

Premium SMS in the United States

Gerbsman Partners 2003

About this report

Gerbsman Partners decided late in 2002 to expand its international business model to focus on and to develop "Domain Expertise" in the worldwide Wireless and Technology market. Early research made clear to us that three areas of significant interest stood out among the wireless offerings out there – Premium SMS, WiFi and Wireless Entertainment. As a part our commitment, we have spent the first half of 2003 visiting market leaders in each of these segments in the US, Europe and Israel. These interviews, conversations and findings serve as the foundation for this White Paper. Gerbsman Partners is committed to continuing its efforts in wireless and is offering assistance to understand, navigate and execute business related to these three themes.

Executive Summary

Messaging has been a viable business case for years and looking at European and Asian markets, which is no surprise. What's new is that the US market is finally coming to life and has shown its potential, generating small but visible revenues.

- Early successes such as "American Idol" and "Nashville Star" have generated millions of messages. Although not functioning with Premium SMS ability, Carriers enjoy this new revenue and feel there is enough evidence to continue supporting the service in the future.
- Carriers are now preparing to launch Premium SMS - the ability to add "Premium" charges on top of basic messaging charges, involving specific service requests. Predicted rates will be anywhere from 25 cents and up. Logically there is a "ceiling" of how much carriers can charge for these services through the phone bill, but expectations are that prices below the 5-10 dollar range will be accepted with more valuable transactions making use of "e-wallet" type applications to clear purchase through credit or debit accounts.
- As the US market continues to grow, new applications start to enter this market. Examples like "American Idol" and its SMS voting offering, as well as opt-in lists, has taught the pioneers in this market - and they are using it. Looking ahead, options for the market may include stagnation and a lack of development, or development into a prosperous revenue channel previously unexplored.

Our intention with this white paper is to provide insight into the current market and to identify possible front-running companies. We also would like to provide a sense of the timing issues surrounding Premium SMS. This white paper will help navigate the terms and tendencies.

US market overview - SMS in United States

Basic data

- *Penetration*
138.9 million wireless subscribers (all devices) in the U.S. as of 2001; will be 209 million by 2005 (IDC, 2001).
- *SMS (Text Messaging) Today and Tomorrow*
65 million SMS subscribers in 2001; will be 142 million by 2005 (IDC, 2001)
6.4 billion text messages will be sent out this year (Merrill Lynch/Mobile Lifestreams, 2001).
- *Wireless Internet Today and Tomorrow*
Wireless Internet subscribers will climb to 84 million by 2005 (IDC, 2001).

Wireless Week, one of the leading wireless publications in the US market, recently reported that Sprint PCS had announced sales of more than 10 million ring tones and screen savers the last 11 months. Verizon Wireless claims they sell about 2 million BREW applications a month (Service provided by Qualcomm for CDMA customers including games, ringtones and screen savers.) Mobliss, the company responsible for the technical solution behind the "American Idol" SMS voting campaign, received over 2 million messages for this season's competition. Similar optimism comes from the traditional industry analysts; The Gartner Group, IDC and The Yankee Group all predict very positive numbers for the US SMS market in the future. Below are various collected data points showing the general market acceptance of SMS for the United States.

- IDC forecasts a steady growth of total revenue, reaching \$4.5 billion by 2006, up from approximately \$1 billion this year.
- The Yankee Group states that the number of active SMS users in the United States will continue to grow from 31 million this year to 95 million in 2006.
- Active messaging users today account for 19% of total mobile phone subscribers (140 million plus) today and are expected to reach 47% in 2006.

All predictions aside, the US market has started to provide revenue for several different applications. SMS campaigns has been launched and proven successful, short code libraries are expanded and improved, and Premium SMS rate ability are to be released this fall. Several early adopters have proven in the US market that SMS can bring about broad usage supported by massive marketing.

Mobliss Inc. is probably the one company that stands out being responsible for both "American Idol" and the less visible "Nashville Star". As the industry for mobile messaging in the States is forming, several possible competitors are waiting to expand their offerings to reach larger audiences. Although not organized in any particular way, there are some noticeable groupings in the new wireless messaging environment. In the list below are several interesting and cutting-edge competitors for the mobile messaging market in the United States.

