The State of U.S. DBS (Circa 3rd Q 2004)

Only a few foresaw the huge potential of direct broadcast satellite.

By Jimmy Schaeffler ■ *The Carmel Group*

It began ten years ago in the form of the first U.S. high-power Direct Broadcast Satellite system launch. It has since become something most pundits never thought possible. Today, U.S. DBS has penetrated one out of every 4.6 of the 107 million U.S. TV Households, and one out of every 3.8 of the 89 million U.S. multichannel TVHHs.

Behind those statistics are 13+ million DirecTV subscribers, 10+ million EchoStar subs, and 25,000+ Voom subscribers. By any standard, that growth is truly remarkable.

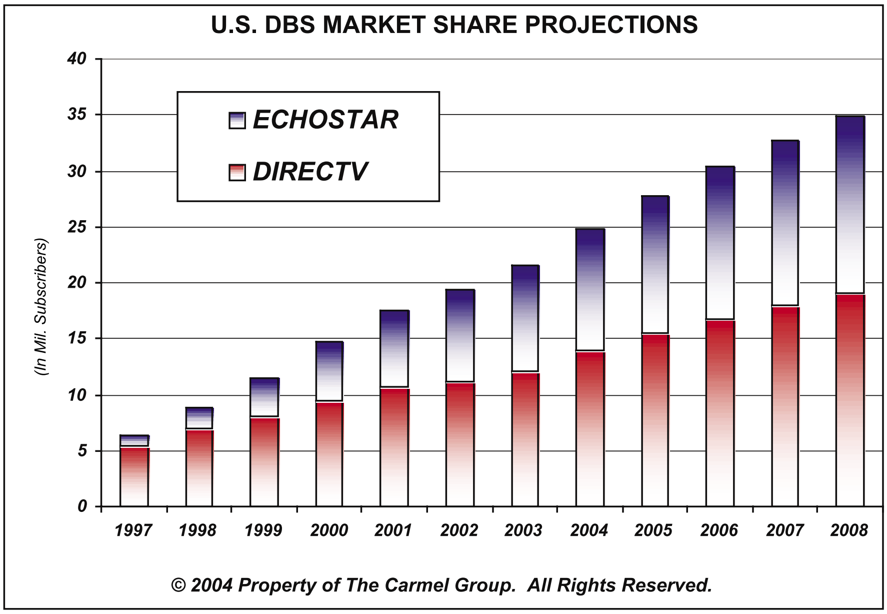
Yet, the events of just the past nine months — since Rupert Murdoch, Chase Carey and Mitch Stern took over the real reins of DirecTV — offer the best key to understanding DBS's future. What's happened in that period is also the basis of The Carmel Group's seven-year projections of 33 million total subscribers by year-end 2010.

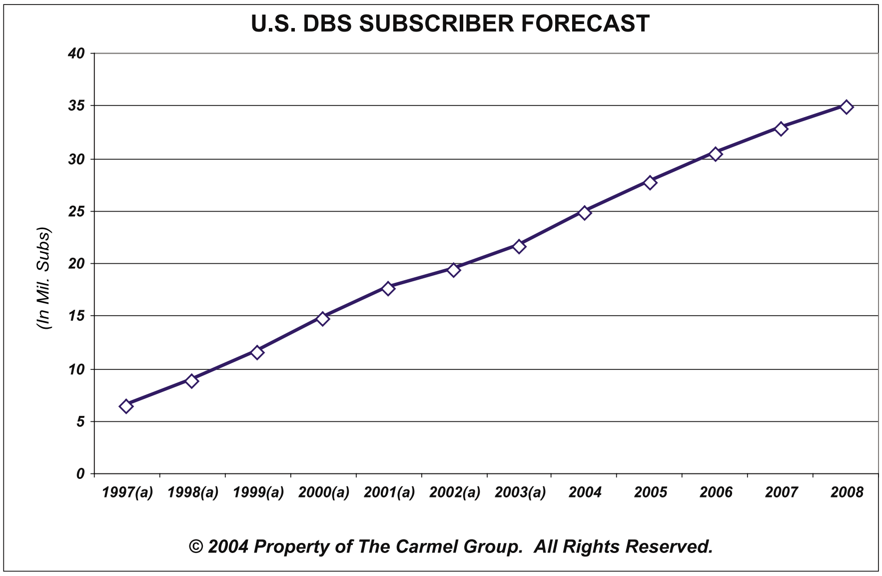
Growth Details

As indicated by the charts (right), DirecTV's share of future U.S. DBS growth projections is conservatively estimated at 19.1 million, and EchoStar's share is at 15.7 million by year-end 2010. Note that this projection does not yet include the most recent U.S. DBS entrant, called Voom.

