Leichtman Research Group, Inc.

Research Notes

4Q 2008 *Actionable Research on the Broadband, Media & Entertainment Industries*

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The DTV Transition's Moving Parts

In less than two months, at midnight on February 17, 2009, the long-anticipated digital TV transition in the US will take place. Consumer awareness of the transition has rapidly grown in the past year. Just two years ago LRG found that only 33% of adults had heard of the digital transition, and last year 45% had heard of the transition, while an LRG survey conducted in September-October of 2008 found that 95% of adults were aware of the transition – and this awareness has likely increased even more in the past couple months as broadcasters and others have dramatically increased the frequency of information about the transition. Yet, while general awareness of the digital transition is now nearly ubiquitous, the actual implications of the transition remain unclear to many consumers.

As described on the National Telecommunications & Information Administration (NTIA) and US Department of Commerce's website for the TV converter box coupon program, www.dtv2009.gov, the end result of the digital transition is fairly simple:

> *At midnight on February 17, 2009, all full-power television stations in the United States will stop broadcasting in analog and switch to 100% digital broadcasting.*

The site further describes the benefits of the digital transition as:

> *Digital broadcasting promises to provide a clearer picture and more programming options and will free up airwaves for use by emergency responders.*

The Federal Communication Commission's (FCC) website for the digital transition, www.dtv.gov, uses a little more hyperbole to describe the benefits of the transition:

> *Digital Television (DTV) is an advanced broadcasting technology that will transform your television viewing experience. DTV enables broadcasters to offer television with better picture and sound quality. It can also offer multiple programming choices, called multicasting, and interactive capabilities. Converting to DTV also will free up parts of the scarce and valuable broadcast spectrum.*

Those portions of the spectrum can then be used for other important services, such as public and safety services (police and fire departments, emergency rescue), and advanced wireless services.

In reality, with over 85% of households in the US subscribing to some form of multi-channel video service (via cable, DBS, or Telco), the direct consumer benefits of the digital transition as described by the NTIA and the FCC – better picture and sound, and more programming options – will be a new experience for relatively few consumers.

Perhaps the most significant benefit of the digital transition, the freeing up of the "valuable broadcast spectrum," is not a tangible consumer benefit. As seen in the difference between the FCC and NTIA descriptions, this benefit has been somewhat repurposed over time to emphasize the emergency response advantages rather than the multi-billion dollars garnered from the sale of the spectrum for potential service in the future.

If it's flat and has a big-screen, it's high-def, right? Apparently, a lot of HDTV buyers think so.

A recent survey by the Leichtman Research Group (LRG) shows that 18 percent of HDTV owners think they're watching high-definition shows, when in fact they're viewing standard definition programming.

- **Washington Post**
  November 25, 2008

Given all the attention currently being paid to the digital transition, it is not surprising that many consumers believe that there is more in-store for them.

LRG's recent survey, as part of the sixth annual study on HDTV in the US, found that over one-third of adults who had heard of the digital transition believed that, after the digital transition, all programs will be in HD. This perception was frequently held among those to whom HDTV is important:

- 37% of current HDTV owners, and 48% of those interested in getting an HDTV believe that all TV programs will be in HD after the transition

Also, 16% of those who have heard of the digital transition believe that they will need to have an HDTV set to receive programming after the transition:

- This belief is held by about one quarter of non-subscribers to multi-channel video services, as well as 23% of multiple HDTV owners and 24% of those interested in getting an HDTV

Confusion related to HDTV is not unique to the relationship between HD and the digital transition. For example, LRG estimates that 18% of individual with an HDTV think that they are watching HD programming, but are not.

Although the broadcast digital transition itself may not be directly responsible for the growth of HDTV in the US, the FCC's related digital tuner rule, requiring all new TV sets as of March 1, 2007 to include digital tuners, almost certainly had a major impact on the market. The rule strongly contributed to the sale of tens of millions of digital television sets, and the growth of HDTV to over one-third of US households – a level of adoption that is highly unlikely to have been achieved by now if propelled solely by consumer market-driven forces.

Whether it is the sale of digital and HD television sets, the proliferation of HD programming options, or the migration from analog to digital cable, there are many "moving parts" that are directly or indirectly impacted by the digital transition, and these trends will continue long after analog broadcasts are turned off.

HDTV Sets Now in Over One-Third of U.S. Households

New consumer research from Leichtman Research Group, Inc. (LRG) found that 34% of households in the United States have at least one high definition television (HDTV) set – approximately double the percentage of households that had an HDTV set two years ago.

The growth of HDTV sets was largely driven by on-going consumer purchasing of TV sets coupled with a dwindling supply of lower-end non-HDTV sets being sold. Overall, 22% of all households purchased a new TV set in the past 12 months, with 43% of this group spending over $1,000 on a new TV.

These findings are based on a survey of 1,302 households throughout the United States, and are part of a new LRG study, *HDTV 2008: Consumer Awareness, Interest and Ownership*. This is LRG's sixth annual study on this topic.