US new (and not-so-new) comers

Mobliss – American Idol, Nashville Star

Offers the technical support and hosting for mobile voting/marketing capabilities. Will have the ability to charge Premium rate per vote very soon. A telling quote from their CEO, Brian Hill shows their optimistic view of what's to come: "It will not be like selling advertising, it will be like asking if [you] like to share a new revenue stream."

UPOC - Buddy lists and "celebrity-sighting"

Business model is very similar to what Howard Reingold talks about in his latest book "Smart Mobs" – the phenomenon of mobile "swarming" and the experience of other mobile-centric cultures (for example: helping topple Estrada in the Philippines, helping organize the World Trade Organization rioters in Seattle, etc.) They have a very interesting business idea as messaging volume is mostly for p2p activity: UPOC builds lists to expand this mode of communication to include various one-to-many scenarios. With the ability to charge at Premium SMS rates, UPOC's situation is extremely positive.

Enpocket – Event ticket sales

Enpocket envisions launching applications that enable event ticket sales with bar codes as receipts, with sales prices averaging \$25 or more. Also offers marketing/campaign solutions.

YellowPepper

Mobile marketing and event design company offering alerts, service requests and competitions.

Goldpocket Interactive – Interactive Television

iTV designer company from Los Angeles, supporting TV by adding interactive components to programming such as SMS vote, competitions etc.

Mobileway – Carrier interconnect

A mobile content and transaction "facilitator" that supports revenue sharing business models as "technology partner".

Inphomatch – inter-carrier messaging

One of the biggest inter-carrier messaging solutions in United States. Enables mobile users to send SMS from one mobile operator to another.

Pinnacor – Messaging and content solutions for Carriers

Messaging service provider serving several mid-size carriers, including Virgin Mobile.

Infospace – Messaging and content solutions for Carriers

Seattle based content aggregator supplying portal and content for Cingular Wireless, among others.

Ztango/ Mobilestreams – Content and SMSC for Carriers

Company similar to Infospace in terms of providing content and messaging solutions to US Carriers, including Verizon.

Proteus and Cingular – opt-in event voting and alerts.

Sports alerts have proven to be big business abroad. Proteus has collaborated with FOX Sports and Cingular to launch event-driven messaging with NASCAR.

Networks and technology

Contrary to European and most Asian markets, the US has two main competing network standards (with a third smaller market segment), creating two markets in one. The first, CDMA, has Qualcomm, and in many cases Motorola, spearheading this market with Sprint, Verizon and Alltel as the top three service providers. Secondly, GSM is supported by AT&T, Cingular and T-Mobile holding the top three Carrier positions. A third standard is belongs to Nextel, the pioneer with push-to-talk applications launched on GSM and CDMA networks. Worth mentioning is Nextel's iDEN technology provided exclusively by Motorola.

US Carrier networks and customers

Tier 1	Network Standard	# Subscribers	Key market
AT&T	GSM/GPRS	20.1 M	Nationwide
Sprint PCS	CDMA2000 1rx	17 M	Nationwide
Cingular	GSM/GPRS	22 M	Nationwide
Verizon	CDMA2000 1rx	31 M	Nationwide
T-Mobile	GSM/GPRS	10 M	Nationwide
Nextel	iDen	10 M	Nationwide

Tier 2	Network Standard	# Subscribers	Key market
Alltel	CDMA/ CDMA2000 1rx	6.8 M	Midwest/South/ Lakes
US Cellular	CDMA/ CDMA2000 1rx	3.9 M	Chicago
Centurytel	TDMA -> CDMA	700k	Midwest/South/ Lakes
Triton PCS	TDMA -GSM	700K	East Coast
Western Wireless	CDMA2000 1RX	1.1 M	West/ Midwest
Qwest	CDMA2000 1RX	1.1 M	Midwest

