



## AT&T Wireless: Will Cingular's Big Bet Pay Off?

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Last week Cingular, the second-largest wireless telephone firm in the U.S., beat Britain's Vodafone in a battle for AT&T Wireless with a \$41 billion bid. If regulators approve, the merger will create the country's largest wireless telephone company. But will Cingular be able to build real value from the deal? Professors at Wharton and other experts give the proposed merger a thumbs-up in terms of strategy. But they also warn that it is too early to tell whether Cingular's \$41 billion, \$15 per share cash offer will prove to be a good investment - in part because the whole wireless telephony industry is in flux.



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[Gerald Faulhaber](#), a professor of public policy and former chief economist for the Federal Communications Commission, says that industry insiders have been predicting wireless industry consolidation for some time. "The reason these companies are having trouble making money is because the competition is pretty tough," he says.

Faulhaber notes that the merger accomplishes several things for Cingular. For starters, it reduces the number of players in the wireless industry from six to five. It takes out AT&T Wireless, which had been an aggressive price-cutting competitor in the past. And it vaults Cingular from third place to numero uno status as the largest cellular provider.

"This deal completes Cingular," says Jeff Kagan, an independent telecom analyst in Atlanta. If the merger goes through, the company will grow by about 22 million subscribers to 46 million customers, besting Verizon Wireless, which currently has 37 million subscribers. In addition, the merger addresses issues that each company has faced: not enough spectrum, not enough capacity, dead spots, and busy circuits. "After the merger, the new company will have twice the spectrum, twice the capacity, twice the cell towers, and that should alleviate the problems," he says.

### Is the Price Right?

Relative to certain kinds of metrics, such as numbers of subscribers and earnings, the price Cingular is paying seems like a fairly hefty bid, says [Robert Holthausen](#), a professor of accounting. But, he says, that doesn't mean it's not a smart thing to do. The economies of scale are so huge for wireless telephones that the industry probably can't support many wireless competitors over the long term, he suggests.

The bidding war between Cingular and Vodafone over AT&T Wireless reportedly concluded in a late-night, \$15 a share deal that had an unusual stipulation: The buyer had to sign within 60 seconds of seeing the contract. But is the result just what you'd expect from a good 60-second decision - maybe right in its general thrust, but a little loose in the particulars?

[Harbir Singh](#), a professor of management who has done lots of research on mergers, is unsure. He read that the final price exceeded what the CEOs of SBC and BellSouth had originally approved (Cingular is jointly owned by the two regional companies). The only new piece of information they had, he says, is that Vodafone's stock price went up on news that the company's bid had not been accepted. Singh believes that's not much to go on. "To me what matters is new information about the assets, not about the other bidders. There's been no evidence they got new data about the assets on Tuesday and if they did, that they had enough time to correctly value the new data.

"I sincerely hope that Cingular has made careful calculations and has a well-developed plan for how to extract synergies because the company has been put in a position where it has paid a lot for this acquisition. Now things will have to go really well for Cingular before it can successfully generate value," he adds.

Kagan sees two big challenges ahead for Cingular if the merger passes anti-trust muster. The first is integrating the company's service networks. The second is improving customer service, which he says has been a challenge for both SBC and BellSouth. "If they can do that, I think they'll be firing on all cylinders like Verizon is now and they'll give Verizon a run for their money." If that happens, there will be two huge national wireless companies, with Sprint "a distant third," according to Kagan.

And will this game of musical chairs continue? Kagan and Wharton professors think so. But no one is sure whether the five companies will eventually be reduced to three. Kagan believes that regulatory approval is likely for this merger, but the chances of more transactions being approved will decline if the number of players shrinks. Three may be the breaking point, Kagan says. "I think that's going to be sticky. There's a fifty-fifty chance of that happening."

Interestingly, Cingular's biggest competitor approves of the merger. Verizon Communications' CEO Ivan Seidenberg has spoken positively about the Cingular-AT&T Wireless deal. It's not a typical reaction for a company that suddenly finds itself pulled out of its number one spot, but Faulhaber explains that Seidenberg has a good reason for his enthusiasm: "The reason is that people in the industry are hoping that we'll get more consolidation, which will make it easier to obtain higher prices," Faulhaber says.

While the Cingular-AT&T Wireless merger is a straight-forward consolidation play, Faulhaber adds, the future of the wireless sector as a whole is less clear. Although he downplays the difficulty of switching technologies – once the towers are all built, he asks, who cares what frequency they're set to? – he is concerned about the relative infancy of the U.S. cellular industry in general. "The thing that stares you right in the face about wireless is how seriously behind the rest of the world we are, particularly East Asia. I don't know of any other technology where we are a full generation behind, except this one. It shouldn't be that way, but it is," he says.

Now that the wireless industry is beginning to mature, Faulhaber says it faces a huge challenge ahead: Finding new opportunities for growth. While some see data as the opportunity of the future, he's not so sure. "I've been very dubious about that strategy, but it's clear that wireless companies need something that can take them beyond where they are now."

In spite of the 17% stake that Japan's DoCoMo Wireless holds in AT&T Wireless, Faulhaber says that no one in the U.S. has yet figured out how to make data pay. Games, ring tones,

hand-held Internet browsing? Faulhaber is skeptical whether there's a great business model there. "It's not clear to me exactly where everybody goes from here," Faulhaber says. "I'm pretty sure that the business model of downloading ring tones is probably not a great long-term strategy."

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