connectedplanetonline.com/3g4g/news/tmobile-expanding-4g-061610/>.

<sup>3</sup> See <http://connectedplanetonline.com/3g4g/news/tmobile-expanding-4g-061610/>.

of a 4G roadmap highlights the short-term decision making that led T-Mobile to fall behind with 3G.<sup>4</sup>

AT&T's Operations CEO John Stankey recently disclosed that while T-Mobile is working to deploy HSPA+ to 75 million people by the end of June<sup>5</sup>, AT&T will deploy HSPA+ technology to cover 250 million people by the end of this year.<sup>6</sup> It appears as if T-Mobile is again falling behind in the rush to build wireless data networks.

Of even more concern is the state of T-Mobile's backhaul network. The transfer speeds HSPA+ provides cannot be used unless a cell tower is tied to a fiber backhaul. According to a recently Morgan Stanley analyst report, T-Mobile presently has 10,000 cell sites upgraded to fiber, with plans to connect 48,500 by the end of the year. This represents less than half of the company's cell sites. Implementing T-Mobile's HSPA+ strategy will require capital expenditures beyond what T-Mobile has currently committed. Unfortunately, T-Mobile is slashing capital expenditures that are critical to its incomplete data strategy, with spending falling 41% in Q1 2010 vs. Q1 2009.

## **New Leadership, Same Lack of Direction**

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In May, Deutsche Telekom announced that T-Mobile CEO and President Robert Dotson would be leaving and replaced by T-Mobile's Chief Regional Officer in Europe, Philipp Humm ("Humm"). This change in management is crippled by the same indecision surrounding T-Mobile's wireless data plans—the transition won't take place until February 2011.

In a May 26 research note, Goldman Sachs analyst Jason Armstrong wrote: "[W]e expect the new CEO to bring a heightened focus on cost cuts and potential partnerships/JVs."<sup>7</sup> Continuing, Armstrong predicted that Humm would draw on his experience as DT's Chief Regional Officer in Europe, where he "was instrumental in structuring the UK Orange JV, and a network sharing agreement with Hutchinson." Noting T-Mobile's smaller scale versus its US peers, Armstrong continued, "we expect the new CEO to draw on his past experience in Europe as it relates to cost management on both the opex/capex fronts (especially as it relates to 4G)."

Goldman Sachs has joined a number of other T-Mobile watchers who are speculating that DT will attempt to minimize its US subsidiary's operating and capital expenditures and pursue alternatives where risks and costs can be shared with partners. This decision is a double edged sword—while T-Mobile saves money upfront by outsourcing its network, the company also loses control over the timing of build-out and quality of the network. Given the precarious

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<sup>4</sup> See <http://www.fiercewireless.com/story/ts-stankey-defends-pace-hspa-lte-moves/2010-05-18>.

<sup>5</sup> See <http://connectedplanetonline.com/3g4g/news/tmobile-expanding-4g-061610/>.

<sup>6</sup> See <http://www.fiercewireless.com/story/ts-stankey-defends-pace-hspa-lte-moves/2010-05-18>.

<sup>7</sup> Jason Armstrong, Goldman Sachs & Co., "Quick Bytes: T-Mo US Positions For Next Stage-Cost Cuts/JVs in Focus," May 26, 2010.

position T-Mobile find itself in, surrendering control of its future to third parties suggests desperation and a lack of a credible internal strategy for future growth.

## **New Leadership, Same Lack of Direction**

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Company observers are expressing concern over the impact of the long transition period DT has established for replacing CEO Dotson. Goldman Sachs analyst Jason Armstrong observed that T-Mobile's extended "(i)nterim transition period," with Dotson still in command and Humm easing his way into his new role, may benefit the competition. "We expect postpaid industry peers to continue to benefit from recent weakness in the interim, as T-Mobile US will likely be in a transition period through early 2011 (when the new CEO officially takes over)."<sup>8</sup>

DT's leadership indecision runs the risk of putting T-Mobile even further behind the competition when the company finally gets a new CEO early next year. In the meantime, T-Mobile will have squandered many months during which it could have been implementing desperately needed new strategies .

DT may be willing to endure such an inexplicable delay in launching T-Mobile in a new direction because it lacks a strategy for turning T-Mobile around. Given T-Mobile's current market position, this is troubling.

## **Will T-Mobile Survive DT's Mismanagement?**

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Recently T-Mobile achieved the dubious distinction of being named one of the ten brands that the online financial site, 24/7 Wall St, predicted would disappear in 2011.<sup>9</sup> Arguing that the US cellular market is a duopoly, the article concludes: "As it now stands, T-Mobile has no future in the US." The article also floated the name of another potential acquirer, Mexican billionaire Carlos Slim's Telcel, which has 60 million subscribers. Ultimately, 24/7 Wall St concludes, "T-Mobile has little brand equity in the US. Maybe Deutsche Telekom will just change the firm's name."

In a recent comparison of Clearwire and Harbinger's proposed network, observer Tony Daltorio concluded: "Right now, both Clearwire and Harbinger have high hopes and good reason for them. Perhaps investors should wait to see which one Deutsche Telekom chooses. *With its track record, the company it passes over will likely be the winner in this contest.*" (emphasis added)<sup>10</sup> Daltorio's skepticism reflects the growing lack of confidence in DT's management and their strategy for wireless data in the US.

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<sup>8</sup> Jason Armstrong, Goldman Sachs & Co., "Quick Bytes: T-Mo US Positions For Next Stage-Cost Cuts/JVs in Focus," May 26, 2010.

<sup>9</sup> <http://247wallst.com/2010/06/15/247-wall-st-ten-brands-that-will-disappear-in-2011/3/>.

<sup>10</sup> Tony Daltorio, <http://www.investmentu.com/2010/June/clearwire-vs-harbinger-capital.html>.

It would appear that T-Mobile has not learned the painful lessons of being late to market with 3G data services. Not only do a number of recent rumors circulating through the industry imply that DT is hesitant to commit the capital and operating resources necessary to build a competitive 4G network, DT is also showing signs of an unhealthy obsession with maintaining dividends at levels that suggest acquiescence to the short-term demands of some investors, and may well not be sustainable in the long term. DT has failed to respond to demands from major investors for a change in strategy at T-Mobile, and having failed to remain competitive with either low-cost or premium wireless operators in the US, DT seems content to allow T-Mobile's business to continue to contract.