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Judgment Day: Indy Show Experts Cross-Examine Programming Costs

Cable's entire video business model went on trial Wed at the **Indy Show** in San Diego, with experts from all sides arguing that the current trajectory is basically unsustainable. "The foe is the price of the bundle," argued **Moffett Research** partner *Craig Moffett.* Cord cutters aren't necessarily ditching the video bundle for OTT, he said, "they're disconnecting for over-the-air broadcast TV because that's all they can afford... The risk is that the bundle gets so expensive that people are forced to look for an alternative." Noting **Comcast**'s earnings call Wed in which the MSO said content costs are expected to increase 10% YOY for the full year, Moffett put it this way: "I think the surprising thing about the 10 percent number is that it doesn't surprise anyone anymore." He called it "a horrifying thing" for the industry as programmers—under massive Wall Street pressure to grow despite full distribution—feel cornered into demanding constant price hikes. "The closer they get to the cliff, the more they step on the accelerator," he said. **Needham & Co** managing director *Laura Martin* said programmers are unlikely to unbundle their various nets, so "I think over time you might have to throw off entire bundles." That's a scary prospect, considering that many of those bundles include sports content vital to customer retention and **Deutsche Bank** managing dir *Douglas Mitchelson* predicting that rising sports costs won't top out any time soon. "It's pretty early days, and sports still has a huge amount of leverage," he said. But in another Wed panel, **Pac 12** evp/gm *Lydia Murphy-Stephans* defended sports pricing as both necessary to fund the "extraordinary" live production costs and to recognize its "DVR-proof" value. **Fox Networks** pres, distribution *Michael Hopkins* got a few audible groans from the small operator-heavy crowd when he suggested that "sports is a pretty small percentage" of the overall cable bill after factoring in equipment fees and other charges: "Set-top box charges are more than **ESPN**." But he said "both programmers and distributors have failed" on rising costs over the years. "Had we all just said 'let's do video on demand' in 2001, I wonder what the DVR penetration would be today," he mused, adding that half of some Fox shows' total viewing is now time-shifted. Hopkins also suggested that cable emphasize the bundle's value, noting that grocery store owners don't publicly complain about the wholesale price of **Coke**. "I think we spend a lot more time denigrating our industry than promoting it," he said. "We should focus more on promoting what we have instead of publicly talking it down." **NBCU** evp, content distribution *Matt Bond* agreed that cable content is "dramatically by magnitudes improved over what it was 20 years ago"

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Access Intelligence, LLC, 4 Choke Cherry Road, 2nd Floor, Rockville, MD 20850

and has never been a better value. That discussion prompted **MCTV** pres *Robert Gessner* to rise from the audience and take the mic to argue that it's not about value—it's about affordability. Challenging the earlier Coke analogy, he said "I think it would be a far different world if every grocer said you could sell it in a 5-gallon bucket, and that's it." The Indy Show crowd then applauded. And so the trial continues…

Comcast 2Q: When it comes to raising debt to fund M&A activities, **Comcast NBCU** execs have a different take than *John Malone*. Given Comcast's total amount of debt ($48bln), "we feel that we are very comfortable in the range that we have set, which is 1.5 to 2 times," CFO *Michael Angelakis* said on the company's earnings call Wed. Asked if Comcast would be willing to raise the same level of debt (4 times or so) that Malone reportedly is considering for **Charter** to take on to acquire a company like **Time Warner Cable**: "We really prefer to have a bit of conservatism in our balance [sheet] that provides appropriate flexibility… we are pleased with where we are going right now," the financial chief said. When it comes to the company's view on M&A, chmn/CEO *Brian Roberts* was a little vague: "We are really focused on just running the business and executing our plan" while "we want to make sure we are very well educated on what the market is in those kinds of items." Just how big can Comcast get in the US in cable? "I don't think there really is [a limit]. There's been a number of [FCC] rulemakings that have been knocked down, but obviously that's a gray area," Roberts said. Comcast "can't play a major role in consolidation," Moffett Research's *Craig Moffett* wrote in a research note Wed. "They're more like the chaperone, watching and tut-tutting from the back of the room" and from a regulatory perspective, "vertical integration precludes getting much bigger horizontally," he said. On the programming side, **NBC Sports** isn't worried about **Fox Sports 1**. "We have always had a lot of competition for rights between **ESPN** and **Fox** and **Turner** and others," Roberts said. While programming costs were less than expected in the period (8% increase YOY), the company expects low double-digit increases in the 2nd half of the year from planned step-ups in some contracts and the timing of network launches. As a result, full-year programming expenses are expected to be up 10% YOY, according to Angelakis. Moffett said Comcast "isn't going to play much of a role in constraining programming cost" because "as a vertically integrated player they are fundamentally conflicted." Overall, the company upped its net income to $1.7bln, a 29% increase YOY thanks to broadband growth and increase in bundling. Revenue was up 7% YOY. On the Comcast Cable side, HSD was a bright spot with 187K net additions, the highest 2Q net adds in the last 5 years. The rollout of wireless gateways and WiFi hotspots, as well as new products like X1, contributed to a 17.1% YOY increase in capital expenditures ($1.5bln total). The MSO is on track to begin deploying its next generation cloud-based guide X2, which features voice control, by year-end. On the video side, the MSO reduced its sub losses by 10% as it lost 159K video subs in the period vs a loss of 176K a year ago. The company added 161K digital voice subs, up 3K YOY. Combined net additions of voice and data subscribers increased to 189K compared to 138K last year, and Comcast now counts 52.1mln subs with all 3 products combined.

