Leichtman Research Group, Inc.

Research Notes

4Q 2009 *Actionable Research on the Broadband, Media & Entertainment Industries*

What a Difference a Decade Makes

With the decade nearing its close, now is an appropriate time to reflect on the striking changes that have taken place in the television and Internet marketplace over the past ten years. Three product categories – broadband (Internet service), DVRs (digital video recorders), and HDTVs (high definition televisions) – illustrate patterns of growth between the years 2000 and 2010 and offer useful lessons for the future.

How much growth has taken place in the past ten years?

- At the start of the year 2000, less than 1% of US households had a DVR; today nearly 40% have a DVR
- At the start of the year 2000, under 1% of US households had an HDTV set; today almost 50% have an HDTV set
- At the start of the year 2000, 1% of households subscribed to a broadband Internet service; today over two-thirds of US households subscribe to a broadband Internet service

A closer look at the evolution of DVR, HDTV, and broadband categories reveals several critical trends in the way that US consumers adopt new products and services. These trends are interrelated and may be taken as lessons that bear on predictions about new products and services going forward.

Lesson #1: Adoption and ongoing growth are frequently led by those with higher incomes. It is easier for those with greater disposable income to purchase a product when it is new, and an economic divide frequently remains well after adoption becomes more mainstream. As recent LRG studies documented, the household penetration of DVR, HDTV, and broadband is now significantly greater among those with annual incomes over $75,000 than among those with annual incomes under $30,000.

Annual Household Income	Have a DVR	Have an HDTV	Subscribe to Broadand
Under $30,000	16%	29%	37%
$30,000-$75,000	32%	44%	70%
Over $75,000	54%	61%	89%

Sources: Various LRG Surveys

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Lesson #2: Appeal alone does not drive adoption; changes in the marketplace, bundling and product delivery are often key. Rarely is consumer adoption purely about demand. How a product or service is priced or packaged can have major implications for short-run and long-run adoption. The "tipping point" is frequently not about an escalation in demand after the initial wave of early adopters, rather it is often related to changes in the way a product is priced or sold.

As a case in point, through the first five years of the decade, HDTVs were in 10% of US households, while DVRs were in only 6% of households. The more rapid increase in HDTV penetration over the past five years was linked to a reduction in the cost of the sets, coupled with the digital transition that essentially took lower priced alternatives of analog sets off the market.

DVRs are a prime example of how a change in the delivery of a product or service can dramatically alter consumer adoption. DVRs began receiving a great deal of attention at the Consumer Electronics Show in 1999, and expectations were high for widespread adoption of this "game changing" technology. Yet, as stand-alone boxes, adoption of TiVo and other early competitors was modest. It was not until the DVR was bundled into a satellite TV set-top box, and then a cable TV set-top box, that DVR penetration took off. Ultimately, the bundling of DVRs in HD-capable cable, DBS, and Telco boxes spurred DVRs to the current level of penetration, and this bundling with HD will continue to be the prime driver of future growth for DVRs.

> *Leichtman says HDTVs are the biggest driver of Blu-ray sales, and that is only the beginning of this dependency for the duo. He says the lowering price points for higher quality HDTVs is today's main factor helping the Blu-ray market grow. "Blu-ray is surviving because of the evolution of HDTVs," he claims.*
>
> **- Digital Trends**
> *November 30, 2009*

DVRs are an ideal proxy for many new products that attempt to "go it alone" as stand-alone devices. The number of stand-alone TiVo units peaked at 1.75 million in 4Q 2007, and now stands at 1.54 million units. Even with this modest deployment, TiVo is one of the most successful stand-alone devices in recent history. Many others have fallen by the wayside, while other new entrants like Apple TV, Slingbox, and Roku struggle to reach 1% penetration levels.

Lesson #3: New products and services take time to grow, and growth is rarely linear. Given the option of a new product or service, consumers are prompted to ask themselves: *What problem does this product or service solve? What benefit or advantage does this product or service provide when compared with alternative products that I already own* *or could purchase? At what cost?* Consumers' answers to these questions are likely to be affected by a number of factors noted above, including other offerings in the marketplace, pricing and the way that new products and services are bundled. As the growth of HDTV, DVR and broadband categories over the past decade illustrates, early growth is often slow and may escalate more rapidly once an ideal confluence of availability, marketing and marketplace conditions is achieved.

Did you know?

51% of multi-HDTV owners purchased a TV set in the past 12 months.

The proliferation of HDTVs, DVRs, and broadband over the past decade has forever altered the way that consumers watch television and use the Internet. As these three categories continue to expand over the next decade, new products and services will capitalize on the lessons their dynamic growth provides.

Nearly Half of U.S. Households Have an HDTV Set

New consumer research from Leichtman Research Group, Inc. (LRG) found that 46% 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 was spurred by declining HDTV set prices, along with the limited availability of non-HDTV sets being sold. The mean purchase price among those who bought an HDTV set in the past year was about 22% lower than last year. Among first year HDTV owners, the mean purchase price of an HDTV set was about $870 – 35% less than the price paid by new HDTV owners a year ago.

These findings are based on a survey of 1,300 households throughout the United States, and are part of a new LRG study, *HDTV 2009: Consumer Awareness, Interest and Ownership*. This is LRG's seventh annual study on this topic.

