

September 27, 2007

Telecom Services

Cutting the Cord: Wireless Substitution Is Accelerating

Wireless substitution could reach almost one-third of households by 2012, up from 13% now. The rural wireline carriers and Qwest are most exposed given their lack of wireless assets, while AT&T and Verizon are hedged. The tower companies, Leap, and Metro PCS are among those best positioned to benefit from substitution.

New analysis dimensions demographics and geographies of the change: In this report we analyze the growing phenomenon of US households going wireless only. At the end of 2006, an estimated 13% of US households had cut the cord, according to the National Health Interview Survey. We forecast that another 21 million households will go wireless only over the next five years, reaching 32% of households. We find that this trend is prevalent and accelerating across most demographic profiles, but is most pronounced among the young and lower income groups. More than 50% of households containing unrelated adults have cut the cord, according to recent data. We believe this phenomenon is driven by improved wireless coverage and better pricing and will be supported by new handsets and new wireless technologies, such as Unlimited Mobile Access (UMA) and femtocells. These technologies allow for voice transmission over Wi-Fi connections.

Steep access line decline underway: Our base case forecast implies that access lines in service will fall by an average of 3.5 million lines per year over the next five years as a result of wireless substitution alone. This will likely combine with cable competition to keep industry line loss in excess of 5% per year. Even where the access line remains, more and more traffic will run on wireless networks, reducing switched access revenues.

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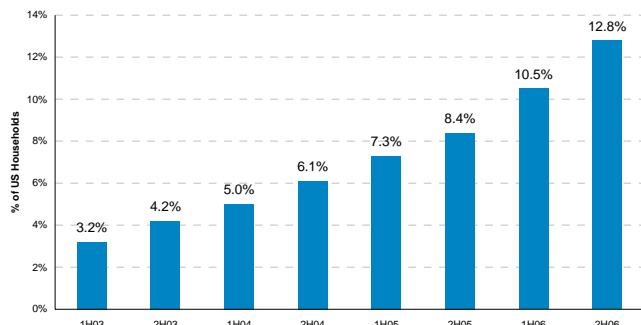
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Investment Case

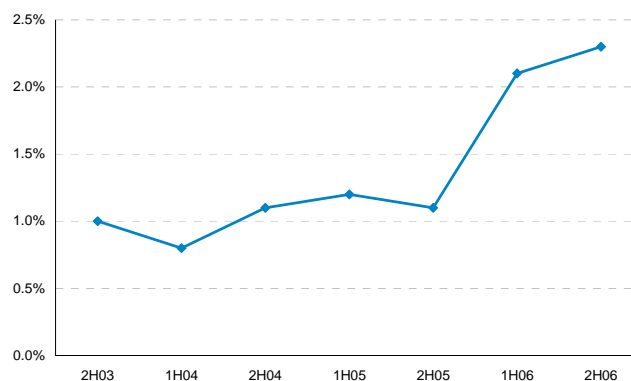
How Many Have Cut the Cord?

1 in 8 Households Have Cut the Cord



Source: CTIA's Wireless Industry Indices, Morgan Stanley Research

Substitution Picking Up Steam Incrementally



Source: CTIA's Wireless Industry Indices, Morgan Stanley Research

Key Findings:

- New technology and economic considerations continue to lead to increased wireless substitution.
- Almost one-third of households will have cut the cord by 2012.
- All of the parts of the following categories are cutting the cord more:
 - Household Structure: Unrelated adults without children lead this category with 54% penetration.
 - Household Ownership: Those who rent have cut the cord more than those who own their homes.
 - Age: 18-29 year olds rely solely on their wireless devices more than any other age group.
 - Job Status: Students in college are more likely to live in wireless-only households than any other profession.
- Location: Substitution is more prevalent among urban residents than of rural ones.
- Ethnic Group: Hispanics and African-Americans are more likely to live in wireless only households.
- Poverty Status: Cutting the cord has increased dramatically amongst those considered poor.