Nonetheless, if we add Voom to the DBS mix, The Carmel Group estimates its subs will measure 3.5 million by 2010, based on the assumption the company is acquired and is operating under a new parent company; following current trends, The Carmel Group believes Cablevision will have significant difficulty holding onto Voom between now and 2010. Including Voom, the total U.S. DBS projection would come in at 38.3 million by year-end 2010.

As for U.S. DBS industry revenues, these come in at approximately $27 billion as of year-end 2010, which again does not yet include the nascent Voom service.





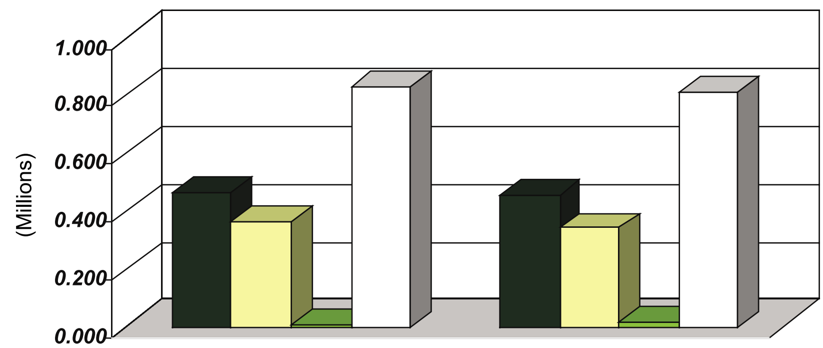
DirecTV's Momentum

Like a racehorse fresh from the start gate, the new management at DirecTV is already leading the entire pack (including cable) for the quarter mile, but has even grander visions for the mile, or whatever length measures the finish in this race. During the past two quarters since year-end 2003, El Segundo, CA-based DirecTV has added a stunning 915,000 net new subscribers since January 1, 2004, on the way toward a record year of well over two million. At the same time, the cable industry has lost hundreds of thousands of subscribers (most of them to DBS).

DirecTV's Average Revenue Per Unit (ARPU) on a monthly basis is now measured at $65.00 for the quarter ended June 30, 2004, and monthly churn is down to a remarkable 1.4%, or 16.8% on an annualized basis. This means that fewer people, percentage-wise, are leaving the DirecTV system as subscribers than just about ever before. Nonetheless, all this success does not come without a price, and that's why the Subscriber Acquisition Cost (SAC) is so important. DirecTV's Q2 SAC measured $645, which means that in order to repay DirecTV for the cost of obtaining a new subscriber, the subscriber will have to pay DirecTV the standard ARPU of $65 over the course of at least ten succeeding months. Fortunately for DirecTV, assuming the average subscriber life these days is in the range of five years, overall, without other costs included, DirecTV can count on the average subscriber bringing it $3,250 in total revenue during the lifetime of its subscription (which really is the core of the business, in most people's minds).

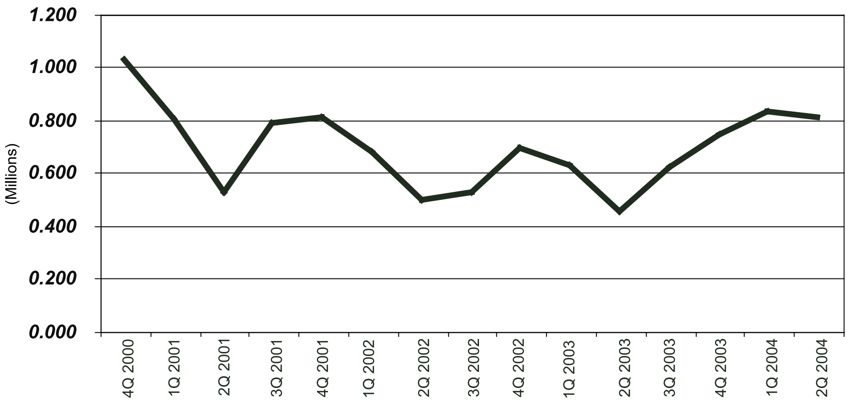
Yet perhaps more important to readers of this article is the information about subscriber growth, which is indicated in the charts (above right). These indicate DirecTV's continued lead over its rivals in the U.S. DBS sphere. With just over 13 million reported subscribers as of June 30, 2004, DirecTV leads EchoStar by almost three million subscribers. The overall size of the U.S. DBS market as of June 30, 2004, measures 23,190,000 (including Voom, DirecTV and EchoStar.) DirecTV's total market share comes in today at 56.2%, while EchoStar measures 43.7%, and Voom has less than a 1/100% share. EchoStar's 2nd Q net new subscribers tally is 29% less than DirecTV's. Additionally, looking at The Carmel Group's "3-Year Quarterly Net New DBS Subs Growth" chart, what is typically a decline after 4th Q in any given year, has become an increase under the guidance of Rupert Murdoch, Chase Carey, Eddy Hartenstein, Mitch Stern and a new News Corp.-controlled DirecTV.

