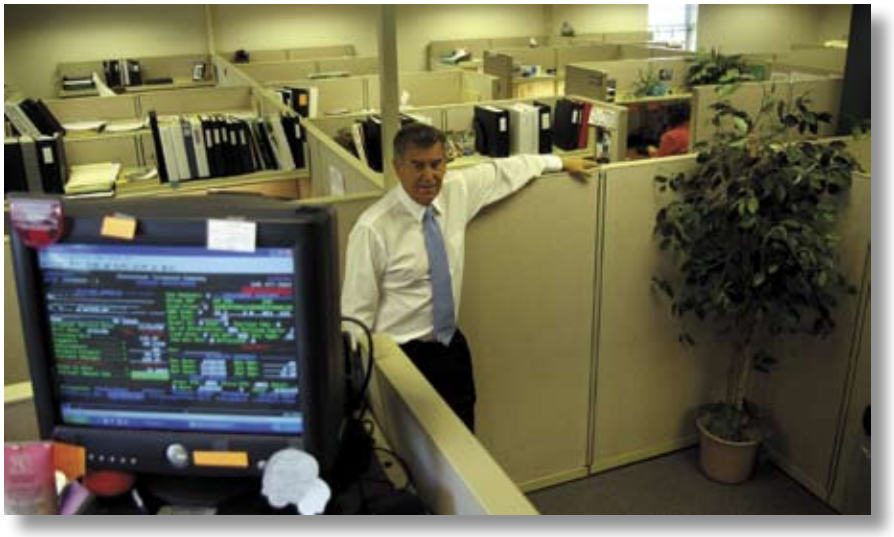
Shentel: Mid-Size Telco Invests in the Future

By Masha Zager ■ *BBP Telecom Editor*

Most U.S. telephone customers are served by one of a few very large companies – which are becoming fewer and larger by the day – or by one of many very small companies. Midsize companies are something of a rarity in the industry. But at Shentel, a midsize telco headquartered in Edinburg, Virginia, the management believes its size is the company's greatest advantage – in fact, "Our Size Is Our Strength" is the company motto. As executive vice president Earle MacKenzie explains, "We want to be large enough to serve our customers well, but small enough to not lose the personal touch."

A publicly traded company that started out as a cooperative more than 100 years ago – much of its stock is still owned by local residents – Shentel, through various subsidiaries, provides a wide variety of telecommunications services in its Virginia ILEC territory and in the surrounding region. In addition to its core telephone service, it offers DSL throughout the entire local exchange area, cable television in a portion of its territory, wireless phone service in four states and triple-play services to multiple dwelling units, or MDUs (mostly student and senior housing) in eight states.

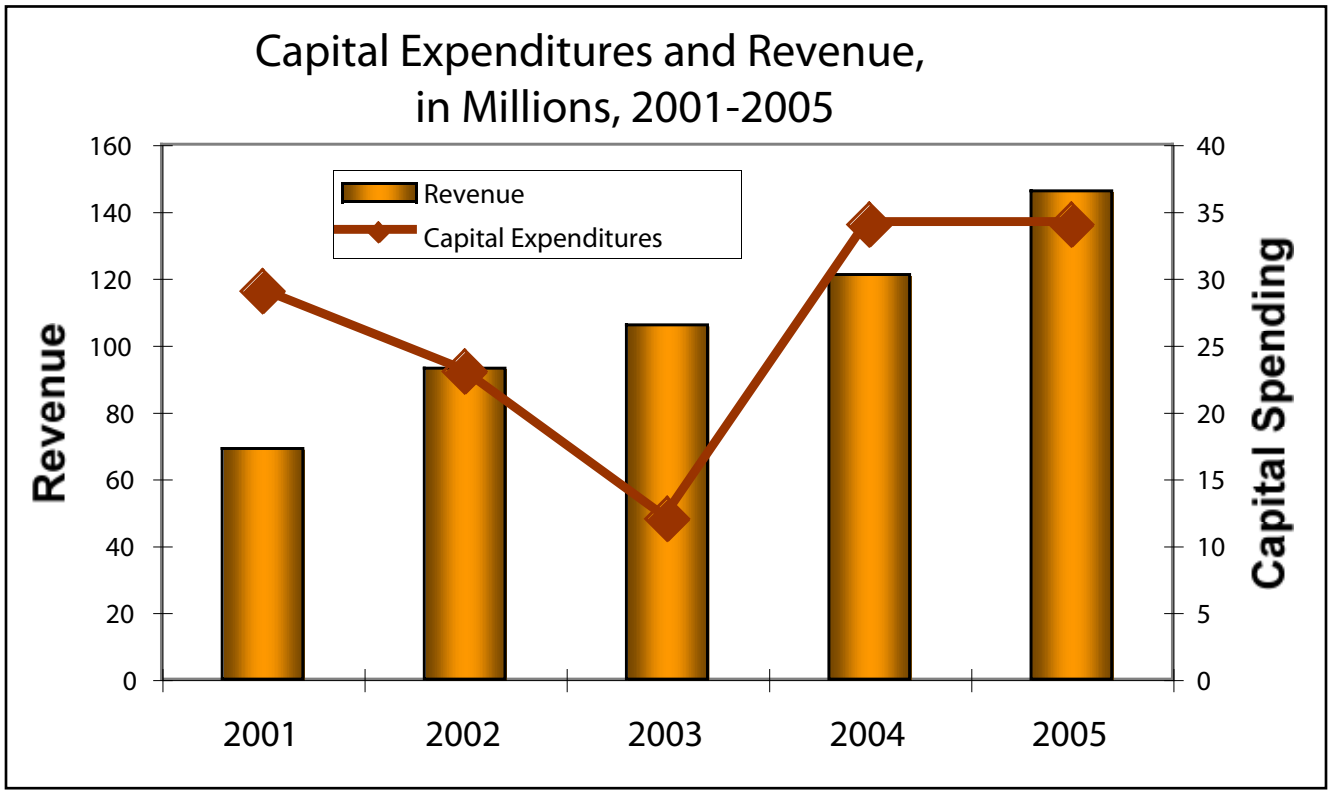
In addition, Shentel is gearing up to deliver triple-play over fiber to the home (FTTH) in greenfield developments. With 2005 operating revenues of $146 million, the company is not only profitable but generates enough cash flow (more than $30 million last year) to finance new investments and still pay about $2 million in dividends to shareholders.