Exhibit 1

Pure Wireless Play Is Most Positively Impacted

	<u>Positive</u>	<u>Negative</u>	<u>Mixed</u>
Primary	LEAP PCS	Q EQ	Bells T VZ
Secondary	S USM Towers	RLECs	CBB Telus

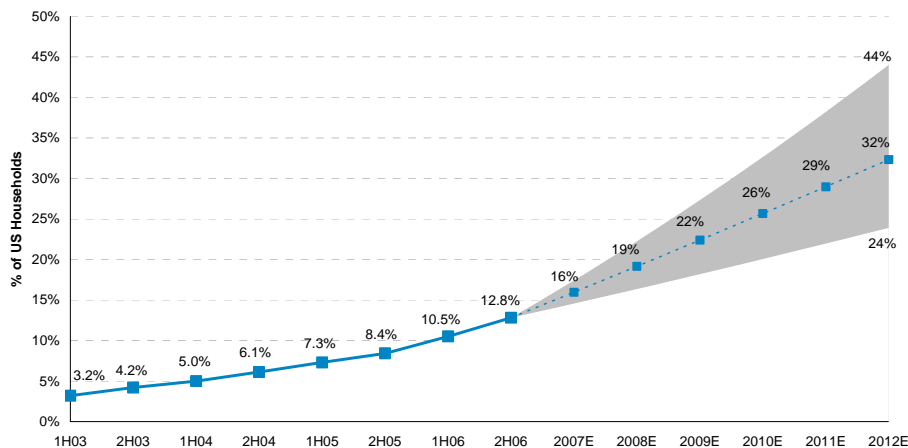
Source: Morgan Stanley Research

Forecast/Scenario Analysis

Where Are We Headed?

Exhibit 2

Nearly One-Third of Homes Become Wireless-Only in Base Case



Key Assumptions

- The US HH structure will remain relatively constant over the next five years.
- Wireless substitution will increase as a function of household structure proportions (see Exhibit 12)
- Substitution data from other countries has shown the extent to which this trend can penetrate.

Source: CDC - Wireless Substitution: National Health Interview Survey, July – December 2006, Morgan Stanley Research

Exhibit 3

Scenario Summaries

Bull Case	Wireless substitution is widespread Wireless-Only HH reach 44% by 2012 based on an almost fully penetrated unrelated adults segment.
Base Case	Wireless substitution continues modestly Wireless-Only HH reach 32% by 2012 based on significant growth in substitution from adults living alone.
Bear Case	Wireless substitution picks up slowly Wireless-Only HH reach 24% by 2012 based on lagging uptake across all sectors.

Exhibit 4

Wireless-Only Household Projection for 2012

	2006 Wireless-Only HH	2012		
		BEAR	BASE	BULL
unrelated adults, no children	54.0%	70%	80%	90%
adult living alone	18.2%	30%	40%	50%
adult(s) with children	10.5%	20%	25%	35%
related adults, no children	8.5%	15%	25%	40%
% of Total US HH				
unrelated adults, no children	2.8%	4.1%	4.7%	5.3%
adult living alone	4.4%	8.2%	10.9%	13.7%
adult(s) with children	2.9%	6.3%	7.8%	11.0%
related adults, no children	2.7%	5.3%	8.9%	14.2%
Total Wireless-Only HH	12.8%	23.9%	32.3%	44.1%
implied avg. line loss (million/yr)		2.0	3.5	5.7

