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Sprint PCS (NYSE: PCS) — Buy

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MARKET DATA

Price:	$16.39
52 wk range:	$15.72-$33.25
Price Target:	$24.03
Shares Out:	985.7 million
Market Cap:	$16.8 billion
Proj. LT Growth (after 2010):	3%
Dividend Yield:	none
Beta:	2.54
Revenue 2000:	$6,341 MM
Operating Income (loss) 2000:	($1,904 MM)

COMPANY OVERVIEW

The Sprint PCS Group is a Sprint Corporation unit with its own tracking stock. Sprint PCS provides nationwide service through operating its own digital network in major United States metropolitan areas; affiliating with other companies, mainly in and around smaller United States metropolitan areas; roaming on other providers' analog cellular networks using dual-band / dual-mode handsets; and roaming on other providers' digital PCS networks that use the same technology that Sprint uses: code division multiple access (CDMA).

Sprint PCS provides wholesale PCS services to independent regional affiliates such as Airgate PCS and Alamosa PCS that extend the reach of the Sprint PCS brand and add to the group's subscriber count. The Sprint PCS Wireless Web service offers wireless Internet access and content through partners such as AOL Time Warner, EarthLink, and eBay.

Sprint is the fourth largest Wireless Carrier in terms of number of subscribers, with Verizon, Cingular and AT&T leading the way. Sprint PCS is adding new customers at a faster rate than any of its competitors.

CONCLUSIONS

INVESTMENT CONCLUSION

- Recommending buying 200 shares of Sprint PCS to match S&P weighting. DCF Valuation leads to a value of $24.03 per share outstanding. Current price is %16.39 per share. Recommending a stop price of $12.00 and a target price of $24.03 per share.

SUMMARY

- The company currently has the highest quarterly net additions of subscribers, and a solid brand name recognition and marketing strategy.
- Operating Income was still negative for 2000, is expected to increase to positive figures in 2001 or 2002.
- Costs of switching to third generation infrastructure is lower for Sprint than for some of its competitors due to its current operation infrastructure.
- Expectations were high for the fourth quarter of 2001, but reports indicate that earnings and new subscriptions will fall short of expectations.

Industry Insight

The Wireless market is entering a period of widespread consumer acceptance. The total U.S. customer base for wireless carriers grew by 27% to 101.2 million in the year 2000, which brings the total U.S. wireless penetration to 39% of the population. The growth of the industry is expected to continue in the short term, and slowly decrease as wireless phone penetration approaches saturation levels—which can be estimated to be approximately 70% of the total population.

The wireless services business is already approaching the point of being a mature industry. The industry is restructuring through consolidation and alliances to expand service territory, increase brand awareness, and share the cost of technology upgrades. National flat-rate pricing plans are being offered by six carriers, and the service is becoming more of a commodity. Marketing programs like branding campaigns and more focused consumer marketing are being implemented to increase the number of subscribers.

Investors are evaluating wireless carriers much more carefully. The wireless business has been growing at a furious rate in the past few years, so negative income has been the norm as companies are incurring the costs of expansion. As the market matures, positive cash flows and income will be expected by investors. Because of this, the S&P index for cellular/wireless companies decreased by 52.5% in 2000, and dropped another 24.7% through September 28, 2001 (the S&P 500 dropped 10.1% and 21.2% in the same periods).

After the September 11 events, the wireless industry performed well as America saw the usefulness of cell phones. Investors were expecting continued increases in subscribers during the fourth quarter of 2001, as the fourth quarter is usually a time of higher subscription additions due to the holidays. However, the wireless industry has indicated that subscription increases will fall short of expectations for the fourth quarter. In the past couple of weeks, the wireless industry has taken a hit from investors who invested amid the optimist of the industry.

Technology

The increase in technology should improve the profitability of wireless companies. The U.S. wireless industry is in the process of moving it infrastructure to third generation (3G) wireless technology. The 3G technology uses spectrum capacity much more efficiently, dramatically reducing variable unit costs. There will be significant costs to switch to the 3G infrastructure, however. The 3G technology will have 2 standards: WCDMA and CDMA2000. These standards are incompatible with each other. WCDMA is more globally accepted and it offers greater traffic efficiency, but requires a wider spectrum path. CDMA2000 is a strong option for existing CDMA carriers. The cost of switching from CDMA to CDMA2000 is expected to be much smaller that the switching costs of companies moving to WCDMA, and the switch occur much more quickly. Many companies are moving to an intermediate technology to decrease the present cost of the switch to 3G.

