Wireless Market Brief – US WiFi and Investment Updates

Gerbsman Partners, July 2004

About This Report

Gerbsman Partners made a strategic decision in 2002 to expand its international business model to focus on and to develop "Domain Expertise" in the worldwide Wireless market.

As a part of our commitment to this market opportunity, we have spent significant time visiting market leaders in this segment in the United States, 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 the wireless area and is offering assistance to understand, navigate and execute business related opportunities.

Executive Summary

This market update looks closely at two distinct opportunities in the US telecom market – WiFi provider devaluations and Buy-out funds. The intent is to provide a brief overview of the chain of events leading to today and some thoughts about the near future. The recent years extensive efforts to create viable businesses in the wireless area has brought excellent technologies to life and many of them are available for purchase due to refocusing, down scaling or complete shutdowns. With German T-Mobile spearheading a faster-than-ever growing market, an opportunity for US WiFi presence is emerging. Keeping this in mind and looking towards the successful buy-out funds created, it is clear that a strong period of mergers and acquisitions, licensing, and intellectual property transfers are to come.

- While the WiFi hotspot business is not the billion dollar industry it once was thought to be, offering WiFi can work as a value add and loyalty program. Corporate Buy-out funds will increasingly look towards the giant telecoms for technology projects worth spinning out as ventures.

- European Telco's should look close at US WiFi hot spots for investments and market entry. As prices and valuations have plummeted, many companies struggle with current business models and might seek mergers.

The US hotspot market adjust

Three years ago WiFi emerged in the backwaters of the Dot-com recession. Companies promised aggressive growth and scale to bring in revenues. As capital increased, news on market expansion contracts kept coming. T-mobile, Verizon, Boingo Wireless, GRIC (now GoRemote), iPass, Wayport (now owned by Starbucks) and Cometa Networks (now gone) all competed for market share. Three years of aggressive growth and venture funding have now "connected" most Airports, major Hotels, Borders Bookstores, Starbuck's coffee stores, Kinko's business centers (now owned by FedEx), Mailboxes etc (now owned by UPS) and even McDonalds.

Small business owners have followed this trend by either partnering with independent and often self-funded WiFi service providers or building their own networks and offering free service. Sip & Surf, ZRNet, Pacific WiFi to mention a few, all offers "Hot Spot in a Box" and hosted solutions in straight competition to the Boingo's and GoRemote's mentioned above.

What used to look like a good business and large financial opportunity, suddenly became a major challenge. As the first real revenue results came out from T-Mobile's US hotspot business, stating an average of only $400 per month per location, trouble started to face the market. A market with predicted value in the Billions suddenly plummeted and stopped somewhere in the hundred of millions.

Market adjustments

The recent shut down of Cometa Networks, a collaboration between several top tier investors, IBM, AT&T and Intel, was just one indication of many, exemplifying the current re-formation of the US WiFi industry. The shut down was a result of lacking management focus, technical perfection and unclear strategy, partners cutting their ties (AT&T), and investors deciding not to provide further funding.

While both Cometa and Toshiba (WiFi service business unit) had to close, aggregators and service providers like Wayport, T-mobile, iPass and Boingo Wireless, and Verizon continues to grow. SBC's partnerships with Wayport for tens of thousands of hot spots, T-Mobile's commitment towards the United States by acquiring spectrum in the western regions and continued growth strategy for WiFi, indicates strong belief in an "expanding wallet-share" strategy. FatPort from Canada is also worth mentioning as their continued expansion includes residential Voice over IP (VoIP).

Independent WiFi service provider Sip & Surf continue to grow, as does the number of individual locations with free WiFi access. Cities are starting to offer free or Coop WiFi service like City of Cerritos in So.Cal and WiMAX puts their belief on citywide coverage. As an example, NY Manhattan recently announced a City-wide WiMAX pilot project with Mesh Networks and Tropos Networks. If this will mean that WiFi will be free is hard to say, but sizable revenues will either come from market dominance or value added services.

WiFi access business models are changing and companies are scrambling to find creative solutions that will increase the bottom line. Wayport recently announced a new service offering a monthly, unlimited access plan in low $30s.

New business models needed
While the struggle for market share and leadership are yet to be determined, unrealistic business models and erratic market behavior are forcing a re-evaluation of the purpose and expectations on WiFi. This process will cause pain for some, but new and exiting opportunities are likely to emerge for investors and service providers alike.