Source: Morgan Stanley Research

Exhibit 5

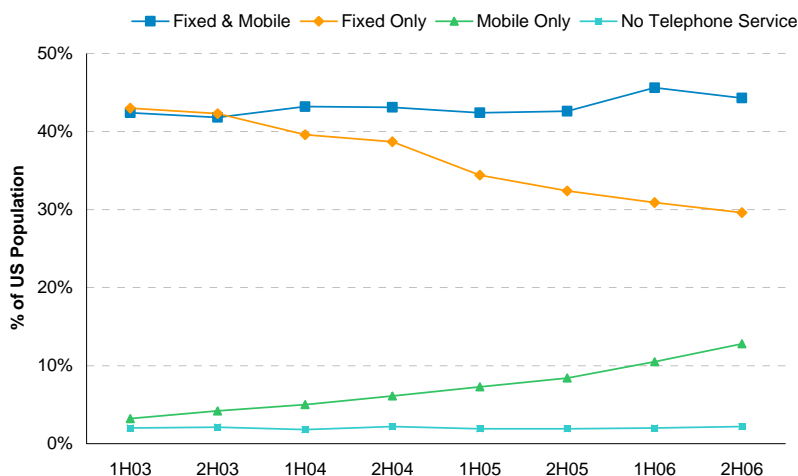
Rewards Outweigh the Risks

<h1>Why?</h1>	New Technologies <ul style="list-style-type: none"> • T-Mobile HotSpot@Home [UMA] • Sprint Airave [femtocell] 	Convenience <ul style="list-style-type: none"> • Using one phone for all calls • All-In-One Products: contacts, calendar, music, internet access, etc.
	Product Driven Consumers <ul style="list-style-type: none"> • Apple iPhone • RIM Pearl • RIM Curve 	Costs <ul style="list-style-type: none"> • More attractive pricing per minute for mobile solutions vs. fixed alternatives • Broadband and wireless bundles (no landline required)
<h1>Why Not?</h1>	Signal Quality <ul style="list-style-type: none"> • Dead spots in rural areas • Dropped calls 	Reliability <ul style="list-style-type: none"> • Emergency Services – Difficult to pinpoint location • Home alarm systems often require landlines • Battery life of wireless phones

Source: Morgan Stanley Research

Exhibit 6

Close to 15 Million Wireless-Only Homes, Up 22% from 1H06

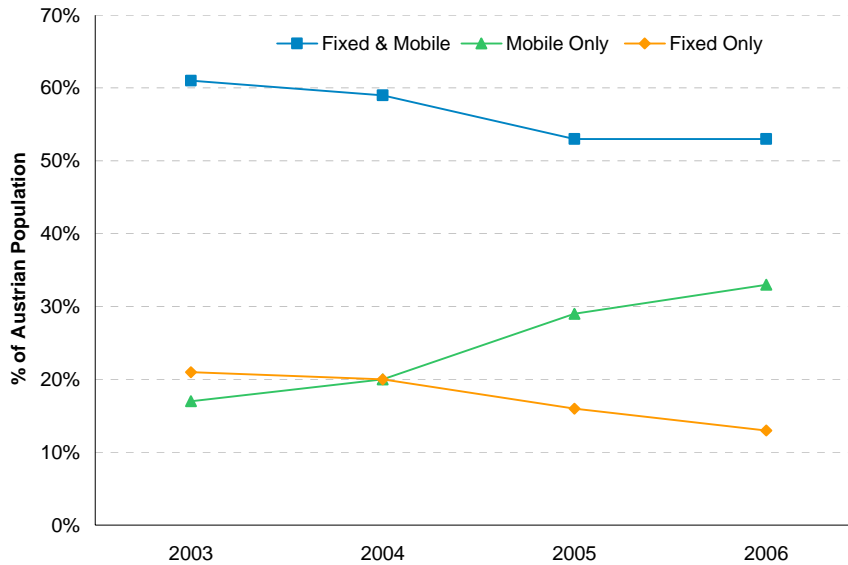


- The move towards wireless-only homes stems from a migration away from a fixed-only household.
- There is still more room for US wireless substitution to mature as line loss continues to slow.
- Although the number of wireless-only households are increasing, the number of households without any telephone service remains relatively stable around 2%

Source: CDC - Wireless Substitution: National Health Interview Survey, July – December 2006, Morgan Stanley Research
Note: Landline and non-landline households with unknown wireless telephone status are not included (-11% of HH in 2006).

Exhibit 7

Austrian Wireless-Only HH at 30% and Still Growing

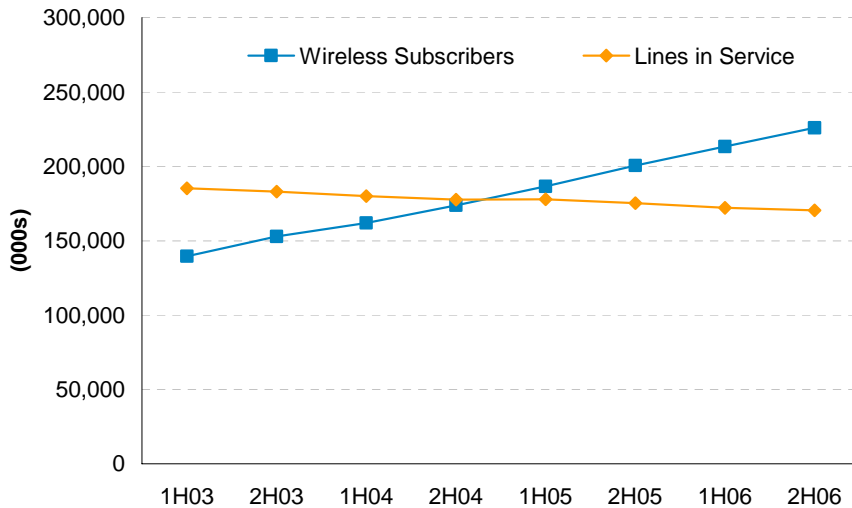


Source: Morgan Stanley Research

- Austria, where wireless substitution is near the highest levels in Europe, has 33% of homes that are wireless-only.
- The presence of four 3G competitors for a population of 8 million people has been a catalyst to the wireless-only migration.
- Mobile broadband has been discounted to 20 euros, while fixed broadband costs around 35 euros for similar effective speeds.

