

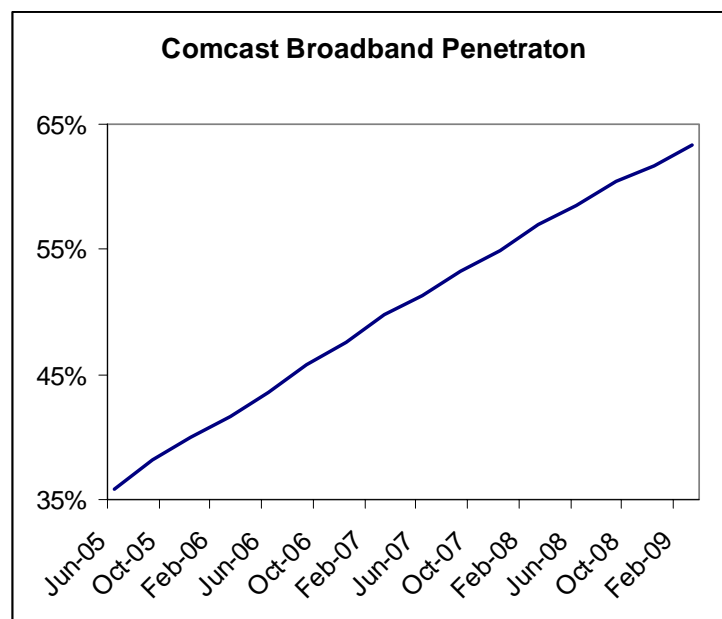
Cable TV – These are the good old days

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With recent strong operational and financial results at Comcast, Time Warner Cable and others, the cable industry looks to be sitting pretty. Driven by strong broadband growth, digital tier upgrades, increasing voice penetration and even a one-time boost from the broadcasting analog to digital conversion, the cable industry has done an admirable job of weathering the stormy economic downturn.

But from our perspective, this could just be cable's high water mark. Consider where those strong cash flows are coming from.

Broadband growth, while very strong so far, is increasingly running into headwinds as the overall percentage of video customers getting broadband reaches penetration in the mid 60's. After all, and unlike video, the cable company gets no additional revenues from having more computers in the household – so once you sign up a customer for broadband, that's pretty much it. With two thirds of their customers already getting broadband, the penetration "S" curve is destined to roll over (for example, see Comcast's data below.)





Competition in broadband is also heating up at the high end, with Cox and Cablevision rolling out DOCSIS 3.0 offerings to compete with Verizon's FiOS – a development that could ignite a new war of capital expenditures.

Likewise, while the cable firms have done an admirable job of stealing the phone company's bread and butter voice lines, with consumers increasingly abandoning voice lines completely in favor of wireless, this is a game of getting a bigger slice of a rapidly shrinking pie. While such a strategy produces impressive growth when the slice is small and the pie is large, it is unsustainable once the slice gets to be a decent chunk of the pie.

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And, speaking of bread and butter, in a case of turnabout being fair play, the phone companies are coming after the cable companies' bread and butter – delivering video programming. While the impact varies from one cable company to the next, AT&T's and Verizon's fiber based triple plays are available in about 10% of cable homes, and that number is growing rapidly. (For example, Verizon's FiOS is now available in nearly 10 million homes – and 2.2 million of them have already signed up.) While the margins on voice and data services are higher than video, the biggest portion of triple play revenues goes to video, so losing video customers hurts – and competing for them leads to poor margins for everyone.

And it's not just the telco guys who are threatening the video golden goose – it's Hulu, YouTube and other online video offerings. Not only do they compete for viewers' time and attention, but perhaps more importantly they are a mortal threat to the bundled programming tiers that have served the cable companies and content owners so well. By disintermediating the programming tier capabilities of the cable company, these services nullify the ability of cable firms to charge tolls to programmers seeking carriage while compelling viewers who want ESPN to take the ABC Family Channel too.

So, even as our economy begins to emerge from this economic recession, I suspect the cable firms will indeed look back on these days as the good old days.



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