Leichtman Research Group, Inc.

Research Notes

3Q 2008 *Actionable Research on the Broadband, Media & Entertainment Industries*

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DBS and Telcos: Friends and Foes

When you look at the "Industry by the Numbers" page in the back of these *Research Notes*, you will see a statistic that has never appeared before. For the first time ever, a Direct Broadcast Satellite (DBS) TV provider reported a net loss of subscribers for a quarter. DISH Network lost 25,000 net subscribers in 2Q 2008 and, combined with DIRECTV, the DBS industry as a whole gained just 104,000 subscribers in the quarter. While the top cable operators also cumulatively lost subscribers in the quarter, and five of the past six years – largely due to competition from DBS – the results for DBS established a low water mark for the industry.

There are numerous factors impacting the trends in the DBS industry:

- Saturation of the multi-channel video market – over 85% of households subscribe to some form of multi-channel video service
- A nationwide slowdown in new housing starts – essentially cutting in half the number of potential new subscribers
- Increased competition within the DBS industry – with DIRECTV directly positioning DISH Network as "the competition" in order to gain higher-end HD (high-definition) subscribers
- An inability to offer a bundle of video, Internet, and phone services (like cable) without partnering with a Telco
- **But, when factored with the other market trends, the top thing impacting DBS may be the Telcos' rollout of their own video services** (along with higher speed Internet services)

LRG's 1Q 2008 *Research Notes* discussed Verizon's rollout of FiOS TV services in Massachusetts, and the related impact on major cable providers in the state. As demonstrated in that analysis, Telcos do have an impact on cable providers in the limited areas where they are available, but it is becoming evident that Verizon and AT&T's rollout of video services may be having a larger effect on DBS.

The Telcos' impact on DBS is not only because of what they are doing – rolling out competitive TV services – but also because of what they are not doing – selling the bundled partnerships with DBS as often, as they emphasize their own video services and potentially take some subscribers already in those partnerships.

> *"What we're seeing is a change of gears to focus on the* ***higher end, more valuable subscribers,*** *[industry analyst Bruce Leichtman, head of the Leichtman Research Group, said]."*
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> *Bright House Networks — a Verizon competitor in the Tampa Bay market — is doing the same thing, Leichtman said, focusing on the subscriber who gets cable, phone and Internet. "And they've been very successful at driving that strategy," he said.*
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> **- St. Petersburg Times**
> *July 29, 2008*

The relationship between DBS providers and Telcos has been an important one over the past decade, as the two industries needed each other to provide the video and Internet bundle (and later the "Triple Play" video, Internet, and phone bundle), which cable could deliver on its own. The grouping of DBS and Telco broadband service also become a natural combination for consumers:

- A recent LRG survey found that 47% of DBS subscribers in areas where cable TV was available subscribed to a Telco broadband Internet service (while just 16% subscribed to a cable broadband service)
- At the end of 2Q 2008, there were nearly 4 million DBS subscribers in formal partnerships with RBOCs (AT&T, Verizon, and Qwest) – and LRG estimates that there are about 6 million more consumers who subscribe to DBS, as well as broadband Internet from these three Telcos who are not in bundled agreements

But the relationships between Telcos and DBS providers have shifted as Telcos have increased the distribution of their own landline video services. At the end of 2Q 2008, Verizon's FiOS and AT&T's U-verse video services were available to about 15 million households and accounted for a combined 1.93 million subscribers – an increase of 1.365 million over the past year.

LRG analysis of industry data reveals that the number of video subscribers obtained by the Telcos in the first half of 2008 is nearly the same as the number of video subscribers Telcos obtained in the first half of 2007 (a total of 1,067,000 in the first half of 2008 compared to 1,044,000 in the first half of 2007). There was, however, a major shift in the distribution of video subscribers – a shift from the DBS partnerships to the companies' own video services.