Exhibit 8

US Wireless Subs Grow as Lines in Service Falls



Source: CTIA Wireless Industry Indices Year-End 2006 Morgan Stanley Research
Leap Wireless International, Inc -Bank of America 2007 Annual Investment Conference

- Another indication of the growing trend of wireless substitution is evident in the growth of the number of wireless subscribers relative to the number of lines in service.
- A significant consequence of increasing subscriber growth is shown by LEAP, which notes that over 60% of their customer base uses its phones as their only phone.

Exhibit 9

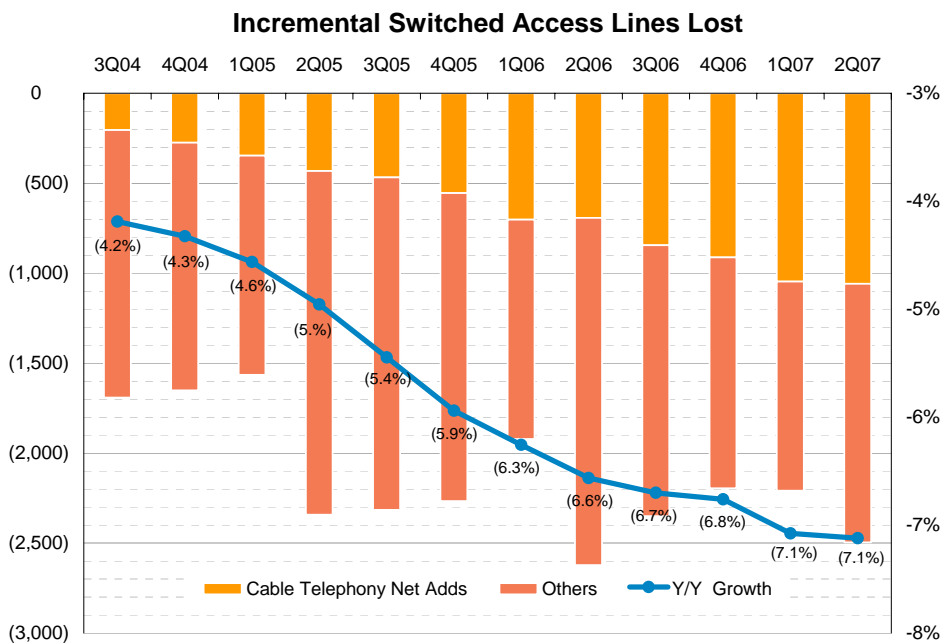
Increasing Wireless Footprint –90 Million Covered POPs Today; 180 Million Covered POPs by 2009

New Markets for Leap and Metro PCS		
2007	2008/2009	
Los Angeles	New York	Chicago
Raleigh / Durham	Boston	Washington, D.C. / Baltimore
Rochester	Philadelphia	Las Vegas
Charleston		

Source: Company data, Morgan Stanley Research

Exhibit 10

Majority of Lines Loss Coming from Households Cutting the Cord on their Main Line

