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ATandT, Verizon To Be Challenged by Smaller Carriers in Prepaid Market: Citadel

By: Michelle Maisto

Regional, prepaid carriers such as Leap are in a position to benefit, as costly 4G handsets intersect with falling 3G smartphone prices, according to Citadel Securities.

Regional U.S. carriers with a focus on the prepaid market may not be able to compete as aggressively for customers as the nation's four largest players—Verizon, AT&T, Sprint and T-Mobile—but changes in the market are nonetheless working in their favor, according to a May 25 research report from financial services firm Citadel Securities.

Leap Wireless, which operates third-generation EvDO (Evolution Data Optimized) technology, might find itself in a "sweet spot" as 4G LTE (Long-Term Evolution) handset prices rise above the consumer-expected $200 mark and 3G smartphone prices fall, explained the report. (Case in point: after the introduction of the iPhone 4, AT&T marked down the iPhone 3GS to $49—reportedly hurting sales of newer Android smartphones such as the Motorola Atrix 4G.)

Another smaller carrier, MetroPCS, has already deployed 4G LTE technology across its entire footprint, putting it in a less-desirable position than Leap.

"We see the traditional line between the regional prepaid operators and national carriers as becoming increasingly blurred," wrote analyst Shing Yin, the lead author on the report. "We believe an industry sea change is already under way, one that will heavily favor the prepaid business model—and Leap Wireless in particular—going forward."

Also expected to benefit the prepaid operators, said the analysts, is a "trifurcation" of the market into low-end, mid-tier and high-end subscriber segments. While the big four will continue to target the high-end, Leap and MetroPCS may be poised to benefit from the lower end of the postpaid market as it shakes out.

Their "scrappiness," too, is

expected to benefit them.

"The subscriber mix moving toward the prepaid (i.e., 'no contract') tier has been shifting of late," stated the report. "More recently, the prepaid operators have made bold attempts to extend their reach by negotiating national roaming plans and have begun offering premium hardware devices (smartphones), making their service offerings more akin to—and therefore more competitive with—their larger rivals."

Their "scrappiness," however, comes as the larger carriers are beginning to focus more on the prepaid market as contract-based subscriber growth slows.

Whether the Leaps of the market truly compete with the AT&Ts of the world was a point of contention during a May 12 Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights hearing regarding AT&T's proposed $39 billion purchase of T-Mobile. One witness, Gigi Sohn, president and co-founder of Public Knowledge, a public interest group focused on citizens' rights in an increasingly digital culture, rhetorically asked whether anyone had ever seen AT&T advertise against MetroPCS or Cricket—her point being that the smaller carriers aren't its real competition. By contrast, the 2009 ad battle between AT&T and Verizon drove AT&T to ask a judge to prevent Verizon from airing its Island of Misfit Toys ads. (The judge declined.)

"Saying that a behemoth like AT&T competes against [Cellular South], U.S. Cellular or Cricket is like saying that Walmart competes against the mom-and-pop stores," Sohn added.

Over the next five years, Citadel Securities expects prepaid subscriber growth to increase by an average of 11 percent a year, while postpaid growth flattens.

"By 2015," the report added, "we expect that total U.S. industry connections will be ~365MM, with almost 40 percent of those connections categorized as prepaid."

Also working in the regional carriers' favor, said the report, is the current economic climate, in which financially pinched consumers may turn to prepaid plans.

"We believe the regional prepaid providers offer consumers a certain value proposition that the national carriers have thus far been unable to match," the firm added. " As the entire wireless industry moves toward the rapid adoption of smartphones, we believe the prepaid specialists are poised to gain an ever greater portion of the economic pie from their current subscriber bases (who have likely stood by with envy for years watching their postpaid counterparts enjoy the best devices)."