Leichtman Research Group, Inc.

Research Notes

1Q 2009 *Actionable Research on the Broadband, Media & Entertainment Industries*

The Phenomenon That Isn't

In the 2008 U.S. presidential election, about 1.4% of all voters selected a candidate other than Barack Obama or John McCain. If you were one of these approximately 1.8 million people, or close to one of these people who voted for someone other than Obama or McCain, you might be more inclined to believe that the percentage of people who voted for someone other than a major party was greater than it was. This could even foster a perception of the election results as an indictment of the two party system that will only increase in the future.

In recent months, there have been several articles in major newspapers, online, and industry trade magazines addressing the "phenomenon" of consumers disconnecting from their multi-channel video services (cable, DBS, or Telco video), due to the widespread availability of video online (as well as through other sources that don't require a subscription). These articles have added fuel to a perception that the "cord-cutting" that has impacted the telephone industry, has begun in the multi-channel video industry, and will soon intensify.

It would be dangerous to make assumptions about American politics based solely on non-Obama or McCain voters – so too, it is imprudent to assess the video industry based off of limited anecdotal evidence. In cases like these, errors are made by perceiving small (often passionate) niche groups to be larger than they are; and more importantly, that these individuals represent harbingers of things to come.

Certainly there are some people who are choosing to disconnect their multi-channel video subscription and only watching TV shows via the Internet or through other sources. Aggregated together, however, ***the current impact of this group is imperceptible in both consumer research, and in an analysis of industry data.***

Despite an increasingly saturated market for multi-channel video, and a significant slowdown in new housing growth, more people than ever now subscribe to some form of multi-channel video. And, there is little evidence of defections from the category due to online video.

A recent LRG study of 1,250 households nationwide found that:

- Non multi-channel video subscribers who watch recent TV programs online at least once per week account for under 1% of the total sample

- In total, just 0.16% of the sample are current non multi-channel video subscribers who dropped service in the past year, and watch TV shows online at least once per week (it was not determined if online video was the cause of their dropping service)

While this type of consumer research attempts to provide a representative sample of the population, industry data also yields similar findings. LRG analysis of the major cable, DBS, and Telco video providers in the US found that:

- The top multi-channel video providers in the US combined to add 1.7 million net new video subscribers in 2008 – about 350,000 fewer than in 2007
- Even in 4Q 2008 – when nationwide economic issues intensified – the industry still added about 315,000 net new video subscribers (about 150,000 fewer than in 4Q 2007)

Yet even if data reveal that cord-cutting is not widespread today, some believe that we are beginning to see the seeds of a trend that is just beginning to grow. Comparisons are made to the telephone, newspaper, and music industries, as examples of what is in-store for subscription TV. Certainly, many Americans (particularly younger individuals) have cut the cord to their traditional landline phone, and now only use wireless service. The newspaper and music industries have also been permanently changed by the Internet and digital distribution of content. ***But, unlike these predecessors, technology alone does not make subscribing to a TV service redundant or easily replaceable.***

Content ownership and distribution makes subscribing to a TV service unique. While broadcasters have made much of their content available online, cable programmers are far more disciplined in how they distribute their content. The unique business model of cable programmers, including both advertising revenue and affiliate fees from multi-channel video providers, makes it illogical for them to freely distribute their content when it originally airs and encourage consumers to disconnect from their multi-channel video services. Unless it is assumed that technology will allow consumers to steal and distribute video – or programmers suddenly start to behave irrationally – cord-cutters are left with a far different, and very limited, selection compared to what they had in the past.

Bruce Leichtman, of the Leichtman Research Group, said that 1 percent of adults view televisions shows online daily, and 8 percent watch shows at least once a week, up from 6 percent last year.

His survey also found that 8 percent of adults who watch video online "strongly agree that they now watch TV less often."

- **New York Times**
  March 2, 2009

Beyond the challenges that are, and will continue to be, created by the business model for content owners, it is important to look at how consumers are watching online video today, and the related impact on traditional TV viewing.

Time spent watching online video is increasing:

- comScore reports that the total time spent watching online video increased from 28.8 billion minutes per month in January 2008 – to 52.4 billion minutes in January 2009
- LRG analysis of comScore data finds that online video users are now watching 11.9 minutes of video online per day – compared to 6.9 minutes per day a year ago

Hypothesis: Cable TV subscribers are increasingly likely to "cut the cord" given the proliferation online video.

Is this notion the product of a feverish imagination? Cable industry analyst Bruce Leichtman, for one, believes the broadband-video threat is way overblown.