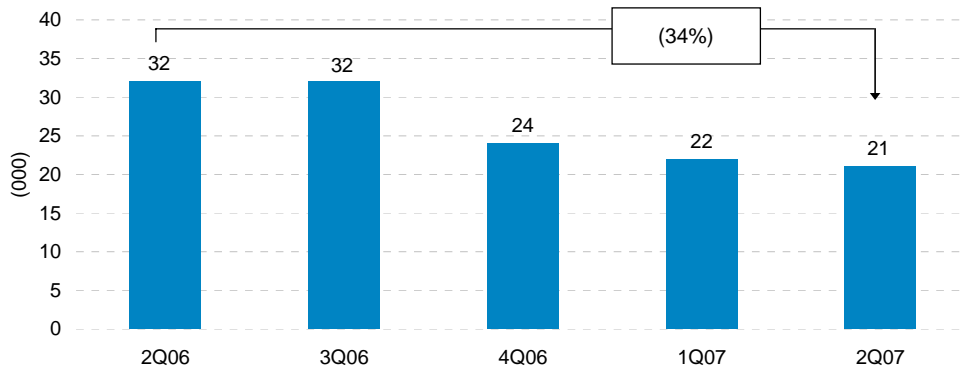


- Line loss is at 7.1% Y/Y, and has increased sequentially after showing signs of improvement in the last year.
- Primary residential line loss accounted for 42.3% of the 9.2 million lines lost in the past year.

Source: Company Data and Morgan Stanley Research, Note: Data shown for VZ, T, and Q

Exhibit 11

CBB: Declining Gross Adds Driving Line Loss



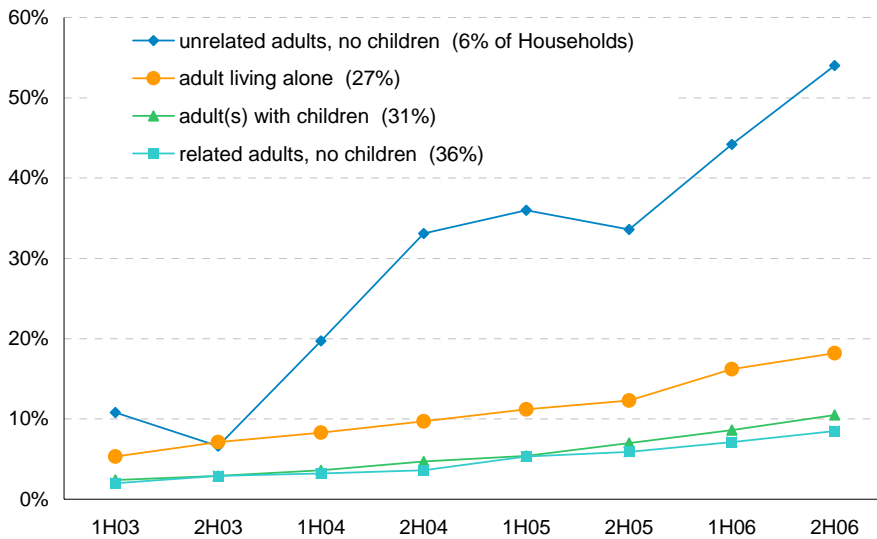
- Cincinnati Bell, among other carriers, cites declining gross adds as a greater threat to line loss than disconnections
- In light of this trend, Cincinnati Bell's efforts are focused on new wireless strategies in wireless like CBB Home Run, which uses UMA technology.

Source: Company Data, Morgan Stanley Research

Who Is Cutting the Cord?

Exhibit 12

Roommates Lead the Way

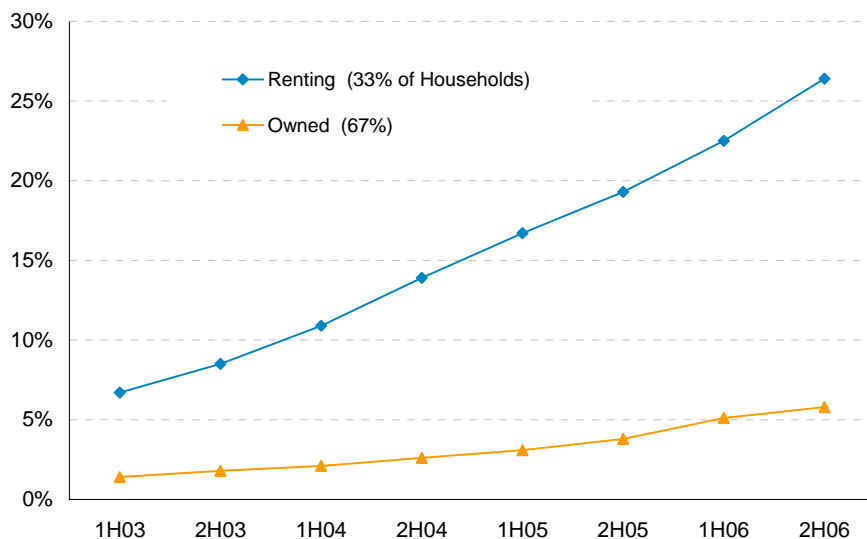


- Unrelated adults far surpass any other household structure of wireless-only households.
- We feel that this correlates with the high percentage of under-30 adults that also live in wireless-only HH (see Exhibit 14)

