Leichtman Research Group, Inc.

Research Notes

4Q 2006 *Actionable Research on the Broadband, Media & Entertainment Industries*

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The Telco Video Story 2006: For What Its Worth

With 2006 coming to a close, so ends another abbreviated chapter of "The Telco Video Story." Despite continued strong efforts on the public relations front, and aggressive lobbying in Washington, DC and state capitals throughout the country, the telcos made limited progress over the past year in their long awaited efforts to deliver video service to compete with cable (and DBS).

The four largest telcos (the RBOCs) did add just over one million video subscribers in the year-long period from the third quarter of 2005 through the third quarter of 2006; however, about 90% of these new video subscribers came via DBS partnerships. As of the end of 3Q 2006, there were a total of 2.15 million subscribers in RBOC/DBS partnerships – compared to less than 200,000 subscribers to wireline video offerings from the telcos.

Over the past year:

- The top ten cable companies added about 235,000 Basic video subscribers
- DBS providers added nearly 1.8 million subscribers – with about one-quarter of net additions coming from telco partnerships. (About half of DBS subscribers in RBOC/DBS partnerships were new to the DBS provider, while the other half previously subscribed to the DBS company and opted-in to an RBOC package.)

At first glance, Verizon's fiber network appears to possess two major advantages: raw speed and huge capacity. The network already offers the highest Internet connections available. What's more, Verizon can offer countless HDTV channels minus the picture-distorting compression techniques cable and satellite operators allegedly use because of network-capacity shortages. . . . "There's very little content," said Bruce Leichtman of the consulting firm Leichtman Research Group. "If there was, maybe Verizon could take advantage of it."

- Dow Jones MarketWatch
September 15, 2006

LRG Leichtman Research Group

The newly revised edition of "The Telco Video Story" (as opposed to those written in the '90s) started being written about two years ago. And, while some may have forgotten the early chapters, a look back reveals that Verizon and SBC (now AT&T) projected that by the end of 2006 the two companies would combine to pass about 15 million households with a video offering. Yet, at the end of 3Q 2006, Verizon and AT&T actually passed a combined 1.25 million households with a landline video offering.

As a comparison, the top ten cable companies now deliver telephone service to about 75 million passings – having added about 23 million phone passings in the past year. In this timeframe, cable operators added about 2.5 million phone subscribers, and now have a total of over 7.7 million phone subscribers. (Over the past year, the RBOCs lost over 4.4 million retail phone lines – including primary and additional line losses.)

Yet the book is certainly not closed on telco video. In the words of Buffalo Springfield's '60's hit song, *For What It's Worth*:

There's somethin' happening here,
What it is ain't exactly clear.

Verizon and AT&T report that about 10% of households are subscribing to telco video services where they are being marketed. Verizon added nearly 100,000 FiOS video subscribers in the past two quarters alone, and the seemingly daily announcements of new franchise agreements now appear to be followed up with real deployments. And, AT&T did launch video service in parts of San Antonio, Texas in mid-2006 (with 3,000 subscribers at the end of 3Q 2006), and recently added service in the Houston areas. (AT&T will likely fall well short of its targeted twenty markets by the end of 2006.)

I think it's time we stop,
Hey, what's that sound,
Everybody look what's going down.

It will be interesting to see where "The Telco Video Story" is at this time next year.

HDTV Growth Still Driven by Higher Income Households

New consumer research from Leichtman Research Group, Inc. (LRG) found that the one in six households in the United States now have at least one high definition-capable TV (HDTV) – a rapid increase from about one out of every fourteen households just two years ago. Yet, as much as ever, a disparity exists in HDTV ownership by household income level.

LRG's latest research revealed:

- The mean annual household income of HDTV households is 42% above average
- 26% of households with annual incomes of over $50,000 have an HDTV compared to 7% of households with annual incomes below $50,000

These findings are based on a survey of 1,300 households throughout the United States, and are part of a new LRG study

Well-to-do consumers still dominate buying: 26% of HDTV owners have more than one set — up from 11% last year — according a study out Wednesday from Leichtman Research Group.

*"That's a dramatic difference," says Bruce Leichtman, president and principal analyst. "**What is developing is an HD divide**. If I'm a marketer, I realize I'm not just selling to new customers. I'm selling to a lot of existing customers."*

- **USA Today**
  October 24, 2006

HDTV 2006: Consumer Awareness, Interest and Ownership. This is LRG's fourth annual study on this topic.