QUARTERLY NET NEW SUBS: MAR '04 VS. JUN '04



	Mar-04	Jun-04
DirecTV	0.460	0.455
EchoStar	0.360	0.340
Voom	0.010	0.015
Total	0.830	0.810

3-YEAR QUARTERLY NET NEW DBS SUB GROWTH



For consumers, DirecTV offers several hundred-channel choices of standard digital quality TV, at prices that, according to year-upon-year of in depth studies by The Carmel Group, deliver a better per-channel value than that of just about every cable system nationwide. Also, because audio/video services are still the main determinant in the cable vs. DBS race, and because relatively few consumers have a choice yet of a cable-company-delivered audio/video, plus telephony, plus 2-way Internet broadband in a single "bundled" package, cable has not yet been able to play its vaunted "bundled package" advantage against DBS.

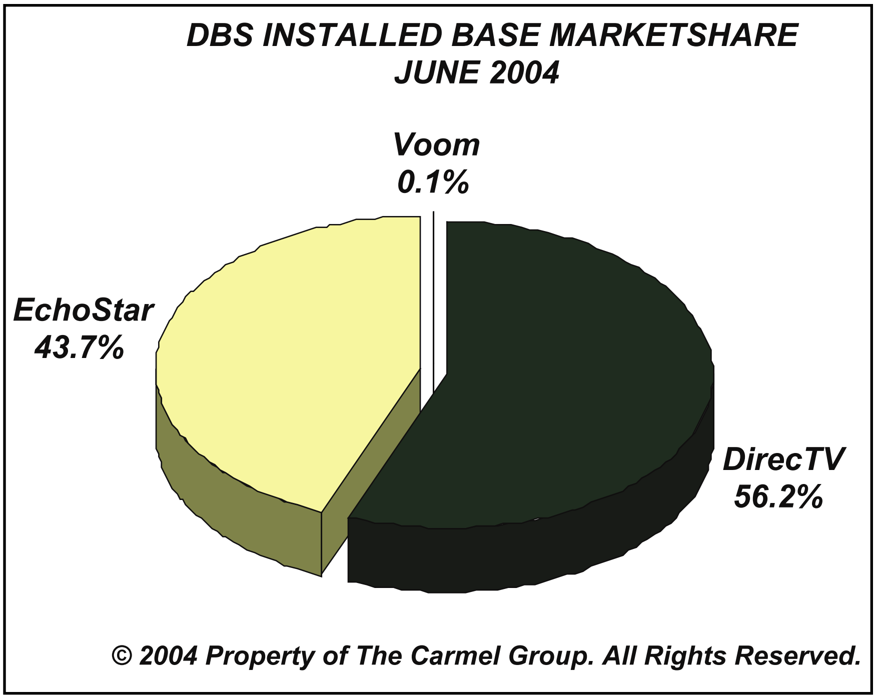
Ahead for DBS multichannel consumers are better and better options to participate in the revolutionary highlights of today's — and tomorrow's — TV. These include High Definition TV (HDTV), Digital Video Recorders (DVRs) and Interactive (iTV). Taking lessons of consumer satisfaction and iTV ARPU from his dominant DBS system in the United Kingdom, BSkyB, Rupert Murdoch is expected to bring DirecTV subscribers to that same level of iTV involvement during the next two or three years.