- **Multichannel News**
  February 21, 2009

While online video usage is growing, it is shortsighted to think of this primarily as an alternative venue for watching TV shows. In fact, consumer use of video online remains much more about short form video:

- comScore reports that the average online video stream in January 2009 was 3.5 minutes
- comScore also reports that Google sites (principally YouTube) represents 42.9% of all online video streams. In the past year Google has increased from 3.4 billion video streams per month to 6.4 billion streams per month
- LRG's recent study found that overall (including those not online), 8% of adults report that they view recent TV shows online weekly – compared to 24% viewing news clips, 20% YouTube or other user-generated video, and 15% sports news or highlights

A cavernous gap between the time spent watching TV and time spent watching video online continues to exist:

- Nielsen reports that the average TV viewer watches more than 151 hours of TV per month – compared to about 3 hours per month among those who watch video online
- Even among young adults ages 18-24 (who are most rapidly changing their viewing behavior), Nielsen reports that the average TV viewer watches more than 118 hours of TV per month – compared to about 5 hours per month among those who watch video online
- Nielsen also reports no decrease in time spent watching TV over the past year (a result also found in LRG's survey)

The disparity in time spent watching video on TV and online, and the relative changes over the past year or two, are not ones that would rationally make one believe that a "break-even" in video viewing is in the offing. More importantly, it is not a logical next step to leap to the conclusion that watching video online will result in consumers completely disconnecting their multi-channel video services.

It is not an either/or relationship between traditional TV viewing and new ways of consuming video. In fact, LRG's study found that those who watch TV shows online are actually heavier media consumers, who are not more inclined to disconnect their multi-channel video subscription:

- Those who watch TV shows online weekly are more likely than average to subscribe to a premium service, have digital cable, use on-Demand, have an HDTV, and subscribe to a bundle of services from a single provider
- Just 6% of those who watch recent TV shows online weekly are likely to switch from their multi-channel video provider – compared to 11% of others

This is not a *Thunderdome-esque* scenario (two men enter, one man leaves) between TV viewing and new viewing opportunities. If we focus on the proposition of online video (and other "over the top" video) as being alternatives to traditional TV, we may miss what these new forms of delivery are actually bringing to the table today, and their potential in the future.

The past year did find some people making decisions to deviate from the norm by disconnecting their video service to only watch video online, or by voting for a presidential candidate other than the Democratic or Republican nominees, but these are not necessarily decision made by "early adopters" that foreshadow the near-term future. When the election of 2016 takes place, we will most likely find our two-party system still intact, and as many subscribers to multi-channel video services as there are today.

Cable operators and the networks have to walk a fine line between preserving their business and not standing in the way of the online video revolution.

About 34% of adults who go online at home watch videos over the Internet at least every week, up from 25% two years ago, a survey released Monday by Leichtman Research Group said.

- **Chicago Tribune**
  February 25, 2009

Online Video Usage Continues to Grow

New consumer research from Leichtman Research Group, Inc. (LRG) found that usage of online video expanded in the past year. In total, 34% of adults online at home report that they view some type of video online at least weekly, including 11% who view video online daily – this compares to 31% of those online who viewed video online at least once a week last year, and 25% two years ago.

While those watching recent TV shows online have increased, TV shows rank well down the list of the types of video that people are regularly viewing online, and the impact on traditional TV viewing and multi-channel video subscriptions has been negligible.

- Overall (including those not online), 1% of adults view recent TV shows online daily, and 8% weekly – compared to 6% weekly last year
- 93% of adults with a TV report spending at least an hour a day, on average, watching TV, and 35% of adults spend at least four hours a day watching TV – similar to last year
- 8% of adults who watch video online strongly agree that they now watch TV less often, while 75% strongly disagree
- 18% of teens who watch video online strongly agree that they now watch TV less often, while 61% strongly disagree
- Among all adults online, 3% strongly agree that they would consider disconnecting their TV service to just watch video online – compared to 4% last year
- Those who watch recent TV shows online weekly are no more likely to consider disconnecting their TV subscription than others

[“O]nly a small percentage of online video is television [programming],” says Leichtman. He estimates that nearly half the viewing is of viewer-created videos on sites like YouTube. “You have to put this in perspective.”

- MediaLife Magazine
January 27, 2009

These findings are based on a survey of 1,250 households nationwide, along with a sample of 250 “teens” ages 12-17, and are part of a new LRG study, *Emerging Video Services III*.

5.4 Million Added Broadband from Top Cable and Telephone Companies in 2008

Leichtman Research Group, Inc. found that the twenty largest cable and telephone providers in the US – representing about 94% of the market – acquired over 5.4 million net additional high-speed Internet subscribers in 2008. Annual net broadband additions were down compared to the 8.5 million in 2007, and the peak of 10.4 million in 2006, and were the fewest in the seven years that LRG has tracked the broadband industry.

The top broadband providers now account for nearly 67.7 million subscribers – with cable companies having 36.9 million broadband subscribers, and telephone companies having 30.7 million subscribers.

