Satellite radio competitors agree to merge

XM and Sirius face an antitrust hurdle, but the big question is whether the combined firm can survive in the iPod era.

By Joseph Menn and David Colker, Times Staff Writers
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The world’s two providers of satellite radio agreed Monday to merge in a $4.6-billion deal, vowing to end their brutal battle for customers and work together to persuade more people to pay for a medium that most use for free.

In implicitly acknowledging that the market can’t support two such services, the deal by Sirius Satellite Radio Inc. and XM Satellite Radio Holdings Inc. also posed a bigger question: Can it support even one?

More than 80 million people listen to AM or FM radio. Some 90 million people have iPods. About 65 million people listen to Internet radio. Yet only 14 million have satellite radio receivers — and have agreed to pay $13 a month to subscribe to digital feeds of music, sports and talk — despite the two rivals’ investments of billions of dollars in marketing and technology.

The bid to combine hundreds of channels carrying the likes of Howard Stern, Oprah Winfrey, the National Basketball Assn. and Major League Baseball will face major hurdles in obtaining the approval of federal regulators, who worry that joining the only two satellite radio providers would hurt competition.

But concerns about creating a monopoly may not be enough to scuttle the deal, given that neither Sirius nor XM has figured out how to overcome the economics of their industry, which has been saddled with hundreds of millions of dollars in losses each year.

"If the market is defined just as satellite radio, they would never approve the only two companies merging into one — that would be like Pepsi merging with Coke," said Howard Liberman, a Washington lawyer and former Federal Communications Commission staff attorney.

But Sirius and XM, he said, will attempt to define the industry as “music that goes into your ear,” including portable music players and AM and FM radio.

The resulting company, which has yet to be named, would be run by Sirius Chief Executive Mel Karmazin, a radio maverick and ex-CEO of Viacom Inc. who is credited with putting Stern and Don Imus on the map.

Under the pact, XM shareholders would get 4.6 shares of Sirius for each XM share they own. Based on last week’s closing price of Sirius shares, which rose 10 cents to $3.70 on Friday, each XM share would be exchanged for $17.02 in Sirius stock, or a total of $4.6 billion. That represents a premium of 22% for holders of XM shares, which rose $1, or 7.7%, on Friday to $13.98.

Shareholders of each company’s stock would end up with a roughly 50% stake in the combined operation, which has not yet been named. New York-based Sirius and Washington, D.C.-based XM would each get to fill the same number of seats on the new board of directors.

Sirius’ exclusive programming includes Martha Stewart, the NBA and Stern — the radio shock jock for whom Sirius is paying an estimated $500 million over 10 years. XM would bring deals with Major League Baseball and Winfrey, as well as distribution partnerships with General Motors Corp. and Honda Motor Co.

FCC Chairman Kevin J. Martin said Monday that he expected the deal to face a “high” hurdle with his agency. In setting rules for satellite radio service in 1997, the FCC granted only two licenses and stipulated that one of the holders would “not be permitted to acquire control of the other” — to “help assure sufficient continuing competition.*
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The companies would need to demonstrate that consumers would clearly be better off with both more choice and affordable prices,” Martin said.

The FCC could change the rule if the Justice Department finds there are no anti-competitive concerns and approves the deal, said Blair Levin, a former FCC official and now an analyst at brokerage Stifel, Nicolas & Co.

"I think it's a close call, but I do think the deal will be approved," Levin said.

Although Sirius and XM are the only satellite radio providers, the Justice Department could base an approval on other competitors in the market, including digital broadcast radio providers, wireless music services on mobile phones and portable players such as iPods, he said.

Karmazin, chosen by both boards to lead the new company, promised more channels and investments in such features as video for the back seats of cars and improved traffic updates.

Sirius and XM will continue to operate independently until the proposed merger is completed. Each service offers more than 100 channels of music, news and other programming.

Some consumer advocates said they feared a monopoly service would raise prices and cut back on programming.

"Such a merger would mean a reduction in the quantity and quality of programming available to the public," said Jeff Chester, executive director of the Center for Digital Democracy, a nonprofit media advocacy group.

The companies could try to ease fears of price hikes by promising not to increase prices for a set period of time, Levin said.

New York University sociology professor Eric Klinenberg, author of a new book about the use of public airwaves, said he hoped the FCC would require the combined company to set aside channels for public access, in the same manner that local governments impose regulations on municipal cable monopolies.

Concerns about competition in the young and limited satellite field can be strong. In 2002, the FCC and Justice Department rejected a proposed merger of the owners of the top two satellite TV providers, Hughes Electronics Corp.’s DirecTV and EchoStar Communications Corp.’s Dish Network, because of fears it would increase costs for viewers.

Analysts said they suspected Sirius and XM were trying to get the FCC to consider the deal before the 2008 presidential election, when control might swing back to the Democrats. The FCC is considering allowing more media consolidation, which Democrats on the panel and in the new congressional majority oppose.

Rep. Edward J. Markey (D-Mass.), chairman of the House subcommittee on Telecommunications and the Internet, said Monday that the radio merger "merits the utmost scrutiny" by policymakers and regulators in light of "dramatic consolidation" of traditional radio.

Traditional radio firms immediately opposed the merger.

"When the FCC authorized satellite radio, it specifically found that the public would be served best by two competitive nationwide systems," said Dennis Wharton, executive vice president of the National Assn. of Broadcasters. "Now, with their stock prices at rock bottom and their business model in disarray because of profligate spending practices, they seek a government bailout to avoid competing in the marketplace."

Analysts said the economic advantages for the companies were obvious. "There is a massive amount of synergy to be gained across the board," said David Bank of RBC Capital Markets. The companies are still at least two years away from making a profit, according to a person close to the XM board.

The deal "has the potential to add tens of millions of new subscribers, mainly because the exclusive content that each offers will be consolidated on one platform, and probably at the same price point," said William Kidd, an analyst with Wedbush Morgan Securities in Los Angeles. "The value proposition to consumers will be much more than if they remain two companies."

Yet there is no guarantee that satellite radio will survive.

"People have to ask themselves, 'Why are we paying for radio?'" said Jupiter Research analyst Barry Parr.
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Times staff writer Jim Puzzanghera contributed to this report.

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