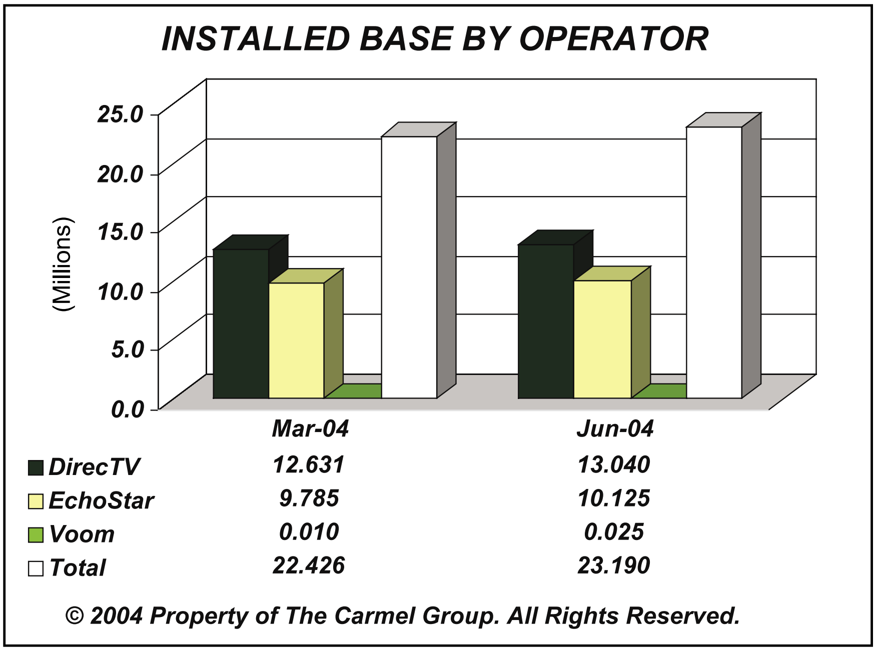
EchoStar's Energy

For Englewood, CO-based EchoStar, the past eight years have been pretty impressive. Chairman, founder and CEO Charlie Ergen has created a company with a stock value in the multiple billions of dollars, the majority of which he and his wife, Canti, own themselves. As such, the company in the past has had the advantage of being able to move a bit more quickly than its larger and more bureaucratic competitors. In fact, business seems to be going well enough lately for the company to have bought back a billion dollars in stock, prompting rumors that the management is planning on taking the company private by buying back all of the publicly traded stock. (Nonetheless, these days, with a much more agile Rupert Murdoch and his team in place at DirecTV, that advantage is waning. During its past eight or so months in office, DirecTV has shown itself to be pretty quick moving, as well. Its recent actions to reduce or eliminate relations with former allies TiVO, Pegasus, PanAmSat, NRTC and Hughes Network Systems are all testament to the New DirecTV's focus on its core business, which is the DirecTV subscriber.)

Turning to EchoStar's recent second quarter 2004 financial data, the company is catching up quickly to the all-important ARPU number of DirecTV, now recording an ARPU that is just 17% less than DirecTV's. The $55.59 2Q ARPU of EchoStar is a vast improvement over the times, five years ago, when DirecTV would record a $58 ARPU and EchoStar a mere $42 ARPU. Interestingly, however, one number that EchoStar would have liked to keep consistently lower than DirecTV's, its SAC, has instead almost caught up. At $576, EchoStar's SAC is now just a bit more than 10% less than DirecTV's (at one point in the past, it was more than 40% less). Additionally, EchoStar's churn turns in at 1.71% as of 2nd Q end, which amounts to an annualized figure of 20.52%. What is odd in this scenario is that EchoStar's churn is about 20% higher than DirecTV's, yet in the critically important area of subscriber satisfaction, J.D. Power recently ranked EchoStar's DISH Network first, suggesting it has achieved significant goals toward keeping its subscribers happy and resistant to leaving the service.

In the area of subscriber data, the charts below point out the EchoStar-DirecTV dominance in the satellite multichannel service sector, and the continued quarter-over-quarter growth that is oc-





curring. For year-end 2004, The Carmel Group sees EchoStar finishing with 10.9 million subscribers, amounting to a total of 1.4 million net new subscribers added during 2004; for DirecTV, The Carmel Group predicts it ends 2004 with 14.0 million total subscribers, having added 1.8 million during 2004 alone. Year-end 2004 will close with a U.S. DBS base of an estimated 24.8 million subscribers. Both sets of DirecTV and EchoStar data amount to record year growth statistics. For the first half of 2004, EchoStar and DirecTV have added 1.59 million net new subscribers.