Other key findings include:

- Total net broadband additions in 2008 were 63% of the total in 2007

- The top cable companies added 3.2 million broadband subscribers in 2008 – 77% of the total net additions for the top cable companies in 2007
- The top telephone providers added 2.2 million broadband subscribers in 2008 – 50% of the total net additions for the top telephone companies in 2007
- The top cable companies netted 59% of the broadband additions in 2008
- In the fourth quarter of 2008, cable and telephone providers added over 1 million broadband subscribers – with telephone companies adding about 570,000 subscribers and cable companies adding about 460,000 subscribers in the quarter

The total number of broadband subscribers in the US doubled in the past four years, growing to nearly 68 million at the end of 2008. With increased market penetration, growth inevitably had to slow, but there was still room for 5.4 million more broadband subscribers in 2008.

Leichtman Research Group unveiled new numbers suggesting that the top 20 cable and telco providers (94% of the market) acquired more than 5.4mln net additional high-speed Internet subs in 2008. Yes, annual net broadband additions were down compared to the 8.5mln in 2007, and the peak of 10.4mln in 2006. And it was the lowest add rate in the seven years that LRG has tracked the broadband industry. But consider the current state of the economy: Despite a housing crisis, eye-popping unemployment and what seems to be a 401K Armageddon, more than 5mln people plunked down an extra $20-60 to ride the broadband wave.

- CableFax
March 6, 2009

Industry by the Numbers – (as of the end of 2008)

Top 10 Cable MSOs in the U.S.

	Passings	Subscribers	Availability	Penetration	Net Adds in 2008	Net Adds in 2007
Basic Cable	115,300,000	57,055,000		49.5%	(860,000)	(475,000)
Digital Cable*	114,900,000	38,320,000	99.7%	67.2%	3,100,000	4,175,000
Broadband Internet**	114,000,000	36,635,000	99%	32.1%	3,190,000	4,125,000
Telephone***	102,500,000	17,100,000	93%	16.7%	3,950,000	4,475,000

Sources: The Companies and Leichtman Research Group, Inc.
Totals include LRG estimates and pro forma results from system sales and acquisitions.
** Digital penetration of Basic subscribers*
*** Internet data does not include RCN*
**** Telephone data does not include Bright House Networks or Suddenlink*

DBS

	Subscribers	Net Adds in 2008	Gross Adds in 2008	Subscriber Acquisition Cost*	Average Revenue Per Sub/Month**
DIRECTV	17,621,000	861,000	3,904,000	$715	$83.90
DISH Network	13,678,000	(102,000)	2,966,000	$720	$69.72
Total DBS	**31,299,000**	**759,000**	**6,870,000**		

Sources: The Companies and Leichtman Research Group, Inc.
** Includes leased equipment and unreturned box costs*
*** Includes revenue from commercial accounts and other non-consumer spending*

Telco Video

	Subscribers	Net Adds in 2008	Net Adds in 2007
Verizon FiOS	1,918,000	975,000	736,000
AT&T U-verse	1,045,000	814,000	228,000
Total	**2,963,000**	**1,789,000**	**964,000**

Sources: The Companies and Leichtman Research Group, Inc.

U.S. Residential Telephone Lines – Gains and Losses

	4Q 2007	1Q 2008	2Q 2008	3Q 2008	4Q 2008
RBOC Net Adds*	(1,690,000)	(1,736,000)	(2,058,000)	(2,252,000)	(1,890,000)
Cable Net Adds	1,125,000	1,170,000	1,090,000	965,000	725,000

Sources: The Companies and Leichtman Research Group, Inc.
** Retail residential phone lines include both primary and additional lines, but do not include wholesale lines*
Includes LRG estimates and some results adjusted from prior reports

Top Broadband Internet Providers in the U.S.

Broadband Internet Provider	Subscribers at the end of 4Q 2008	Net Adds in 2008
Cable		
Comcast	14,929,000	1,336,000
Time Warner	8,727,000	847,000
Cox*	4,000,000	275,000
Charter	2,881,100	198,800
Cablevision	2,445,000	173,000
Mediacom	737,000	79,000
Insight	458,500	72,500
Cable One	372,887	31,853
RCN	302,000	17,000
Other Major Private Companies**	2,075,000	175,000
Total Top Cable	**36,937,487**	**3,205,153**
Telephone Companies		
AT&T	15,077,000	921,000
Verizon	8,673,000	660,000
Qwest	2,847,000	236,000
Embarq	1,412,000	135,000
Windstream	978,800	107,400
Century Tel	641,000	86,000
Frontier	579,943	57,098
FairPoint	295,360	4,783
Cincinnati Bell	233,200	11,700
Total Top Phone	**30,737,303**	**2,218,981**
Total Broadband	**67,674,790**	**5,424,134**

Sources: The Companies and Leichtman Research Group, Inc.

** LRG estimate*
*** Includes LRG estimates for Bright House Networks and Suddenlink*
Totals reflect pro forma results from system sales and acquisitions
Top cable and telephone companies represent approximately 94% of all subscribers
Company subscriber counts may not represent solely residential households

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