> *Consumer electronics sellers, like car dealers, tell us every year that this is the best year to buy a new television.*
>
> *And in a sense, they — the consumer electronics people, that is — have been right. Each year has brought significantly lower prices and additional features to flat-panel sets, [and brought] them into 40 million American homes, 34 percent of total households in the United States, according to a study done by the Leichtman Research Group.*
>
> - **NY Times**
>   *December 2, 2008*

Other findings include:

- Combined, 38% of HD owners say that replacing an old/broken set or wanting to buy a new TV set was the most important reason for getting their HDTV – compared to 22% citing picture quality, and 7% the quality of HD programming or the number of HD channels
- 44% with annual household incomes over $50,000 have an HDTV compared to 20% with annual household incomes under $50,000
- 33% of HDTV owners have more than one HDTV set, and 25% are likely to get another HDTV set in the next year

- 9% of HD owners say that they switched multi-channel video providers when they purchased their HDTV
- 42% of HDTV owners say that they were told how to receive HD programming when they purchased their set
- LRG estimates that about 58% of all HD households are now watching HD programming from a multi-channel video provider – up from 53% last year. However, about 18% of individuals with an HDTV continue think that they are watching HD programming, but are not.

About 40 million US households now have at least one HDTV set, and LRG forecasts that this number will double over the next four years. While more people than ever before have HDTV sets, educating consumers on HD programming remains an issue.

1.3 Million Add Broadband in the Third Quarter of 2008

Leichtman Research Group, Inc. found that the twenty largest cable and telephone providers in the US – representing about 94% of the market – acquired approximately 1.3 million net additional high-speed Internet subscribers in the third quarter of 2008. These top broadband providers now account for nearly 66.7 million subscribers – with cable companies having 36.5 million broadband subscribers, and telephone companies having about 30.2 million subscribers. Other broadband findings for the quarter include:

- The top cable companies added over 870,000 subscribers, representing 67% of the net broadband additions for the quarter versus the top telephone companies
- Overall, broadband additions in 3Q 2008 amounted to 61% of those in 3Q 2007 – with cable having 82% as many additions as a year ago, and Telcos 40%
- The top cable broadband providers have a 55% share of the overall market, with a 6.3 million subscriber advantage over the top telephone companies

Bruce Leichtman, president and principal analyst for the company, said cable companies have succeeded in consistently marketing broadband as part of their bundled services as telephone companies focused on "higher value subscribers."

- **Newsday**
  November 22, 2008

Over the past two quarters the top cable providers accounted for 71% of the net broadband additions, adding over 900,000 more broadband subscribers than the top telcos. Cable's recent success compared to the telcos should not necessarily be interpreted as consumers suddenly choosing cable's speed advantage over that of the telcos' DSL service. It is more a function of the telcos' shift in focus towards higher value subscribers while cable has been consistent in marketing broadband as part of its nearly ubiquitously available Triple Play bundles.

Industry by the Numbers – (as of the end of 3Q 2008)

Top 10 Cable MSOs in the U.S.

	Passings	Subscribers	Availability	Penetration	Net Adds in 3Q 2008	Net Adds in 3Q 2007
Basic Cable	115,050,000	57,575,000		50.0%	(210,000)	(210,000)
Digital Cable*	114,650,000	37,860,000	99.7%	33.0%	765,000	780,000
Broadband Internet^	113,600,000	36,200,000	99%	31.9%	870,000	1,060,000
Telephone**	101,300,000	16,100,000	93%	15.9%	965,000	1,140,000

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

** Digital cable penetration of basic subscribers is 65.8%*

*** Telephone data does not include Bright House Networks or Suddenlink*

DBS

	Subscribers	Net Adds in 3Q 2008	Gross Adds in 3Q 2008	Subscriber Acquisition Cost*	Average Revenue Per Sub/Month**
DIRECTV	17,320,000	156,000	1,002,000	$715	$83.59
DISH Network	13,780,000	(10,000)	825,000	$735	$69.82
Total DBS	**31,100,000**	**146,000**	**1,827,000**		

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 3Q 2008	Net Adds in 3Q 2007
Verizon FiOS	1,615,000	233,000	202,000
AT&T U-verse	781,000	232,000	75,000
Total	**2,396,000**	**465,000**	**277,000**

Sources: The Companies and Leichtman Research Group, Inc.

U.S. Residential Telephone Lines – Gains and Losses

	3Q 2007	4Q 2007	1Q 2008	2Q 2008	3Q 2008
RBOC Net Adds*	(1,506,000)	(1,652,000)	(1,774,000)	(2,058,000)	(2,252,000)
Cable Net Adds	1,140,000	1,140,000	1,160,000	1,090,000	965,000

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 3Q 2008	Net Adds in 3Q 2008
Cable		
Comcast	14,738,000	381,000
Time Warner^	8,634,000	222,000
Cox*	3,945,000	60,000
Charter	2,858,200	70,900
Cablevision	2,427,000	32,000
Mediacom	726,000	24,000
Insight	445,100	20,500
Cable One	368,614	7,345
RCN	301,000	6,000
Other Major Private Companies**	2,050,000	50,000
Total Top Cable	**36,492,914**	**873,745**
Telephone Companies		
AT&T	14,841,000	148,000
Verizon	8,459,000	129,000
Qwest	2,793,000	61,000
Embarq	1,388,000	24,000
Windstream	962,700	28,400
Century Tel	628,000	21,000
Frontier	571,946	12,646
FairPoint	294,134	(278)
Cincinnati Bell	231,100	2,100
Total Top Phone	**30,168,880**	**425,868**
Total Broadband	**66,661,794**	**1,299,613**

Sources: The Companies and Leichtman Research Group, Inc.

** LRG estimate*
*** Includes LRG estimates for Bright House Networks and Suddenlink*
^ Time Warner totals now include commercial subs in order to be consistent with other providers
Top cable and telephone companies represent approximately 94% of all subscribers
Company subscriber counts may not represent solely residential households

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