RBOC Video Adds		
	First Half 2007	First Half 2008
DBS partnerships*	688,000	310,000
Landline video**	356,000	757,000
TOTAL	1,044,000	1,067,000

** AT&T, Verizon, and Qwest – includes LRG estimates*

*** FiOS and U-verse TV services*

- In the first half of 2007, DBS partnerships accounted for 66% of RBOC video subscriber adds
- In the first half of 2008, DBS partnerships accounted for 29% of RBOC video subscriber adds
- There were 378,000 fewer DBS partnership adds in the first half of 2008 than in the same period in 2007
- Perhaps not coincidentally, DBS net adds in the first half of 2008 were 429,000 fewer than in the first half of 2007 (843,000 in the first half of 2007 vs. 414,000 in the first half of 2008)
- Gross adds (before churn) for DBS providers were also down 229,000 in the first half of 2008 from the prior year (3,569,000 in the first half of 2007 vs. 3,340,000 in the first half of 2008)

While upgraded FiOS and U-verse video and Internet networks represent only about one-third of all combined passings for Verizon and AT&T, the services demand a much greater share of the attention of the two companies. One of the key goals of these services is to sell the higher speed (and higher priced) Internet offerings that the upgraded networks provide. These upgraded Internet customers, however, often come at the expense of traditional (lower speed and priced) DSL subscribers. In the first half of 2008, Verizon added 449,000 FiOS high-speed Internet subscribers, but also had a net loss of over 130,000 DSL subscribers.

As Telcos continue to increase the availability and penetration of their video offerings, coupled with the higher speed Internet services, DBS subscribers (along with DSL subscribers) become targets for their acquisition strategies. In many ways it is much easier to switch a customer's video service from satellite to Telco, while increasing their Internet speeds, than to switch someone from cable TV and cable Internet service (not to mention discounted cable phone service).

Bundles are booming, analysts say.

Cable companies have signed up 15 million telephone customers in the U.S., and "the vast majority of them are in triple-play bundles," said Bruce Leichtman, president of Leichtman Research Group in Durham, N. H.

Consumers are opting in because they see a way to save on bills that have taken a bigger and bigger slice out of their household budgets. And then there's the convenience factor of dealing with a single vendor.

- **Buffalo News**
  August 16, 2008

DISH Network's CEO, Charlie Ergen, has for years said that the company's chief competition was cable TV. While it is still true that cable is the company's primary opponent, newfound direct competition among DBS providers, and increased competition from the Telcos is having a major impact on DISH Network, and the DBS industry as a whole – and this is a trend that is likely to continue.

DVRs Now in Over One-Quarter of U.S. Households

New consumer research from Leichtman Research Group, Inc. (LRG) found that 27% of TV households in the United States have at least one Digital Video Recorder (DVR), and 30% of those households have more than one DVR.

DVR owners are very happy with the service – 87% would recommend their DVR service to a friend, and 81% rate their DVR 8-10 on a 10 point scale (with 45% rating the service as 10). Yet recorded viewing is not necessarily the priority in DVR households – 68% of DVR owners say that they usually watch recorded DVR programs when there is nothing on regularly scheduled TV that they want to watch.

These findings are based on a survey of 1,300 households throughout the United States, and are part of LRG's study, *On-Demand TV 2008: A Nationwide Study on VOD and DVRs*. This is LRG's seventh annual study on this topic.

LRG's research also found that:

- 35% of DVR owners feel that they spend more time watching programs recorded on their DVR than regularly scheduled programs
- 45% of DVR owners record five or fewer programs per week
- 68% of digital cable subscribers say that they have used Video on-Demand – with 85% of this group having used VOD in the past month
- 42% of VOD users are more likely to keep digital cable because of on-Demand

The number of US households with DVRs has essentially doubled in the past two years and – with a continued push from cable, DBS, and Telco TV providers – will likely double again over the next four years. DVRs, along with on-Demand, continue to change the way that many people watch TV. LRG forecasts that DVRs and on-Demand's share of total TV viewing time in the US will increase from about 6% today to 16% at the end of 2012.

Only 6 percent of TV viewing is now time-shifted, either as a show recorded on a DVR and viewed later or as one seen through a video-on-demand service, according to a new study from Leichtman Research Group in Durham, N.H.

"For some programs, particularly on the broadcast networks, it has a greater impact," says Bruce Leichtman, president and principal analyst at LRG. "But in its totality, it's relatively modest."

- **MediaLife**
  September 16, 2008

Broadband Growth Slows in the Second Quarter of 2008

Leichtman Research Group, Inc. (LRG) found that the twenty largest cable and telephone providers in the US – representing about 94% of the market – acquired 887,000 net additional high-speed Internet subscribers in the second quarter of 2008. These top broadband providers now account for 65.1 million subscribers – with cable companies having 35.3 million subscribers, and telephone companies having over 29.7 million subscribers.