CBS: A day before **Time Warner Cable** steps up to the earnings plate, **CBS** hit it out of the park. Revenue grew 11% YOY to $3.7bln, ahead of analyst's $3.5bln expectation. Net income grew to $472mln from $427mln in 2Q12. As for its negotiations with Time Warner Cable (currently set to expire at 5pm ET Fri), Moonves was brief. "Receiving fair value for our content is core to who we are, and we will remain resolute to the principle, now and in all future negotiations," he said. More than 85% of CBS viewing is through satellite, cable or telco video providers, he said. As for **Aereo**, "we think it's a lot more wind than reality—we don't think it's catching on at all," Moonves said. He dismissed the idea that Washington might intervene in retrans, saying he has seen no interest. For 2Q, advertising revenues were up 5% driven by an 11% increase at CBS broadcast. Cable networks increased 16% to $518mln from $446mln for the same prior-year period. "We had affiliate revenue increases across all types of distributors—traditional cable, DBS, and telco," said CBS COO *Joseph Ianniello*.

OTT: **Amazon** said it would produce 5 more original pilots for kids to stream on Amazon Instant Video and LOVEFiLM in the UK. On tap: "Gortimer Gibbon's Life on Normal Street," a live action show about 3 tweens in a surreal world; "Grid Smasher," mixing puppetry and CGI; "Hard-Boiled Eggheads," animated special agents for kids 6-11; "The Jo B. & G. Raff Show," aimed at preschoolers; "Wishenpoof!," animated series by the creator of "Blue's Clues" and "Super Why."

Earnings: **Crown Media** shares closed up 18 cents, a 6.5% increase, after it reported solid 2Q numbers. Rev climbed to $89.5mln from $86.7mln a year ago. Net income climbed 22% to $16.5mln. During Wed's earnings call, Crown chief *Bill Abbott* talked up the power of original scripted series, pointing to the ratings success of **Hallmark Channel**'s "Cedar Cover." He also touted Hallmark Movie Channel, which saw 30% growth in upfront revenue.

BUSINESS & FINANCE

People: **NFL** Net pres/CEO *Steve Bornstein* will exit when his contract expires in the spring of '14, the *NY Times* reported. He'll be succeeded by NFL Media COO *Brian Rolapp*. -- **NCTC** elected 3 new directors to its board: **Suddenlink**'s *Gordon Bourne*, **RCN, Grande and Choice Telecom** CEO *Jim Holanda* and **Antietam Cable**'s *Brian Lynch*. *John Higginbotham* of **Franklin Plant Board** was re-elected to a 3-year term, having joined the board in '11 to fill an unexpired term. -- **Turner Media Group** tapped *Marie Hughes* as vp, strategic media planning. -- **Viacom** promoted *Karim Mawji* to svp, digital platform for its music & ent ad sales group.

Honors: Congrats to **Cox**, ***CableFAX The Magazine***'s MSO of the Year. "We really like to treat customers as we would like to be treated," **Cox** pres *Pat Esser* told us. **Cable One** was named Independent Operator of the Year and honored at Tues' Independent Show dinner. The average tenure for employees companywide is 10 years, with 14% having been there more than 20 years. Read about all it in the just released Top Ops edition of ***CableFAX: The Magazine*** at cablefax.com. -- **ACA** presented its PAC Leadership Award to Armstrong and its PAC Individual Award to **GCI** pres/CEO *Ronald Duncan*. **Outdoor Channel** received the Partnership Award for its support of ACA as an associate members, and **Shentel**'s *Chris Kyle* took home the *Lyn Simpson* Grassroots Spirit Award.