Other findings include:

- 61% with annual household incomes over $75,000 have an HDTV – compared to 44% with annual household incomes of $30,000-$75,000, and 29% with annual household incomes under $30,000
- 38% of HDTV owners have more than one HDTV set
- 36% of HDTV owners say that they were told how to receive HD programming when they purchased their set
- 6% of HDTV owners switched video providers because of HD
- LRG estimates that about 64% of all HD households are now watching HD programming from a multi-channel video provider – up from 58% last year. However, about 14% of individuals with an HDTV continue think that they are watching HD programming, but are not.

With the cost of HDTV sets decreasing, HD penetration grew across all incomes groups over the past year. Lower prices also helped to expand the number of HDTV sets in many homes – multiple HD sets account for about 35% of all HD sets in US households.

Over 900,000 Add Broadband in the Third Quarter of 2009

Leichtman Research Group, Inc. found that the nineteen largest cable and telephone providers in the US – representing about 93% of the market – acquired 910,000 net additional high-speed Internet subscribers in the third quarter of 2009. These top broadband providers now account for over 70.8 million subscribers – with cable companies having 38.7 million broadband subscribers, and telephone companies having about 32.2 million subscribers.

Other broadband findings for the quarter include:

- The top cable companies added about 650,000 subscribers, representing 72% of the net broadband additions for the quarter versus the top telephone companies
- Overall, broadband additions in 3Q 2009 amounted to 70% of those in 3Q 2008 – with cable having 75% as many additions as a year ago, and Telcos having 60% as many adds as a year ago

Did you know?

In the first three quarters of 2009, major cable and phone companies added 3.1 million net new broadband Internet subscribers.

One advantage that is likely to prove more powerful over time is the high speeds of the cablecos compared to telcos. Nearly 90 percent of cable broadband lines have speeds over 2.5Mbps in the fastest direction, compared to 46% of the telco's DSL and fiber, according to Leichtman Research Group, Inc.

- TelecomTV
November 6, 2009

- Comcast had 362,000 net broadband adds in 3Q 2009 – more than the combined adds for all Telcos
- The top cable broadband providers now have a 55% share of the overall market

While the top cable and telephone companies now account for over 70 million subscribers, the market was still able to add over 900,000 subscribers in 3Q 2009. Over the past year, the top broadband providers have added nearly 4.2 million subscribers – with cable providers accounting for 53% of the total.

Industry by the Numbers – (as of the end of 3Q 2009)

Top 10 Cable MSOs in the U.S.

	Passings	Subscribers	Availability	Penetration	Net Adds in 3Q 2009	Net Adds in 3Q 2008
Basic Cable	116,150,000	56,100,000		48.3%	(380,000)	(220,000)
Digital Cable*	116,000,000	39,900,000	99.8%	71.1%	560,000	765,000
Broadband Internet**	115,000,000	38,350,000	99%	33.3%	650,000	870,000
Telephone***	104,500,000	18,900,000	95%	18.1%	605,000	965,000

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*

Telco Video

	Subscribers	Net Adds in 3Q 2009	Net Adds in 3Q 2008
Verizon FiOS	2,708,000	191,000	233,000
AT&T U-verse	1,817,000	240,000	232,000
Total	**4,525,000**	**431,000**	**465,000**

Sources: The Companies and Leichtman Research Group, Inc.

DBS

	Subscribers	Net Adds in 3Q 2009	Gross Adds in 3Q 2009	Subscriber Acquisition Cost*	Average Revenue Per Sub/Month**
DIRECTV	18,441,000	136,000	1,086,000	$697	$85.32
Dish Network	13,851,000	241,000	887,000	$694	$69.51
Total DBS	**32,292,000**	**377,000**	**1,973,000**		

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*

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U.S. Residential Telephone Lines – Gains and Losses

	3Q 2008	4Q 2008	1Q 2008	2Q 2009	3Q 2009
RBOC Net Adds*	(2,222,000)	(1,890,000)	(1,768,000)	(1,774,000)	(1,864,000)
Cable Net Adds	965,000	720,000	715,000	505,000	605,000

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 2009	Net Adds in 3Q 2009
Cable		
Comcast	15,684,000	362,000
Time Warner	9,167,000	121,000
Cox*	4,150,000	40,000
Charter	3,010,100	52,400
Cablevision	2,522,000	19,000
Mediacom	765,000	11,000
Insight	493,400	11,900
Cable One	388,567	2,095
RCN	309,000	2,000
Other Major Private Companies**	2,170,000	32,500
Total Top Cable	**38,659,067**	**653,895**
Telephone Companies		
AT&T	15,638,000	90,000
Verizon	9,174,000	63,000
Qwest	2,951,000	28,000
CenturyLink^	2,189,000	43,500
Windstream	1,050,500	25,900
Frontier	621,331	7,521
FairPoint*	295,000	(1,107)
Cincinnati Bell	234,500	(900)
Total Top Phone	**32,153,331**	**255,914**
Total Broadband	**70,812,398**	**909,809**

Sources: The Companies and Leichtman Research Group, Inc.

** LRG estimate*
*** Includes LRG estimates for Bright House Networks and Suddenlink*
^ On July 1, 2009, CenturyTel and Embarq merged to form CenturyLink
Totals reflect pro forma results from system sales and acquisitions
Top cable and telephone companies represent approximately 93% of all subscribers
Company subscriber counts may not represent solely residential households

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