Leichtman Research Group, Inc.

Research Notes

3Q 2005 *Actionable Research on the Broadband, Media & Entertainment Industries*

Fear and Greed in DVR Land

It has been said that the two great motivators in business are fear and greed. For the TV industry of the last few years, nothing has wrought more of both of these elements than the Digital Video Recorder (DVR). Over-zealous forecasts (from the halcyon days of the late '90s) predicted that up to half of all US households would have a DVR today. And this fabulous potential incited the fear of a metamorphosis in TV viewing that would leave the traditional advertising-based revenue model on the verge of extinction.

Here we stand in 2005 and DVRs are making their way (at a reasonable pace) into more and more US households, and consumers are responding very positively to the service. Yet with a clearer vision in the present, we now see that the overall impact on TV viewing and the related advertising model may not be as substantial in the near-term as many had feared.

In this issue:

The Leichtman Research Group study … determined that 88% of DVR users "usually skip commercials when they watch programs recorded on their DVRs."

Although the ad-zapping statistic might appear jarring to advertisers and TV executives at first blush, LRG president Bruce Leichtman notes that ***56% of DVR users also skipped commercials before getting their DVRs.***

"There's this wide-eyed assumption, 'My god, people are skipping ads because of DVRs.' But people have been walking away from commercials forever," he said.

- The Washington Post
July 22, 2005

Recent consumer research from Leichtman Research Group, Inc. (LRG) found that the number of households with DVRs has more than doubled in both of the past two years. As of mid-2005, about 8% of all US households had a DVR – up from under 2% just two years ago.

On the greed part of the equation, DVRs are now generating millions of dollars of incremental revenue for DBS and cable operators, set-top box manufactures, and TiVo itself. Twenty-two percent of

LRG Leichtman Research Group

Time Warner Cable's digital cable customers subscribe to DVR service, and about 14% of all of DirecTV's customers get TiVo DVR service as part of their DBS subscription. (Yet, DirecTV has begun to shift away from the established TiVo brand, to deliver its own DVR offering – and more importantly, to save the over $1 monthly per subscriber fee to TiVo.)

> *DirecTV's decision to go its own way could "pave the way for more partnerships with cable companies" looking for an edge in DVRs . . .*
>
> *But others are less sanguine.*
>
> *"It comes back to this equation:* ***Do operators want to give up revenue (to TiVo) if they don't have to?****" says Leichtman Research Group President Bruce Leichtman.*
>
> **- USA Today**
> *August 23, 2005*

While DVR owners like the service very much (83% of DVR owners would strongly recommend their service to a friend), this does not mean that DVRs have dramatically changed the way that people watch TV.

- 70% of DVR owners say that they usually watch recorded programs when there are no regularly scheduled programs that they want to watch.
- Nearly half of DVR owners report that they record five or fewer programs each week – with the mean number of programs recorded each week being around 9.

If we (generously) assume that these recorded programs represent one-sixth of TV viewing in the typical DVR home, and multiply this by the 8% who have a DVR, *we find that about 1% of all TV viewing in the US today is of programs recorded on a DVR.*

Certainly the percentage of recorded viewing will grow over time. LRG forecasts that by the end of 2009, 42.5 million households will have a DVR (representing about 36% of US households at that time). If one-quarter of all TV viewing in those households is of recorded programming, it will mean that about 10% of all TV viewing will be of recorded DVR programs.

Yet the real fear of the DVR was, and still is, its related impact on the advertising business. LRG's study found that:

- 88% of DVR owners say that they usually skip commercials when they watch programs recorded on their DVRs

However, DVRs do not appear to be exclusively responsible for ad skipping.

- 56% of DVR owners also say that, even prior to getting their DVR, they often changed channels when commercials came on or avoided watching commercials.

Clearly DVRs make it easier to skip advertising, but DVRs did not give birth to ad zapping. For years now, advertisements were just one punch of a

TV remote, turn of a radio dial, or flip of a magazine page away from being omitted.