Indications are that value added services such as "Voice over Wireless LAN (VoWLAN) are highly touted and looked upon favorably by most larger telephone operators. WiFi technology becoming integrated into cell phones will enable large opportunities for providers of cellular service and WiFi. As each hot spot needs broadband, Voice over IP providers are also looking towards WiFi expecting WiFi voice handsets to come as well. FatPort's example of offering hotspot, Broadband and VoIP are yet another indication of the service bundle strategy to increase revenues.

Among the many companies that have not been able to attract additional funding to continue, there are excellent technologies available. As en example, Cometa had actual customers and was known for spending a long time building a solid technology infrastructure investing tens of millions. Significant amounts of technology should therefore be available. Who will pick them up is yet to be determined.

When looking at T-Mobile's success offering WiFi throughout United States, questions regarding what they do differently arise. While using their global service business (T-Systems) as contractors, technology is deployed and hosted by the same people that manage their cellular offerings. With several international successes behind them, T-Mobile has emerged as dominant market leader. Vodafone's attempt to buy AT&T was most likely an attempt by Vodafone to look to T-Mobile for a US recipe for success. One can only wonder what France Telecom and its wholly owned subsidiary Orange are planning for the US market. There is something to it when looking at European telecoms in terms of how plans and expectations are met. Maybe this recent turbulence in WiFi connectivity on the US market will open new, previously unseen opportunities for partnerships and investments.

Turning (it) back around

While hotspot revenue expectations proved to be inflated and unrealistic, VC's have looked upon mid-size buy-outs as an option for newly raised funds. Statistics from the British Venture Capital Association (BVCA) indicate the 92% of recent capital raised for funds are earmarked for buy-outs while 3% is for growth and 4% for early stage.

These statistics combined with the recent sales of companies like Eastman, Chrysalis, Linksys and the Cinvens acquisition of IPC all point towards a continued formation of buy-out funds that have a clear strategy to optimize value from corporate buy-out technologies as well as mid-size companies in need of complete management overhaul, are creating a interesting dynamic.

With experts in corporate buy-outs and large amounts of capital available for business building, current WiFi service providers that struggle will increasingly be asked to approach a merger or acquisition situation to redeem as much value as possible. As the market adjusts, the opportunities will become fewer and fewer. Over time, prices and valuations will decrease forcing orderly shut downs and Intellectual

Property experts will take over. A well funded strategy to combine entities in a struggling market with new management and a group of industry investors behind them may create a whole new option for WiFi companies.

Conclusions

- Looking at the strategy of T-Mobile, operators will seek to launch similar initiatives. SBC's collaboration with Wayport to extend offerings as well as R&D efforts to combine offerings all point in one direction: WiFi can be considered a success if the purpose is to extend reach, as opposed to create billion dollar business.
- Swisscom, Wind, TeliaSonera and British Telecom all aggressively look towards WiFi as a competitive tool to enhance wallet-share in Europe. T-Mobile is the only one expanding beyond Europe, and doing so successfully provides a clear example for European Telecoms regarding realistic US telecom opportunities.
- Combining various entities within wireless companies and then having them managed by outside start up specialists, will potentially assist mobile and fixed operators maximize enterprise value in these units.

About Gerbsman Partners

Since 1981, Gerbsman Partners has focused on maximizing enterprise value for highly leveraged, under-performing, under-valued and under-capitalized companies and their Intellectual Property.

Gerbsman Partners has also assisted numerous emerging growth and middle market companies develop and execute their financial and capital formation strategies, access the capital markets and provide for technology and life science strategic alliances and licensing of Intellectual Property.

Please visit Gerbsman Partners updated web site www.gerbsmanpartners.com for additional information.

Previous White Papers can be found at www.gerbsmanpartners.com/news.html

For additional information, please call or email:

Steven R. Gerbsman
+1 415 456 0628
steve@gerbsmanpartners.com

Patric Carlsson
+1 415 244 5018
patric@gerbsmanpartners.com

Gunnar Ostergren
+1 415 205 5700
gunnar@gerbsmanpartners.com

Motti Abramovitz
+972 54 774 762
motti@gerbsmanpartners.com