The introduction of advanced wireless applications will lead to increased revenues for carriers. The cost of offering consumers different options should decrease as the industry matures. Digital technology is dominating Analog technology in the wireless market. Digital technology offers numerous advantages. Digital signals have greater clarity, and is less likely to fade, have static, or have noise interference. Digital service enables many users to use channels at the same time, which leads to increase capacity.

Investment Highlights

Company Strategy & Segment Information

Sprint PCS is the fourth largest U.S. wireless provider, with 11.2% of the market. It has the highest quarterly net additions with 20.3% of new subscribers. Its churn percentage (the amount of its customers that it loses, either because the consumer discontinuous service on purpose or because the consumer doesn't keep up with payments) is the lowest of its major competitors.

Sprint PCS uses an all digital network, and uses CDMA technology. As the third generation of infrastructure come into effect, Sprint will migrate to the CDMA2000 technology. This gives it a great advantage over those carriers who are positioned to switch to the WCDMA technology, as the CDMA2000 platform will be far less expensive to transfer to.

Sprint PCS has excellent brand recognition among consumers, and markets itself very successfully in television commercials, radio commercials, and print advertisements. This has led to its leading position in quarterly net additions. Sprint has recently initiated a Clear Pay plan to take advantage of customers who are averse to long term contracts.

Investment Risks

Sprint PCS has a very high beta (2.54), which is expected for a technology stock. This has resulted in a large decrease in stock price coinciding with the downturn in the economy. As we expect the economy to increase in the coming year, we should expect Sprint PCS to increase as well.

Sprint PCS is still a rapidly growing company, and as such has high expansion costs. To date, Sprint PCS still has a negative operating income. Investors are beginning to be much more critical of companies that promise large profits in future years. The wireless industry is starting to be viewed as a more mature industry, and profitability is starting to be expected.

Sprint PCS has reported that it estimates that it will fall short of expectations for the fourth quarter of 2001, for earnings and for new subscriptions. In the short term, pressure is on the wireless companies to show continued high growth in subscriptions and positive profitability.

FINANCIAL SUMMARY

Condensed Combined Statements of Operations

(millions, except per share data)	2000	1999	1998
Net operating revenues	6341	3373	1294
Operating expenses	8269	6610	3864
Operating loss	(1928)	(3237)	(2570)
Interest expense	(933)	(698)	(491)
Other partners' loss in Sprint PCS	0	0	1251
Minority interest and other, net	(11)	66	179
Loss before income taxes and extraordinary items	(2872)	(3869)	(1631)
Income tax benefit	1004	1388	541
Loss before extraordinary items	(1868)	(2481)	(1090)
Extraordinary items, net	(3)	(21)	(31)
Net loss	(1871)	(2502)	(1121)
Diluted loss per common share before extraordinary items	(1.95)	(2.71)	(2.21)

Condensed Combined Balance Sheets

(millions)	2000	1999
Current Assets	1850	1315
Property, plant and equipment, net	9522	7996
Goodwill and other intangibles, net	7734	8188
Other	657	425
Total Assets	19763	17924
Current liabilities	3392	2578
Long-term debt and capital lease obligations	14136	11304
Other	343	722
Group equity	1892	3320
Total Liabilities and Group Equity	19763	17924

Condensed Combined Statements of Cash Flows

(millions)	2000	1999	1998
Net loss	(1871)	(2502)	(1121)
Adjustments to reconcile net loss to net cash used by operating activities	1863	810	962
Net cash used by operating activities	(8)	(1692)	(159)
Net cash used by investing activities	(3054)	(2509)	(861)
Net cash provided by financing activities	3163	4044	1193
Increase (Decrease) in Cash and Equivalents	101	(157)	173
Cash and Equivalents at Beginning of Year	16	173	0
Cash and Equivalents at End of Year	117	16	173

Sprint PCS	Market	Price
	High	Low
2000		
4th quarter	39.19	19.38
3rd quarter	65.88	27.81
2nd quarter	66	44.06
1st quarter	66.94	42.56
1999		
4th quarter	57.22	33.41
3rd quarter	39.13	26.47
2nd quarter	30.38	20.75
1st quarter	24.16	10.44
1998		
4th quarter	11.69	7.03

Growth Rates		Period	
	2001 - 2005	2005 - 2010	2011 terminal
Revenues	20%	15%	3%
Operating Income (% of Rev)	estimated individually	15%	18%
Interest Expense (% increase)	10%	5%	3%
Depreciation (% of Rev)	30%	25%	20%
Capex (% of Rev)	30%	25%	20%
Discount Rate	10%		
Income Tax Rate	40%		

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