Like DirecTV, EchoStar is focusing a lot of energy on HDTV and DVRs these days, realizing they are key to future subscriber growth and happiness. And perhaps even more so than DirecTV, EchoStar is working toward future broadband-by-satellite opportunities with its current partner in that area, SES Americom.

Voom's Visions

Fortunes are somewhat mixed these days for Jericho, NY-headquartered Voom, as it attempts to get more of its HDTV-centric set-top boxes into more homes across the nation. As of end of 2nd Q 2004, Voom reported approximately 25,000 subscribers had subscribed to its new system, which was launched in October of last year. Compared to the early fortunes of DirecTV and EchoStar, this Voom data point is low. On the other hand, neither DirecTV nor EchoStar were fighting two strongly entrenched incumbents on the satellite side alone, to say nothing of the newly invigorated cable companies that still control around 70+% of today's U.S. multichannel universe.

Voom has recently been the primary purchaser both of new spectrum and Ku-Band orbital slots at 166° West longitude (WL) and 175° WL above the Pacific Ocean, as well as of terrestrial-based Ku-Band spectrum within the burgeoning Multichannel Video Distribution and Data Service (MVDDS) realm. It also has entered into a recent deal with SES Americom, to utilize the latter's Fixed Satellite Service (FSS) satellites to deliver future services. These new spectrum purchases are important for Voom because its current orbital location, at 61.5° WL, provides a less-than-optimum view of subscriber dishes located on the West coast of the United States.

Voom's number one challenge lies in getting its product and service into more retail and other distribution outlets, at attractive prices considering the superior HDTV content the service offers, in order to begin competing with the new "big boys" in the business, i.e., DirecTV, EchoStar, and the larger cable Multiple System Operators (MSOs). Noteworthy is the fact that Voom has among its executive leaders top-level industry veterans such as former ComSat exec Mickey Alpert and former DirecTV exec Bill Casamo, as well as the man responsible for HBO and cable's packaged tiers, Voom chairman Chuck Dolan.

Note that Voom is appearing for the first time on The Carmel Group's U.S. DBS charts, albeit in a limited role, because of its limited subscriber growth.

Cable Competition

What the recent subscriber counts, especially from DirecTV, indicate to the nation's cable operators is that they cannot continue "business as usual" if they are going to stop the bleeding. In fact, they need to ramp up their transitions to the new advanced services like HDTV, DVRs and iTV, as well as their offerings of robust two-way Internet broadband and telephone services, to augment fully-digital and affordable audio/video services. It's really that simple.

Ultimately, if cable companies are well-managed and exhibit superior and innovative products and services to their multichannel audiences, the U.S. DBS providers will have an extremely difficult time continuing to bring in one and a half million subscribers together during the first six-months of any future year. If not, the large cable company stocks will remain sleeping, and many of the mid-to-smaller cable companies will be purchased or go out of business.

DirecTV [NYSE: DTV]

EchoStar [NASDAQ: DISH]

Voom [NASDAQ: Voom]

Present At The Creation: Origins Of DirecTV

DirecTV's Eddy Hartenstein, now the company's vice-chairman, and Bill Butterworth, once its senior VP for technology, are both generally credited with bringing the DirecTV model to fruition over the past decade.

United States Satellite Broadcasting (USSB) was one of two key investors and participants in the launch of DirecTV in the 1993-94 timeframe.

For a cost estimated at $100 million, USSB's chairman Stanley S. Hubbard purchased and controlled several transponders on the DirecTV system, offering DirecTV subscribers exclusive rights to premium services such as HBO and Showtime.

Another DirecTV partner, the National Rural Telecommunications Cooperative (NRTC) purchased the franchise rights to sell and manage subscribers in rural franchise territories for approximately $125 million.

The NRTC sold its subscriber base of almost a million and a half subscribers to DirecTV during the first half of 2004. Bob Phillips has been NRTC's CEO for almost two decades.

What It Means To MDUs

Of utmost importance to this magazine's audience is the benefit the U.S. DBS providers can offer owners, managers and occupants of Multiple Dwelling Units (MDUs).

