A matter of competition

Approval of Sirius-XM deal will turn on how FCC sees radio marketplace

By Hiawatha Bray, Globe Staff | February 21, 2007

Whether federal regulators allow Sirius and XM to merge rests on how they view the radio marketplace: Does combining the nation's only two satellite radio companies create a monopoly, or does the growing presence of music on cellphones, computers, and iPods amount to competition?

That is the biggest issue the Federal Communications Commission and the Justice Department will have to wrestle as they weigh the proposed $13 billion merger of rivals Sirius Satellite Radio Inc. and XM Satellite Radio Holdings Inc.

Critics worry that a combined company will lead to higher prices and poorer service, as customers deal with a monopoly service provider. Supporters of the deal believe that competition from nonsatellite services -- from traditional free radio broadcasting to digital audio players -- would keep the merged company honest.

Carmi Levy, senior research analyst at Info-Tech Research Group in London, Ontario, Canada, believes the companies must join forces to survive. Both companies have lost billions and neither has turned a profit.

"Left on their own," said Levy, "both of these companies are likely to implode."

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One satellite radio firm, even a monopoly, is better than none, he added. "I have a funny feeling that even if the FCC frowned on this, it will have no choice," Levy said.

Craig Moffett, who tracks the industry for the investment firm Sanford C. Bernstein & Co., said XM and Sirius are actually in fine shape and on their way to profitability. Satellite radio listeners buy a receiver, plus pay a monthly fee starting at about $13.

"The perception that these companies are somehow trying to pull off a merger out of desperation . . . has somehow entered the public consciousness," said Moffett. "But it's just not borne out by the facts."

A Justice Department official could not be reached for comment yesterday. A FCC spokesman declined to comment. On Monday, FCC chairman Kevin J. Martin said the transaction faces a "high" hurdle.

Wall Street cheered the merger news. XM shares climbed 10 percent to close at $15.41 yesterday, while Sirius shares jumped 6 percent to close at $3.92, both on the Nasdaq exchange. Under the terms of the deal, Sirius would buy XM in a stock deal that would give XM shareholders 4.6 shares of Sirius for each XM share they own.

Even if the merger goes through, Levy isn't sure satellite radio has a future. He said XM and Sirius have not fared as well as cable companies in convincing people to pay for better programming.

XM began operating in 2001, Sirius in 2002, and have 14 million subscribers between them.

Meanwhile, the electronic entertainment market has been transformed. Popular digital audio players like the iPod let consumers create their own personal "radio station." Broadband Internet, now found in over half of all US homes, can deliver thousands of free audio streams. And traditional radio broadcasters are moving to HD radio, a digital service that not only improves audio quality, but also frees bandwidth so that a station can broadcast three or four audio streams over a single frequency.

Levy thinks that whether or not Sirius and XM merge, they'll need new sources of revenue. For instance, they could market their offerings to earthbound radio stations for broadcast on their new HD radio channels.

Moffett, whose investment firm has no stake in either XM or Sirius, is far more optimistic about both companies. He concedes that the rate of subscriber growth has dropped off recently, with about 30 million subscribers expected by 2010, instead of 40 million. While that's a sharp decline, Moffett said, "DirecTV's been trying for 10 years and they only have 16 million customers."

Moffett also said that large losses posted by XM and Sirius conceal the companies' underlying health. The companies immediately record the full expenses of acquiring customers, but recognize the revenue they generate month by month. Moffett said this makes the companies' income statements look weak, even as their cash flow continues to improve.

Also, the satellite broadcasters' programming costs are based on hefty long-term contracts with the major sports leagues and big-time performers like Oprah Winfrey and Howard Stern. But growing the audience spreads these fixed costs over a larger pool of subscribers.
Get the audience large enough, and satellite radio systems quickly turn the corner to profitability, he said.

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