As we look forward to the continued growth of DVRs, perhaps we can now view it more in the light of day as a service/product that will help a growing segment of consumers evolve their TV viewing habits, rather than as a dreaded instigator of an abrupt change in advertising and TV environments.

Written by Bruce Leichtman, president and principal analyst for Leichtman Research Group. Reprinted with permission from September 14, 2005 issue of SkyREPORT.

"While ***these disparities are largely related to variations in household income across the states****, these differences are strikingly similar to the state-by-state splits in the 2004 presidential election," said Bruce Leichtman, [Leichtman Research Group's] president and principal analyst…*

- Information Week
August 17, 2005

Broadband Penetration Divided into "Red States and Blue States"

Leichtman Research Group (LRG) found that at the beginning of 2005 broadband penetration of households in the US stood at close to 29% nationwide. Significant state-by-state disparities in broadband penetration remain, however. While these disparities are largely related to variations in household income across the states, these differences are strikingly similar to the state-by-state splits in the 2004 presidential election.

- Eight states had broadband penetration over 35% – all voted for John Kerry in 2004
- Eleven states had broadband penetration at or below 20% – all voted for George Bush in 2004
- Cumulative broadband penetration in states that voted for Kerry was 33% – compared to 25% in states that voted for Bush

These findings are from LRG's updated report, *Broadband, Cable and DBS Across the US 2005*, that analyzes state-by-state penetration of high-speed Internet, and DBS television services. The report is based on recent information culled from a variety of sources, including the Federal Communications Commission (FCC) and others.

	Broadband Penetration*^
States voting for Kerry in 2004 election	33.0%
States voting for Bush in 2004 election	25.1%
US Overall	28.6%

Sources: Federal Communications Commission and Leichtman Research Group, Inc.
** Residential and small business broadband subscribers divided by total US Postal Service residential mailing addresses.*
^Cumulative average of the states.

In related broadband research, LRG found that as of the end of the second quarter of 2005, the twenty largest cable and DSL providers in the US, that represent 94% of the broadband market for cable and DSL, accounted for about

37.6 million high-speed Internet subscribers. Combined net additions for these providers in the second quarter of 2005 totaled 1.8 million subscribers – the fewest of any quarter in the past year.

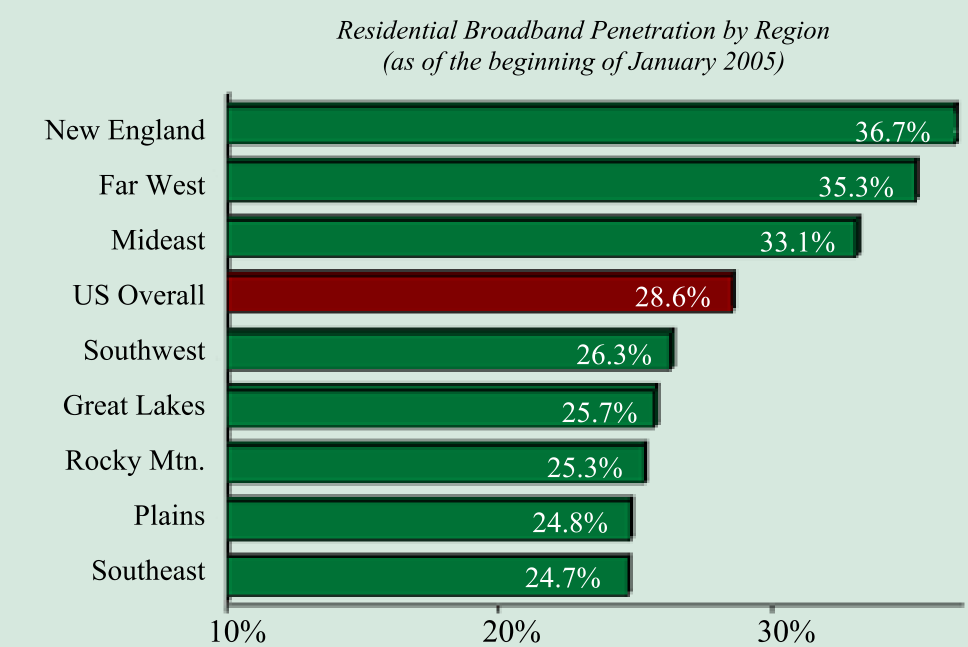
Other key findings for the quarter include:

