

THE GRID: Small Antennae Need Big Money

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NEW YORK (Dow Jones Investment Banker)--Since data-hogging wireless devices became de rigueur, cell operators have strained to manage network traffic. With little fanfare, the distributed antenna systems (DAS) industry has sprouted up to ease the carriers' burden.

This capital-intensive niche is now poised to become a center of financing activity as operators seek investors, borrow to expand, go public or are bought out.

DAS companies bring high-capacity wireless coverage to places cell towers can't reach. Dense urban areas, highways and campuses, for example, often pose challenges for traditional networks built around large towers. Buildings and geography cause interference, and zoning rules have limited intrusive towers.

DAS systems consist of smaller, more tightly spaced cellular antennae, placed lower down on existing infrastructure like utility poles.

Though the antennae are smaller, the systems are much more capital and labor intensive than cell towers. Installing the small transmitters entails laying hundreds of miles of fiber and accessing public rights-of-way and infrastructure controlled by multiple firms and municipalities. DAS firms must operate like (and often be licensed as) utilities.

All the companies in the space agree: It is operational, rather than technological, proficiency that is most important. Good relations with local utilities and governments is often key. Execution risks are acute.

Private equity and venture money has flowed into the sector over the last year. In late January, ExteNet Systems Inc. received \$128 million from a group of five investors including the tower company SBA Communications Corp. and Soros Fund Management. Last September, the largest pure-play DAS firm, NextG Networks, received \$360 million from a consortium led by Madison Dearborn Partners with Accel Partners and Redpoint Ventures. Last April, NewPath Networks received \$47 million from Charterhouse Group Inc., Meritage Funds and their founding investors, Sweetwater Capital.

The capital is flowing in for several reasons.

First, scalability: Once you place a system for one carrier, additional customers (even those using different wireless technologies or operating on different frequency bands) are cheap to add.

Second, DAS systems help with the big carriers' backhaul problem. Existing towers are connected to the networks' core IP networks with old infrastructure that has created data bottlenecks but is expensive to upgrade. While DAS systems are expensive to install, they provide a big pipe straight into the network. Carriers will pay up for that because their own upgrade costs are so high, and DAS can cover areas carriers their towers can't.

Third, like towers, DAS operators have the potential to provide very stable (read: leverageable) cash flows. DAS firms charge the carriers monthly fees dictated by long-term contracts.

The economics are compelling. "In the tower space, your first tenant gives you low single-digit returns, and you need three tenants to get serious profitability," says one investor who has put

money to work in the sector. "In DAS, your first tenant can achieve a double-digit IRR, and with three tenants your returns really get juiced."

Tower companies have set up some of their own DAS transmitters, and SBA's investment in ExteNet shows the tower companies' interest, but the dedicated DAS companies have a headstart mastering the relationships and obtaining the clearances to set up bigger networks of smaller antennae.

NextG, ExteNet and NewPath will keep growing -- and raise more capital. An executive at one says that his company expects to return to the capital markets this summer.

Ultimately, their investors will want to exit the business (NextG filed for an IPO last spring but backed away as the market tanked). The tower companies may want to enter, by acquisition.

In short, it is a sector to watch.

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