Other broadband findings for the quarter include:

- The top cable companies added over 670,000 subscribers, representing 76% of the net broadband additions for the quarter verses the top telephone companies
- Overall, broadband additions in 2Q 2008 amounted to 51% of those in 2Q 2007 – with cable having 85% as many additions as a year ago, and Telcos 23%
- The top cable broadband providers have a 54% share of the overall market, with a 5.6 million subscriber advantage over the top telephone companies
- The top cable broadband providers have a 54% share of the broadband market, with about a 5.1 million subscriber advantage over the telephone companies

Net broadband additions in the quarter were the fewest of any quarter in the seven years LRG has been tracking the industry. While the the relative number of quarterly broadband adds has certainly peaked, the decline in additions this quarter compared to the same period last year was exacerbated by Verizon and AT&T's emphasis on selling higher speed FiOS and U-verse bundled services, often at the expense of the traditional DSL service.

The 20 largest cable and telephone companies added a net 887,000 high-speed Internet subscribers in the three months ending June 30, according to Leichtman Research Group's tally . . . half that of the second quarter of 2007.

Bruce Leichtman, president of the firm, believes the decline in new customers was likely exacerbated by decisions at the two largest phone companies, AT&T and Verizon Communications, to emphasize faster, more expensive services over entry-level DSL.

- **USA Today**
  August 11, 2008

Industry by the Numbers – (as of the end of 2Q 2008)

Top 10 Cable MSOs in the U.S.

	Passings	Subscribers	Availability	Penetration	Net Adds in 2Q 2008	Net Adds in 2Q 2007
Basic Cable	114,650,000	57,800,000		50.4%	(225,000)	(240,000)
Digital Cable	114,250,000	37,100,000	100%	32.5%	800,000	1,225,000
Broadband Internet^	113,000,000	35,000,000	99%	31.0%	667,000	784,000
Telephone*	100,200,000	15,140,000	93%	15.1%	1,090,000	1,125,000

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

DBS

	Subscribers	Net Adds in 2Q 2008	Gross Adds in 2Q 2008	Subscriber Acquisition Cost*	Average Revenue Per Sub/Month**
DIRECTV	17,164,000	129,000	894,000	$707	$81.80
DISH Network	13,790,000	(25,000)	752,000	$699	$69.38
Total DBS	**30,954,000**	**104,000**	**1,646,000**		

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*

U.S. Residential Telephone Lines – Gains and Losses

	2Q 2007	3Q 2007	4Q 2007	1Q 2007	2Q 2008
RBOC Net Adds*	(990,000)	(1,292,000)	(1,483,000)	(1,615,000)	(1,924,000)
Cable Net Adds	1,125,000	1,140,000	1,140,000	1,160,000	1,090,000

Sources: The Companies and Leichtman Research Group, Inc.
** Retail residential phone lines include both primary and additional lines, but do not include wholesale lines*

Top Broadband Internet Providers in the U.S.

Broadband Internet Provider	Subscribers at the end of 2Q 2008	Net Adds in 2Q 2008
Cable		
Comcast	14,357,000	279,000
Time Warner	8,125,000	201,000
Cox*	3,885,000	40,000
Charter	2,787,300	19,300
Cablevision	2,395,000	52,000
Mediacom	702,000	14,000
Insight	424,600	12,400
Cable One	361,269	4,726
RCN	295,000	4,000
Other Major Private Companies**	2,000,000	45,000
Total Top Cable	**35,332,169**	**671,426**
Telephone Companies		
AT&T	14,693,000	46,000
Verizon^	8,330,000	54,000
Qwest	2,732,000	31,000
Embarq	1,364,000	24,000
Windstream	934,000	23,300
Century Tel	607,000	21,000
Frontier^^	559,300	16,280
FairPoint^^^	294,412	(1,166)
Cincinnati Bell	229,000	1,100
Total Top Phone	**29,743,012**	**215,514**
Total Broadband	**65,075,181**	**886,940**

Sources: The Companies and Leichtman Research Group, Inc.

** LRG estimate*
*** Includes LRG estimates for Bright House Networks and Suddenlink*
^ No longer includes Northern New England properties now part of FairPoint Communications
^^ Citizens Communications Company changed its name to Frontier Communications Corporation
^^^ FairPoint Communications added to the list this quarter
Top cable and telephone companies represent approximately 94% of all subscribers
Company subscriber counts may not represent solely residential households

LRG
Leichtman Research Group

Leichtman Research Group, Inc.
3 Ellison Lane
Durham, NH 03824
(603) 397-5400
(603) 397-5410 (Fax)
www.LeichtmanResearch.com