Other key findings include:

- 26% of HDTV owners have more than one HDTV – up from 11% last year
- 29% of HDTV owners are likely to get another HDTV in the next year – up from 18% last year
- Only one-third of adults have heard of the digital TV transition, scheduled for February 17, 2009

Millions of HDTV sets have been sold in the US in the past year, and more homes than ever are actually watching HD programming. Yet even with the price of HD sets decreasing, we see that growth of HD is being driven by those who can most afford to buy one, which

Annual Household Income	Have an HDTV
Under $30,000	6%
$30,000 - $50,000	8%
$50,000 - $75,000	17%
$75,000 - $100,000	25%
Over $100,000	38%

in an increasing number of instances includes households with more than one HDTV set. With just two and a half years to go before the digital TV transition takes place, two-thirds of Americans remain unaware of the pending analog cut-off, helping to explain why this deadline has had little impact on the purchase of HD and digital TVs to date.

Over 2.5 Million Add Broadband in the Third Quarter of 2006

Leichtman Research Group, Inc. (LRG) found that the twenty largest cable and telephone providers in the US – representing about 94% of the market – acquired over 2.5 million net additional broadband subscribers in the third quarter of 2006. These top broadband providers now account for nearly 50.9 million high-speed Internet subscribers – with cable having over 28.1 million broadband subscribers, and telephone companies having 22.7 million DSL and other broadband subscribers.

Other key findings for the quarter include:

- The top telephone providers added 1.33 million broadband subscribers, representing 53% of the net broadband additions for the quarter versus cable
- Total net broadband additions were about 100,000 fewer than the third quarter of last year

- Telephone companies have added more broadband subscribers than cable providers in each of the last eight quarters, acquiring about 1.5 million more subscribers than cable over the past two years
- The top cable broadband providers still have a 5.4 million subscriber advantage over the telephone companies and command a 55% share of the market

Not surprisingly, the broadband market in the US bounced back in the third quarter of 2006 with about 450,000 more net additions than in the second quarter of the year. Through the first three quarters of 2006 there have been over 7.7 million net broadband additions.

[Comcast's] high-speed Internet business also is expected to continue expanding strongly, . . . according to Leichtman Research Group. Cable operators currently are getting about 45 percent of the new customers.

- Pittsburgh Post-Gazette
October 25, 2006

Industry by the Numbers – (as of the end of 3Q 2006)

Top 10 Cable MSOs in the U.S.*

	Passings	Subscribers	Availability	Penetration	Net Adds in 3Q 2006	Net Adds in 3Q 2005
Basic Cable	112,000,000	58,600,000		52.3%	23,000	(100,200)
Digital Cable	111,600,000	29,900,000	99.7%	26.8%	1,305,000	795,000
Broadband Internet^	109,800,000	27,880,000	98%	25.4%	1,190,000	1,218,000
Telephone**	71,500,000	7,440,000	69%	10.4%	880,000	495,000

Sources: The Companies and Leichtman Research Group, Inc.

** Totals reflect pro forma results from system sales and acquisitions, includes LRG estimates for Cox and Bright House Networks and Suddenlink.*
^ Internet data does not include RCN.
*** Telephone data does not include Bright House Networks.*

DBS

	Subscribers	Net Adds in 3Q 2006	Total New Subscribers	Subscriber Acquisition Cost*	Average Revenue Per Sub/Month
DIRECTV	15,678,000	165,000	1,006,000	$632	$72.74
EchoStar	12,775,000	295,000	958,000	$668	$62.86
Total DBS	**28,433,000**	**406,000**	**1,964,000**		

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	Subscriber adds in 3Q 2006	Net Adds in 3Q 2006
Cable		
Comcast*	11,000,000	536,000
Time Warner*	6,398,000	251,000
Cox**	3,200,000	75,000
Charter*	2,343,200	88,100
Cablevision	1,963,880	72,438
Insight	579,300	44,800
Mediacom	544,000	28,000
Cable One	276,434	15,172
RCN	269,000	12,000
Major Privately Held Companiies***	1,575,000	80,000
Total Top Cable	**28,148,814**	**1,202,510**
Telephone Companies		
AT&T	8,148,000	374,000
Verizon	6,583,000	448,000
Bell South	3,449,000	176,000
Qwest	1,973,000	175,000
Embarq	993,000	84,000
Windstream^	603,114	55,268
Covad	531,648	(16,341)
CenturyTel	340,000	27,147
Cincinnati Bell	187,000	12,200
Total Top Phone	**22,738,462**	**1,334,274**
Total Broadband	**50,887,276**	**2,536,784**

Sources: The Companies and Leichtman Research Group, Inc.

** Totals reflect pro forma results from system sales and acquisitions.*
*** LRG estimate.*
**** Includes LRG estimates for Bright House Networks and Suddenlink.*
^ Windstream was formed in July through the spinoff from Alltel and merger with Valor Communications.

U.S. Residential Telephone Lines – Gains and Losses

	3Q 2005	4Q 2005	1Q2006	2Q2006	3Q2006
RBOC Net Adds*	(1,032,000)	(943,000)	(883,000)	(1,423,000)	(1,219,000)
Cable Net Adds	495,000	610,000	750,000	740,000	880,000

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

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