By far the leader in DBS deployment into the U.S. DBS space today is EchoStar, under the guidance of Director of Sales/Commercial Services, Bob Grosz. Grosz came over to EchoStar last year from a MDU telecom services provider located in northern California. Suggests Grosz, "DISH Network is in the MDU market so that residents have an option over franchise cable operators. We are pleased with the relationships we have developed with Private Cable Operators (PCOs) and real estate owners in our efforts to leverage this opportunity."

About a year ago, EchoStar began its effort to grow its subscriber base beyond the core of single-family dwelling units that make up the huge majority of its 10,125,000 subscribers. With an estimated 45 million MDU inhabitants nationwide, these MDU subs represent a huge gap in EchoStar's, DirecTV's and Voom's business models.

Last summer in Broadband Properties, The Carmel Group described the new EchoStar plans and threw out a rough estimate of two thirds of a billion dollars of future incremental income from one million new MDU subscribers at a $55/month ARPU over a one-year period, increasing to almost $2 billion over three years. EchoStar is estimated to service an estimated 500,000 to one million MDU clients today, which is a figure some believe a company like EchoStar can grow to several million during the next decade.

For its part, one of the top focus items listed by Chase Carey, DirecTV's new CEO, has been that of the MDU subscriber. DirecTV, too, appreciates the growth opportunity that these consumers offer to the DBS business. In fact, as fewer and fewer cable and rural subscribers are available to grow the DBS subscriber bases, the multichannel universe becomes more and more important as a future base from which it may acquire new subscribers. Nonetheless, according to most, DirecTV is some ways away from matching EchoStar's focus of the last year on the U.S. MDU marketplace. DirecTV's Executive VP of Sales & Distribution and Business Development, Steve Cox, states that the company is constantly hearing from MDU occupants who are without access to the DirecTV product and service. This kind of interest is a constant reminder to DirecTV of the untapped potential for the MDU side of the DBS business. "People in MDUs want to get everything DirecTV delivers them in the single family unit," Cox adds.

For its part, Voom has focused little of its energies toward MDUs in the past ten months since its initial service launch. Yet because of its presence and headquarters around key northeast cities such as New York, Boston and Washington, DC, Voom and its parent company, Cablevision Systems [NYSE: CVC] are likely to have plenty of reminders, too, of the value of the MDU side of the business. Niche ethnic audiences are especially attractive in many of these Northeast urban neighborhoods.

Two small, yet positive, exceptions to the dearth of Voom-in-MDUs include a recent HDTV-In-All-Rooms deployment Voom completed in the very-upscale Mandarin Hotel, located in Washington, DC. Voom claims the Mandarin is the first "all HDTV" hotel in the world, and it is looking for similar opportunities in hotels located in Boston and New York City. The other is a hotel deployment in New York City planned for a forthcoming New York Fashion Week. Voom's exclusive Ultra-HD fashion channel will cover events during the show and will outfit the Bryant Park Hotel lobby and VIP suites with HDTV sets and special feeds of the show activities. Notes a Voom spokesperson, "Voom will be a real plus for higher-end MDU owners and managers. Right now, it is the clear leader in the provisioning of DBS channels, worldwide."

Yet perhaps the most objective and unbiased comments coming out of today's MDU subsector emanate from the industry's trade group, the Independent Multifamily Communications Council (IMCC), in the words of its president, Bryan Rader, and its executive director, Bill Burhop. Both believe there is still a long ways to go in order for the DBS players to create a clear opportunity in the U.S. MDU space. Yet, two key elements are permanent in the space, which spell some optimisim and which do not seem to go away: Several score million potential subscribers, many of whom want now (or will want) DBS-level affordable services, cannot get them today, and will not be able to get them for the foreseeable future. That spells distribution, sales and multichannel opportunities for those in the satellite TV and MDU sectors. ❖

About the Author

Jimmy Schaeffler is a subscription TV analyst for The Carmel Group (www.carmelgroup.com), a publisher and multichannel consultancy located in Carmel-by-the-Sea, CA, specializing in telecom, computers and the media. In addition to numerous industry projections, The Carmel Group's forthcoming publications include a special, new 350+ page databook, focused on the North American DBS industry, which will publish in 4Q 2004. Mr. Schaeffler can be reached at tel: (831) 643 2222, or by email at jimmy@carmelgroup.,com.