Sprint investors in purgatory until 2013

Sinead Carew, Reuters

Sprint Nextel (S.N), like its bigger rivals, is expected to report a steep decline in fourth-quarter profit margins due to its launch of the costly Apple Inc (AAPL.O) iPhone.

But the comparison ends there, according to analysts, who say that an investment in the No. 3 U.S. mobile provider is a much riskier bet than one in Verizon Communications (VZ.N) or AT&T Inc (T.N) since it may be years before investors see a return.

"If you're buying (Sprint), you're buying it as a long-term investor, not because you're expecting the results to show dramatic improvements in the next couple of quarters," said Barclays analyst James Ratcliffe.

Along with ballooning costs from the iPhone, Sprint is also being weighed down by a $7 billion network upgrade and the cost of running two different networks, one of which it plans to shut down in 2013.

On top of this, Sprint has had a spate of involuntary customer cancellations at retail partners, which typically happens if a customer is behind in bill payments.

Earlier this week Radioshack (RSH.N), a Sprint retail partner, blamed weak Sprint subscriber numbers for its own disappointing forecast.

Taken together, Nomura analyst Michael McCormack said these issues leave Sprint "ill-prepared to deal with the effect of the iPhone." That's bad news given that Sprint already committed to paying Apple a minimum of $15.5 billion over four years.

"In 2012, and to a large extent 2013, you're basically in purgatory," said McCormack, who does not expect clarity on Sprint's investment prospects until the company has completed its high-speed wireless upgrade, scheduled for the end of 2013.

Because the iPhone is so popular, service providers see it as a must-have phone if they want to keep their customers from straying to rival services. Sprint Chief Executive Dan Hesse said the iPhone has been the single biggest cause of customer defections from his company's service.

Operators pay Apple a hefty subsidy that analysts say is about $400 per phone, or roughly double the fee they pay other phone makers. The subsidy allows operators to offer a discount to consumers who sign two-year contracts.

The subsidy will hit Sprint in the fourth quarter -- its first quarter selling the device -- in the form of a wireless service margin decline to 8.6 percent from 17.6 percent in the third quarter, according to the average from eight analyst estimates compiled by Reuters.

In comparison, its bigger rivals have much healthier margins even after steep iPhone related declines. Verizon Wireless' fourth-quarter margin fell to 42.2 percent from 47.8 percent in the third quarter, for instance, while AT&T's margin fell to 28.7 percent from 43.7 percent.

Despite the margin compression, the iPhone is seen as helping subscriber growth at Sprint, which reports quarterly results on February 8. Sprint is expected to report about 272,000 net additions for the quarter, according to eight analyst estimates compiled by Reuters. That compares to a loss of 44,000 subscribers in the third quarter.

But many are questioning whether the subscriber growth rate is sustainable. Credit Suisse analyst Jonathan Chaplin sees Sprint reverting to subscriber losses in the first and second quarters as the iPhone sales surge dies down after the launch.

One hope is that the device will boost Sprint's revenue as smartphone users tend to spend more on data services than subscribers with less advanced phones. However, the benefit is minimized if many of the operators' iPhone customers are upgrading to it from another smartphone as their monthly fees would remain the same.

Evercore analyst Jonathan Schildkraut estimated that 25 percent of Sprint's fourth-quarter iPhone customers moved from another operator while 45 percent upgraded from a smartphone and only 30 percent upgraded from less advanced phones.

Since investors have such bleak expectations going into the quarter, Schildkraut hopes that any positive comments from the company on its outlook for the year will help Sprint's share price, which has languished below $3 since October.

By comparison, Verizon's shares closed at $37.56 on Thursday on the New York Stock Exchange where AT&T ended the day at $29.79. Sprint shares closed at $2.21 also on NYSE.

"It's a challenging quarter and the outlook is going to be challenging," said BTIG analyst Walter Piecyk.

(Reporting By Sinead Carew; Editing by Peter Lauria, Phil Berlowitz)

Posted by Jason Lomberg, Technical Editor

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