Tier 3	Network Standard	# Subscribers	Key market
Airgate PCS	CDMA2000 1rx	500K	NC, SC
Alamosa PCS	CDMA2000 1rx	500K	Midwest
Dobson/ Cellular One	TDMA -> GSM/GPRS	700K	Sold CDMA to Verizon
Leap Wireless/ Cricket	CDMA2000 1rx	1.3 M	Prepaid/ regional
Virgin Mobile	CDMA2000 1rx		Prepaid/ youth
Boost Mobile	CDMA2000 1rx		Prepaid/ youth
TracFone	CDMA2000 1rx	1.8 M	Prepaid/ youth
Metro PCS	CDMA2000 1rx		Local unlimited
Centennial Communications	TDMA -> GSM/GPRS	540K	Midwest/South
Rural Cellular	TDMA -> GSM/GPRS	660K	Midwest/South
Cincinnati Bell Wireless	TDMA -> GSM/GPRS	471K	Ohio

Mobile content from the Carrier perspective

Qualcomm's Internet Services Division offers CDMA-standard customers a WASP service (Wireless Application Service Provisioning) called BREW (Binary Runtime Environment for Wireless). As mentioned earlier, Brew is the technology Verizon uses to sell 2 million downloads per month. Qualcomm hosts content and applications and all pieces are technically tested and qualified by them. Revenue models are pre-negotiated and applications can be offered to many different networks at once, a very successful service and model for Qualcomm. This model is reminiscent of Vodafone Live, as discussed later in this article.

AT&T is the one that has gone the farthest in terms of GSM Carriers, portals and content offerings with mLife. Hosting and promoting the American Idol TV show generated a larger than expected buzz for their product offerings. AT&T is also the one operator expected to first offer true Premium SMS for third-party content providers. Although Sprint claims this as a strength, Sprint works on proprietary standards for messaging, and has not been able to integrate with other networks. Verizon on the other hand has tried to jump ahead to organize the industry through defined service request/short codes for messaging, a preparation for Short code access with Premium content ability.

Carriers across the board support the Premium model and intend to keep 20% – 40% of the incoming revenue, sharing the rest with the content or service provider. It is generally assumed that Premium SMS will be widely available across all carriers within 12 months, beginning this summer.

Challenges ahead

Although there are positive signs, issues remain. Looking at the United Kingdom, the ability to use printed media as a retail channel accounts for 1/3 of mobile content sales.

Also, the ability to offer a service to any mobile user is far more compelling than a carrier-by-carrier scenario. Two main questions still remain unanswered and are very important to resolve in order to replicate the overseas success of Premium SMS: Short code unity – Will the market accept one standard for access codes (i.e. telephone number) with the ability to offer services independent of network subscribers Carriers?

Fee structure and "transaction" clearance – Will all Carriers allow their users to charge across networks and share revenue with content or service providers? ("work-arounds" are possible and aggregators are plenty - Mobilestreams, Mobileway, inphomatch etc.)

Comparative market – United Kingdom

We believe that the viability of Premium SMS in the United States is positive; it will become a viable business segment with a plethora of prosperous companies. As described above, the United States seems to be poised to adopt premium SMS and several companies have spent both time and money successfully educating consumers.

To better bring some clarity around what might be ahead we have compared US to United Kingdom. Much of the country's core culture offers signs of similarity in

technology adaptation, life style, and income levels, as well as media, music and entertainment preferences. The one difference that stands out is UK's early adoption of one standard (GSM) and the network operator's willingness to open their networks for third party content providers. As the United States now settles on standards (GSM and CDMA) and is working towards openness for outside services to bill through the various networks, there might be valuable lessons to learn.

Basic Data

Mobile phone penetration is very high in the UK; an average of 75% to 80% of the population owns and uses a mobile phone regularly. In the 15-34 year old age group, the most likely to use mobile services and content, roughly 83% have a mobile phone. While 73% of all phones are SMS capable, only 27% regularly use other enhanced features such as WAP and mobile Internet services. SMS is the most widely used mobile channel today. Roughly 55 million billable messages are sent each day. Netsize reports, "Premium rates have become the preferred billing mechanism for mobile content and services including SMS, MMS and J2ME."

Size and value

The UK market size in terms of revenue is an interesting example. Basic revenues from mobile entertainment exceeded \$200 million last year, divided up in the three main categories: SMS alerts, ring tones and Icons. SMS alerts account for the biggest segment with \$90 million in yearly revenues for the age segment between 15-34 only. Ring tones earned \$60million and Icons \$49 million.

