IPhone sales hurt carriers' profits

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The iPhone has been a huge hit for Apple Inc., helping send the company's stock to all-time highs and producing record-breaking profits.

But for AT&T Inc., Sprint Nextel Corp. and Verizon Communications Inc., it's breaking the bank.

The three wireless carriers all found themselves answering to Wall Street in recent weeks for posting depressed quarterly earnings, and analysts pointed to the heavy cost of offering the iPhone as a culprit.

The iPhone has become the single most popular smartphone in the United States, and that has left the carriers trapped in a kind of Faustian deal: The more iPhones they sell, the more money they lose.

That's because they have to buy the phone from Apple before they can sell it to their customers for hundreds of dollars less. The carriers are betting that they'll make back the difference and more by signing up customers for two-year plans and collecting monthly fees.

But so far, the carriers are finding that the math isn't adding up.

AT&T was the first carrier to offer the iPhone and has been struggling to make it profitable for years. During the last quarter, the iPhone accounted for 82 percent of the smartphones AT&T sold to its customers, meaning the company had to pay the hefty subsidy on each of the 7.6 million iPhones.

All that money paid to Apple tugged down the company's profits. In AT&T's wireless division, operating margins - a common measure of how much a firm makes - dropped to 15.2 percent from 22.9 percent a year earlier.

"The AT&T wireless model is broken," said Kevin Smithen, a wireless analyst at Macquarie Securities. "AT&T is basically subsidizing Apple's revenues and profit growth."

Investors have taken notice: Since June 29, 2007, the day AT&T first offered the iPhone, Apple's stock has shot up more than 300 percent, to $493.69 from $122.04. Meanwhile, AT&T's stock has dropped 28 percent, to $29.82 from $41.40.

Sprint's stock is down more than 16 percent since it began selling the iPhone late last year. It sold 1.8 million iPhones last quarter, spending $630 million to buy them from Apple. That was a large contributor to the company's $1.3 billion quarterly loss - a 40 percent wider loss than the struggling company saw a year earlier, before it offered the iPhone.

Verizon sold 4.2 million iPhones last quarter, accounting for more than half of the smartphones it sold. But despite those strong sales numbers, Verizon's profit failed to meet Wall Street's expectations, and the firm's stock dropped 2 percent after its earnings release.

Wireless carriers began subsidizing the cost of cellphones years ago, in an era of simpler, less expensive "feature" phones. Carriers might have offered a $300 phone to consumers for $100.

But that doesn't work well with the much more expensive iPhone, which companies buy from Apple for about $600, analysts estimate, before reselling it to consumers for $200 - eating the $400 difference.

A particularly sticky issue for carriers is that many iPhone users don't want to wait for their two-year contract to expire to buy the latest model, which has come out once a year.

Generally the carriers have required consumers to pay the full price if they want a new iPhone before their contract runs out. But now, worried that subscribers will flee to competitors if they can't get a good price on the new phone, several carriers are offering "early upgrade" deals to discount the newest iPhone before two years elapse. That means helping the consumer buy a second iPhone in one year - and handing over additional hundreds of dollars to Apple.

"Can Apple continue to roll through industry after industry, soak up all the profits, and leave everything it touches as a smoking wreckage?" asked Craig Moffett, an analyst at Sanford C. Bernstein & Co. "They've done it with music and handsets, and now they're doing it to the carriers."

Representatives from Sprint, AT&T and Verizon declined to comment on their plans for offsetting the iPhone's effect on their bottom line.

But analysts believe the carriers' best shot at wrestling back some power from Apple is getting consumers interested in alternatives. This year, that has meant souped-up campaigns to entice buyers to look at Google Inc.-powered Android phones manufactured by Samsung Electronics, LG, HTC, Motorola and others.

After heavy promotion, devices such as Motorola's Droid Razr and Samsung's Galaxy S 4G have begun to sell well. They also can take advantage of faster, next-generation 4G wireless technology, while Apple's iPhone still works with the slower 3G.

Best of all for carriers, the Android devices can cost half as much, allowing them to pay closer to $200 for each device instead of $400 for the iPhone.

"They're doing everything they can to make the Android phone something you want to choose," said Chris Larsen, an analyst at Piper Jaffray & Co. "It keeps Apple in balance to some degree."

At a Verizon Wireless store in Los Angeles' Koreatown neighborhood, half a dozen wall-mounted displays feature fancy, back-lit red-and-silver graphics pitching the company's new line of next-generation 4G Android smartphones. The display for the iPhone is smaller and plain, its white motif clashing with the store's color scheme.

"It depends what you like," a clerk says when asked for advice on which type of phone to buy.

"Do you like the Androids' faster download times, bigger screens, longer battery life and better cameras? Or do you like Apple?"

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