

## **Cable Industry Prospects**

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Cable's standing with financial markets has cycled between intoxication and disdain. Today's uncertainty about cable fits this historic pattern and, as with earlier extremes, is overdone.

In the mid-1970s, things looked bleak; operators seemed blocked by regulatory obstacles and lack of marketable product for households in large urban markets. Then came satellite distribution, addressable set-tops, an explosion of programming content, and a famous test of "blue sky" interactive cable services (the Time-Warner Qube system in Columbus, Ohio). Money flowed into cable for expansion in urban markets.

By the mid-1980s, Qube was abandoned, operators had penetrated most urban areas, cash had been consumed to build out and expand their networks, and telephone companies were looking like potential competitors. Conventional wisdom about cable turned gloomy. Once again, the financial markets were out of phase with reality. In fact, cable companies would soon become cash generators as revenues grew on fixed plant built in the early part of the decade.

By the early 1990s, a new network architecture using fiber optics, hybrid fiber coax (HFC), improved network reliability and allowed substantial expansion of capacity for low incremental cost. New programming networks emerged to use the capacity, and operators increased their average revenues per subscriber units (ARPU) to unforeseen levels. MSOs explored a new use for their cable plant to support networks for personal communications services (PCS), the next generation of mobile telephony. A legendary cable leader forecast a future with 500 channels. Market sentiment turned positive.

By the mid-1990s, PCS networks had evolved separately from cable. Demand for 500 channels was in question, and their actual availability seemed to recede into the future. Direct-to-home broadcast satellite service (DBS) was suddenly a real competitor; DirecTV (1994) and Echostar

(1996) entered the market with high-power Ku-band satellites that offered all-digital channel capacity exceeding that of most cable systems.

Such disappointments and concerns would have depressed the market's views about cable but for over-riding good news: telco competition was fading, interactive TV and broadband Internet access were on the horizon, and the market in general was heading into a gigantic end-of-century bubble for technology companies including cable. Cable was hot.

Then came the collapse of the NASDAQ and the wheel turned again. Tech companies were in the doghouse, iTV was on a back burner, many MSOs carried a lot of debt and several filed for bankruptcy protection, and cable accounting practices were regarded warily. Cable share values dropped dramatically from their recent highs although generally not to the extent of the Internet and telecoms companies that had soared much higher and had much further to fall. To repair the damage, the National Cable and Telecommunications Association (NCTA) published accounting guidelines that would provide more visibility and standardization. Operators highlighted their steps to get to free cash flow faster by cutting their capex budgets.

In recent months the market has turned tentatively more positive towards cable, as towards other communications businesses, but it is still out of phase with the fundamentals. Cable operators have largely completed a massive rebuild of fixed plant, spending approximately \$70 billion since 1997. Cable's platform is generally competitive with DBS and can support multiple new revenue streams from broadband Internet access, digital video tiers, on-demand video, and soon, IP telephony. Because future capex requirements will tend to be success-based, growth in top-line revenues will flow increasingly to free cash flow. Operators are well positioned to exploit new opportunities for growth with relatively little additional fixed investment.