Source: CDC - Wireless Substitution: National Health Interview Survey, July - December 2006, American Community Survey 2003-2006; US Census Bureau, Morgan Stanley Research

Exhibit 13

Renters Are Five Times More Likely to Cut the Cord than Owners

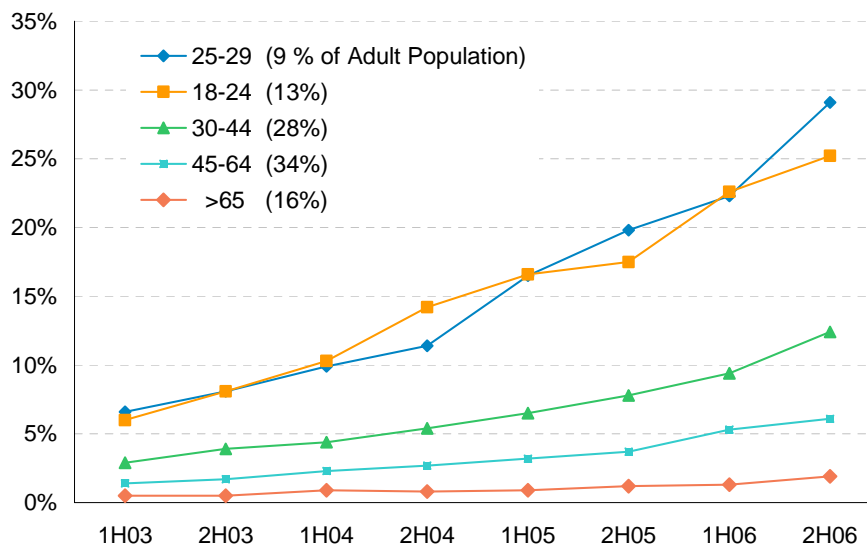


- More and more renters have opted for wireless substitution; 26.4% of renters live in wireless-only households.
- Owning one's home has led to less substitution, although the number of owners in wireless-only homes has increased.

Source: CDC - Wireless Substitution: National Health Interview Survey, July – December 2006, American Community Survey 2003-2006); US Census Bureau, Morgan Stanley Research

Exhibit 14

Wireless Substitution Is Trendy Among Young Adults

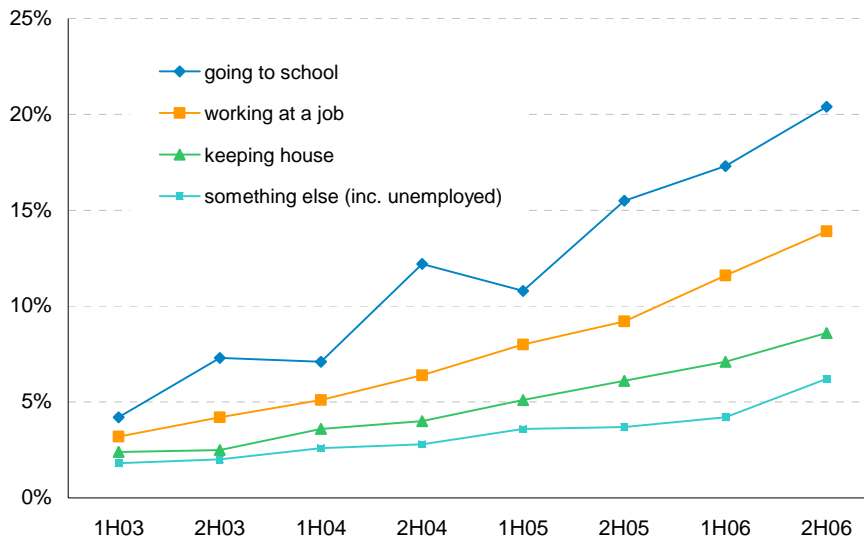


- Wireless substitution is apparent and growing in all age ranges, but adults under 30 have noticeably more wireless-only HH than the rest of the population
- This bodes well for LEAP, which has 52% of its customers under the age of 35.