- The top DSL providers added about 938,000 subscribers, representing 52% of the net broadband additions for the quarter versus cable, which added about 866,000 broadband subscribers
- The top cable broadband providers maintain a 6.4 million subscriber advantage over DSL, representing a 59% share of the total market versus DSL

Despite a seasonal slow down in net additions in the second quarter of 2005, in the first half of the year the top cable and DSL providers added nearly 4.4 million broadband subscribers. Nationwide, broadband continues to be one of the fastest adopted services in US history, but adoption is not yet consistent across all states.

*LRG's updated report, **Broadband, Cable and DBS Across the US**, compiles and analyzes state-by-state and nationwide statistics related to high-speed Internet and Direct Broadcast Satellite (DBS) television service. The tables and charts in this report are based on recent information culled from a variety of sources. This report is produced by LRG twice a year.*

LRG Research Highlights



Source: Broadband, Cable and DBS Across the US

Industry by the Numbers – (as of the end of 2Q 2005)

Top 10 Cable MSOs in the U.S.

	Passings	Subscribers	Availability	Penetration	Net Adds in 2Q 2005	Net Adds in 2Q 2004
Basic Cable	109,038,000	58,267,000		53.4%	(232,600)	(326,600)
Digital Cable	108,575,000	25,314,000	99%	23.3%	652,300	565,100
Broadband Internet*	106,600,000	21,785,000	98%	20.4%	866,100	829,000
Telephone	41,950,000	3,978,000	39%	9.5%	463,900	94,600

Sources: The Companies and Leichtman Research Group, Inc.
** Internet data does not include RCN*

DBS

	Subscribers	Net Adds in 2Q 2005	Total New Subscribers	Subscriber Acquisition Cost	Average Revenue Per Sub/Month
DIRECTV	14,670,000	225,000	964,000	$646	$67.79
EchoStar	11,455,000	225,000	799,000	$676*	$58.46
Total DBS	**26,125,000**	**450,000**	**1,763,000**		

Sources: The Companies and Leichtman Research Group, Inc.
** Includes leased equipment and unreturned box costs.*

Top Broadband Internet Providers in the U.S.

Broadband Internet Provider	Subscribers at end of 2Q 2005	Net Adds in 2Q 2005
Cable		
Comcast	7,705,000	297,000
Time Warner	4,323,000	201,000
Cox	2,846,438	97,779
Charter	2,022,200	43,800
Adelphia	1,556,567	70,537
Cablevision	1,519,864	79,285
Bright House Networks*	785,000	22,000
Mediacom	426,000	19,000
Insight	391,300	23,500
RCN	229,000	0
Cable One	209,600	12,200
Total Top Cable	**22,013,969**	**866,101**
DSL		
SBC	5,968,000	360,000
Verizon**	4,142,000	278,000
Bell South	2,473,000	124,000
Qwest	1,190,000	68,000
Sprint	590,000	39,000
Covad	554,400	7,000
ALLTEL	319,315	36,189
CenturyTel	194,847	21,079
Cincinnati Bell	145,000	4,400
Total Top DSL	**15,576,562**	**937,668**
Total Broadband	**37,590,531**	**1,803,769**

Sources: The Companies and Leichtman Research Group, Inc.

** Bright House Networks totals are estimates*
*** Verizon's totals are adjusted from last quarter to reflect the sale of some access lines – total includes Fios wireline broadbanc connections along with DSL*

Top cable and DSL providers represent approximately 94% of all subscribers. Company subscriber counts may not represent solely residential households.

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