Taking Stock: Even after merger, satellite radio won't be sound

by Malcolm Berko

Dear Mr. Berko: Now that Sirius Radio and XM Satellite Radio are going to merge, my broker wants me to buy 3,000 shares of XM Satellite radio at $17.10. He believes the merger will create a very large and extremely profitable company. He says the combined listeners of 13 million, the combined advertising the combined resources (plant and equipment) and the combined management will make this company billions of dollars over the next two to three years. I think he may be a little too enthusiastic but he makes logical sense. Please tell me what you think. I'd like to give him an answer before he leaves for his annual scuba diving vacation in the Bahamas. So please hurry because I don't want to miss a buying opportunity and lose out on making a big score.

G.L.

Destin, Fla.

Dear G.L.: Please be mindful that losing an opportunity is sometimes a much less regrettable alternative than losing money. XM Satellite Radio Holdings (XMSR-$14.32), with 7.4 million subscribers, and Sirius Satellite Radio Inc. (SIRI-$3.77), with 6 million subscribers, have the urge to merge. When they do, it will be a merger of the deaf and dumb leading the deaf and dumb.

These two companies have accumulated combined losses exceeding $9 billion in the past eight years. Gary Parsons, who is chief executive officer of XMSR, will become CEO of the combined company while Mel Karmazin will become chairman. Unfortunately, neither has proven a capable manager and I think that both of these boys may be a few roses short of a Valentine.

One would think that XMSR with annual revenues of $1.3 billion and SIRI with annual revenues of $950 million ought to be profitable. But Parsons and Karmazin continued to watch their costs of goods and services exceed revenues for nearly a decade and continue to spend money like they were the Pentagon. A merger between these two companies makes as much sense as washing your feet with your socks on. Sirius and XM Radio are losing money at the speed of sound and together they'll probably lose money at twice the speed of sound.

The combined company will have more than 300 channels, many of which have bodaciously ridiculous content and some of which probably have about 37 listeners. Meanwhile about a few dozen stations (out of a total of 300) carry advertising. And that advertising is a real hoot; a sotto voice chick named Wendy advertises her hypnosis tapes that will make you lose weight, stop you from drinking, improve your social life and eliminate your smoking behavior. Another excited advertiser tells you how to make millions by raising chickens in your basement, another tells you how become a millionaire (no experience required) purchasing real estate and another fired-up advertiser wants to show you how to convert all your debts into equity. Sirius and XM seem unable to attract legitimate or righteous advertisers. And some suggest that the reason that they can't is that the accounting they use to measure their subscribers may not agree with the accounting demanded by legitimate advertisers.

The combined losses of these two companies in 2006 scratch just below $2 billion. And while the merger should wring some evident cost savings via personal layoffs and a reduction in fixed organizational costs, it should be noted that Karmazin and Parsons will retain their respective positions with very juicy perks and sweet benefits. Hey, that's the corporate way! I know that many suits on the Street think "this merger is a natural." I think it's a natural too - a natural disaster because it doesn't fix what needs fixing, which is the competition. According to the Bridge Ratings (a radio audience tracker) about 58 million Americans listen to Web radio each week compared to XM's and Sirius combined 13 million satellite listeners. Broadcasters are now offering HD (high definition) radio requiring the consumer to purchase a special receiver that compresses infinitely more programming into the same frequencies, but the service is free. And free is better than paying $12.95 a month, which is certain to increase sometime after the merger ink is dry. Meanwhile there are about 250 million folks who listen to regular radio every week and WiMAX will soon have the capability to broadcast Web radio to your Chevy or Toyota while you barrel down the autobahn at 70 mph.

Keep your powder dry because a $50,000 XMSR investment doesn't make sound cents. Sirius and XM Radio is a merger of two failures, each of which has poor management, lousy marketing, bad balance sheets, terrible income statements and satellites (which have an orbit life of 10 to 12 years) that may need replacing soon. And while the two CEOs enthusiastically endorse this merger, not one of them has told investors how they plan to turn two failures into one success. You might want to suggest that your broker plan his next scuba diving trip in the La Brea Tar Pits.

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