Source: CDC - Wireless Substitution: National Health Interview Survey, July – December 2006, American Community Survey 2003-2006); US Census Bureau, Morgan Stanley Research

Exhibit 15

Increased Substitution in All Professions

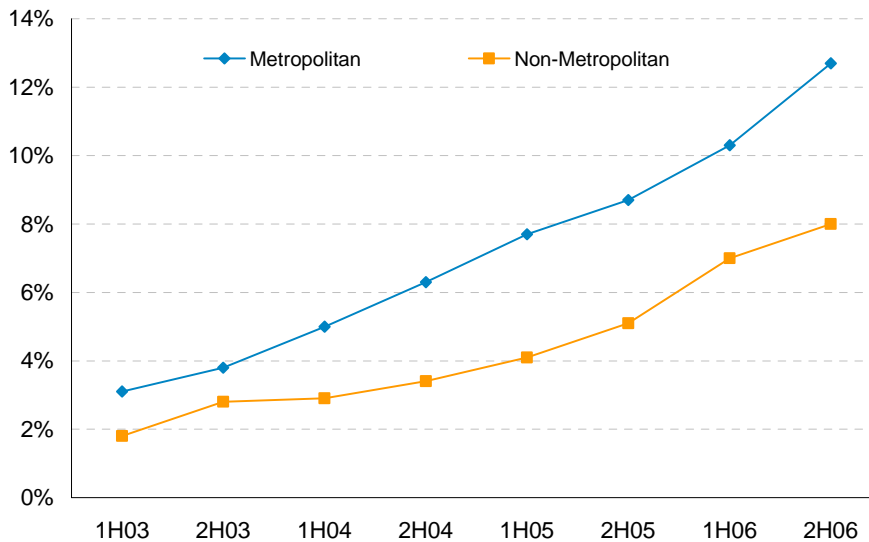


- A growing trend in wireless-only households is evident in the collegiate population.

Source: CDC - Wireless Substitution: National Health Interview Survey, July – December 2006, Morgan Stanley Research

Exhibit 16

Rural Wireless-Only HH Growing Steadily but Still Lags Behind

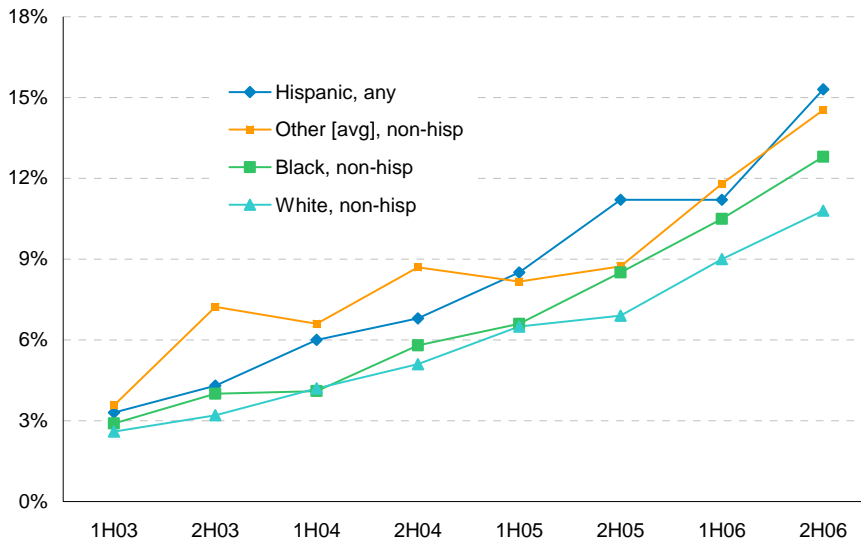


- Of those that live in metropolitan areas, 12.7% rely on wireless-only at home.
- We also note that metropolitan areas are typically three years ahead of rural markets.