Basic data shows active mobile usage with 27% of total mobile users having used mobile Internet services at least once, 14% having purchased a ring tone within the last month. Mobile games on the other hand are used by only 3% of the total mobile population, primarily because of mobile gaming's position as an emerging segment. Data shows that by the end of this year, somewhere between 10%-20% of the total mobile population between the ages of 15-34 will have downloaded a mobile game within the last 3 months.

A recent study from Netsize claims, "10% of Europe's SMS traffic now comes from value-added services and content."

Market Trends

The UK has entered its second phase of mobile service offerings. Early "high-profile" efforts such as the "Genie" portal from O2/British Telecom, as well as Vizzavi from Vodafone and Vivendi Universal were widely publicized in 2001. "Genie" has since become O2 Online, and Vizzavi has become Vodafone Live. Vodafone Live is also the most visible and successful portal re-launch. With the ability to "dock" an application at Vodafone Live, companies now have the ability to offer their solutions to all Vodafone markets.

Many early startups were developed quickly in the latter part of the "dot-com" era. Several companies were successful in raising funds through financing rounds while claiming business visions similar to those of "dotcommers". As expected, the slower than expected growth and unfocused efforts forced the industry to rethink and restart.

Newer and emerging companies tend to use revenue share business models to gain yearly revenues from €1 million to €5 million and beyond, all after 1 -2 years in

existence. Most successes have been content related as alerts and ring tones dominate, representing 75% of all mobile entertainment transactions. In terms of value, ring tones alone exceed \$1.2 billion per year in Europe alone. An interesting observation is that 11% of all ring tones sold in Europe were sold by a Carrier last year. Overall global size of the European market is 30% with US/Canada accounting for only 13%.

How do they do it!

With easy to explain access procedures, mobile content and services, Europe, and the UK in particular, represent a viable and valuable market. In the UK, users spend an average of \$31 per month on mobile entertainment, SMS included. Much of the purchased content originates from advertising in printed media; 33% of all mobile content sold is initiated via print media.

Comparative conclusions

The US is not far behind in terms of service availability; it is the service available to everyone that makes the difference. A transparent billing layer has enabled companies to offer services to all mobile users.

The high investments on infrastructure have established a belief in messaging, evolving from the SMS technology platform towards MMS.

UK carriers provide easy access for outside applications, enabling two-way billing and revenue share business models.

Short codes and Premium rates are standard.

The US and Canadian market is 1/3 the size of the total European market, offering few languages and cultural differences.

US cultural patterns

In order to enter the US market, one should rely on those with the appropriate experience.

Partnerships often serve as a preference booster for a product and those anxious to enter the marketplace are highly advised to spend considerable time in research. Obviously, what companies who offer assistance to others announce in their marketing materials is not necessarily their true reputation in the field. Remember: America is good at selling! Careful analysis of the partnership landscape is well worth the effort.

Mergers are talked about constantly, but questions remain as to who will buy whom and on whom should you concentrate your efforts? It is crucial for your company to know the underlying assumptions when dealing with US market dynamics, and to know which players might be competitors.

Final remarks

Entering or starting anew in the US market is a risky business. The competitive and highly innovative environment is not for every company or entrepreneur. But, succeeding may mean great fortunes and prosperity; misconceptions often lead to lost investment and re-evaluations. Knowing the market and reading the signals correctly are crucial.

With a fairly new market emerging, offering a real and previously untapped revenue stream, knowledge of the market is a make or break proposition.

About Gerbsman Partners

As a result of Gerbsman Partners' 23 years of maximizing enterprise value and specific domain expertise in technology related intellectual property, we have developed an established, proven and responsive distribution channel for our clients. Our channel reaches International and US institutional investors, venture capital funds, investment bankers, lawyers and accountants, as well as leveraging Gerbsman Partners' direct relationships with major wireless and technology companies.

Gerbsman Partners, supported by its International Board of Intellectual Capital, has been involved in over \$1 billion of transactions worldwide and has assisted in M&A, restructuring, licensing, partnership and capital formation for numerous companies and their Intellectual Property.

Our international business and technical team, which includes European and Israeli based sales and technical personnel, looks forward to earning the right to be a resource to you.

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- Wireless Entertainment: www.gerbsmanpartners.com/entertainmentwp.pdf
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