CableFAX Daily Stockwatch

Company	07/31 Close	1-Day Ch
BROADCASTERS/DBS/MMDS		
DIRECTV:	63.28	0.65
DISH:	44.65	1.36
DISNEY:	64.65	0.47
GE:	24.37	(0.11)
NEWS CORP:	29.88	0.46
MSOS		
CABLEVISION:	18.69	0.20
CHARTER:	125.74	1.96
COMCAST:	45.08	2.37
COMCAST SPCL:	43.10	2.31
GCI:	8.85	(0.12)
LIBERTY GLOBAL:	81.12	0.59
LIBERTY INT:	24.46	(0.12)
SHAW COMM:	24.84	(0.39)
TIME WARNER CABLE:	114.07	(0.93)
WASH POST:	537.36	1.66
PROGRAMMING		
AMC NETWORKS:	68.26	1.24
CBS:	52.84	0.51
CROWN:	2.97	0.18
DISCOVERY:	79.72	(1.28)
GRUPO TELEVISA:	27.10	0.64
HSN:	60.06	0.39
INTERACTIVE CORP:	50.61	(2.02)
LIONSGATE:	32.53	0.23
SCRIPPS INT:	70.77	(0.15)
STARZ:	22.49	0.07
TIME WARNER:	62.26	0.19
VALUEVISION:	5.93	0.21
VIACOM:	73.30	0.67
WWE:	10.64	(0.06)
TECHNOLOGY		
ADDVANTAGE:	2.59	0.04
ALCATEL LUCENT:	2.54	0.08
AMDOCS:	38.47	0.16
AMPHENOL:	78.56	0.59
AOL:	36.84	0.28
APPLE:	452.53	(0.79)
ARRIS GROUP:	15.04	0.07
AVID TECH:	5.96	(0.24)
BLNDER TONGUE:	1.00	0.05
BROADCOM:	27.57	(0.27)
CISCO:	25.59	(0.08)
CONCURRENT:	8.14	(0.26)
CONVERGYS:	18.93	0.07
CSG SYSTEMS:	23.68	0.13
ECHOSTAR:	39.96	0.32
GOOGLE:	887.75	(3.17)
HARMONIC:	7.66	0.10
INTEL:	23.34	(0.04)
JDSU:	14.67	0.02
LEVEL 3:	22.05	0.19
MICROSOFT:	31.84	(0.01)
RENTRAK:	21.48	0.03
SEACHANGE:	11.78	(0.16)
SONY:	21.04	(0.59)
SPRINT NEXTEL:	5.96	(0.2)
TIVO:	11.05	0.02
UNIVERSAL ELEC:	30.83	0.84
VONAGE:	3.22	(0.14)
YAHOO:	28.09	0.04
TELCOS		
AT&T:	35.27	(0.15)
VERIZON:	49.48	(0.94)
MARKET INDICES		
DOW:	15499.54	(21.05)
NASDAQ:	3626.37	9.90
S&P 500:	1685.73	(0.23)

Think about that for a minute...

They're Both Right

Commentary by Steve Effros

Cable operators at this year's Independent Show were treated to an almost classic analysis of the challenges that always face us when it comes to dealing with outmoded and unfair regulation and competition.

On one side was cable pioneer Mike Willner, warning that seeking legislative solutions always has to be tempered with the cautionary aphorism "Beware of what you ask for, you may get it!" His message was clear: legislative action always carries with it the risk that once the legislative ball starts rolling, it can tend to change direction and roll right over you! There's no such thing as assuring control of a legislative agenda, particularly in telecommunications. Once it starts, there's no telling where it goes, and in the case of cable and broadband could easily careen toward areas like common carriage and rate regulation.

On the other side, ACA's able leader Matt Polka has long pointed out that the situation, particularly as it applies to things like retransmission consent and outdated regulations, has gotten to the point where there are simply no options left for the smaller cable operator. Retrans has become "take it or leave it" negotiations with an entity that has long been protected by the government and is using the public's bandwidth for free. The FCC's application of rules, like the CableCARD mandate, which is over 17 years old and doesn't apply to our biggest competitors today, is emblematic of legislation that is long overdue for change.

Both Mike and Matt are right. That's the problem. The industry has long complained about the fact that the FCC enforces rules they believe they are required to, even though they know they are outdated. I have argued for years that the Commission could apply the notion of "forbearance" far more than it has to date and eliminate many of the inequities. Sure, they would be taken to court, but I suspect most courts would give deference to an "expert agency" that said these rules are simply no longer applicable given the new competitive marketplace. This is far more likely than the reverse, where the Commission claims new jurisdiction because of new conditions, even though it is not in the legislation! Yet the Commission does that all the time, and often wins. So what's the harm in trying the forbearance route?

In the meantime, however, Matt is right that continued pressure and education of Congress is always a good idea. As should be obvious, if we don't do it, you can be darn sure that someone else will! The last thing we want to happen is what took place in the early '90s when the industry was so concerned about the "unintended consequences" of legislation that we chose not to play. We stayed out of the behind-the-scenes process of drafting the legislation, regulations and the report language surrounding them and decided to simply try to kill the "rewrite." We lost, big time. So we can't simply disengage because we are worried that something might happen. If we do, you can be sure it will!

On the other hand, Mike is right that major telecommunications legislation is a massive undertaking, highly unlikely to consist of just "targeted" issues, and if it starts to roll over a multi-year period, it will not be controlled by any one group. By the time it's over, everyone will and should be concerned about the outcome. In other words, we have to heed the wise advice of both of them, and choose our strategies with care.

Steve

T:202-630-2099
steve@effros.com

(Steve Effros was President of CATA for 23 years and is now an advisor and consultant to the cable industry)