Source: CDC - Wireless Substitution: National Health Interview Survey, July – December 2006, Morgan Stanley Research

Exhibit 17

Limited Dispersion between Ethnic Groups

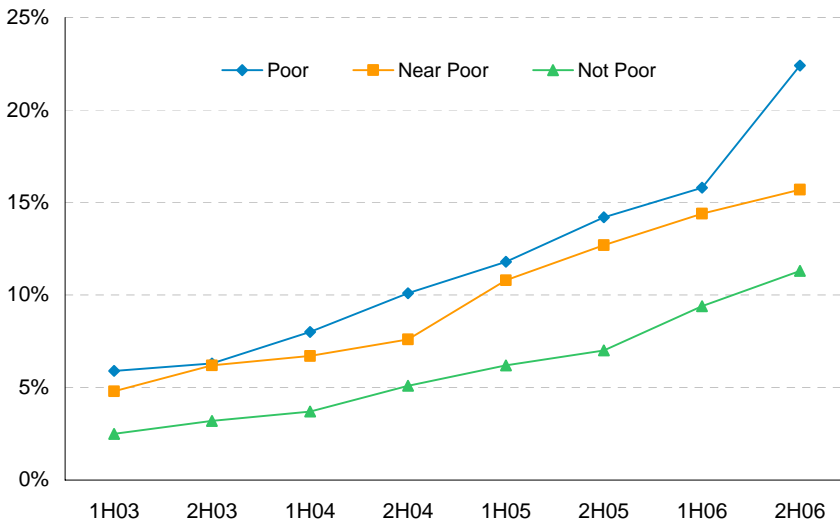


- While Hispanics lead the race in wireless-only households, all races are increasing substitution.

Source: CDC - Wireless Substitution: National Health Interview Survey, July – December 2006, Morgan Stanley Research
 Poor = below the poverty line established by the US Census Bureau, Near Poor = 100% - 200% above the poverty line; Not Poor: greater than 200% of the poverty line


Exhibit 18

Wireless-Only HH Picks Up Steam Regardless of Poverty Status



- Wireless-only households are a growing trend among lower income households.
- This is a positive note for both PCS and LEAP. Leap, in particular, has 79% of its customer base from consumers that earn less than \$50,000/yr.

Source: CDC - Wireless Substitution: National Health Interview Survey, July – December 2006, Morgan Stanley Research
 Poor = below the poverty line established by the US Census Bureau, Near Poor = 100% - 200% above the poverty line; Not Poor: greater than 200% of the poverty line
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Industry Coverage: Telecom Services

Company (Ticker)	Rating (as of)	Price (09/26/2007)
Vance Edelson		
AMDOCS (DOX.N)	E (12/18/2006)	\$35.98
American Tower Corp. (AMT.N)	O-V (09/17/2007)	\$42.93
Crown Castle Corp. (CCI.N)	O-V (06/18/2007)	\$39.46
Level 3 Communications, Inc. (LVL.T.O)	E-V (06/29/2006)	\$4.71
PAETEC Holding Corp. (PAET.O)	O (05/24/2007)	\$12.86
SAVVIS Inc. (SVVS.O)	O (01/30/2007)	\$37.5
SBA Communications (SBAC.O)	O (10/05/2005)	\$35.27
TELUS Corp. (TU.N)	E (09/08/2006)	\$55.85
Time Warner Telecom Inc. (TWTC.O)	O (03/27/2006)	\$22.47
Simon Flannery		
AT&T, Inc. (T.N)	O (03/08/2006)	\$42.83
Alltel Corporation (AT.N)	E (03/08/2006)	\$69.8
BCE Inc. (BCE.N)	++	\$39.96
CenturyTel (CTL.N)	E (08/01/2006)	\$46.05
Cincinnati Bell Inc. (CBB.N)	E-V (11/03/2006)	\$5.09
Citizens Communications (CZN.N)	E (05/07/2007)	\$14.32
Clearwire Corporation (CLWR.O)	E-V (07/27/2007)	\$24.5
Embarq Corporation (EQ.N)	E (02/09/2007)	\$59.77
FairPoint Communications (FRP.N)	++	\$19.17
Iowa Telecom (IWA.N)	U (04/17/2006)	\$19.95
Leap Wireless (LEAP.O)	O-V (04/28/2006)	\$79.78
MetroPCS Communications (PCS.N)	E-V (05/29/2007)	\$26.99
Qwest Communications Int'l (Q.N)	E (08/02/2007)	\$9.3
Rogers Communications, Inc. (RCIb.TO)	O (04/27/2005)	C\$45.5
Sprint Nextel Corporation (S.N)	U (02/24/2004)	\$18.7
Telephone & Data Systems (TDS.A)	E (09/21/2007)	\$68.2
US Cellular Corporation (USM.A)	E-V (08/13/2003)	\$97.96
Verizon Communications (VZ.N)	E (01/19/2005)	\$44.48
Windstream Corp. (WIN.N)	O (04/17/2006)	\$14.22

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