David Ferguson, Vice-President for customer service, standing by customer service staff bullpens; the function is all handled locally.

To some extent, Shentel's success stems from the good fortune of being headquartered less than two hours' drive from downtown Washington, DC. The region is thriving and almost recession-proof; it has benefited from the exurban migration of the last decade. While the number of wirelines is declining in the United States as a whole, it is holding steady in Shentel's ILEC territory in raw numbers (although not in percentage of households).

But the company's success also depends on a management philosophy that is at the same time bold – witness new investments in MDU deployments and fiber -- and deeply conservative (no dilution of equity by investing beyond free cash flow). Perhaps because of its history as a cooperative, Shentel prefers to rely on its own resources as much as possible. Financing for new projects is largely internal, coming from the company's operating profits rather than from issuing new debt or equity. What is unusual about the company is not so much this principle but the thoroughness with which it is translated into action across so many communications businesses.



Shentel puts about 90 percent of free cash flow back into the business.

Know Your Customer

Shentel's customers aren't a homogeneous group. Small-town residents, college students, second-home owners and members of retirement communities have different needs and interests. They watch different television channels and use the Internet differently. They vary in their level of comfort with new technology, and in their interest in home networking.

Mindful of these differences, Shentel is careful not to impose a "one size fits all" service offering on its customers. It tailors services to different locations, based on lengthy discussions with property managers and developers.

Not only do channel lineups differ from place to place, so do services. In MDUs and developments with large senior populations, Shentel offers medical response systems; in areas where it serves off-campus student housing, it provides wide-ranging wireless broadband access. (Students who subscribe to Shentel's Internet service in their apartments have free access to wireless broadband in local coffee shops and campus hangouts; non-subscribers pay for the wireless access.)

Shentel also adapts customer service to local preferences. Residents in the ILEC area like to drop by in person. Shentel accommodates them with a comfortable storefront office, friendly clerks and a drive-by window. Customers who prefer making phone calls can contact knowledgeable, locally based customer service reps during business hours. College students in the off-campus housing served by Shentel can – and do – sign up online at any hour, day or night, and pay by credit card.

Online registration isn't only a benefit for the students. Since student apartments all turn over in late August, this self-service option alleviates what would otherwise be a huge burden on the customer service staff; introducing online registration reduced the number of late-August calls to customer service by half. Another benefit is that students tend to

Table 1: PCS is the Powerhouse (FY 2005)	Revenue	Operating income
PCS	$94,449	$9,729
Telephone	$28,994	$12,631
Converged Services	$9,822	$(3,914)
Mobile (Mainly rental of tower space)	$4,679	$1,993
Total	$137,944	$20,439

PCS services provide two-thirds the revenue, but telephone service is still extremely profitable. The loss at NTC has been turned around; the company was acquired at the end of 2004 and Shentel invested heavily to improve services.

History

The story of Shentel shows how far the communications industry has come in 100 years. Much of the progress for all companies in the industry has been since the 1980s, when digital systems leveled the playing field and new services – mobile and video – were introduced.

1902 Company founded as Farmers Mutual Telephone System of Shenandoah County. As a cooperative, its customers owned stock, paid for with labor, materials, or cash. A share of stock worth $10 at that time has now split into more than 1400 shares worth well over $50,000 at current prices.
1922 Company offers long-distance connection for the first time, through AT&T, for a flat annual fee of $5.
1932 Annual revenue reaches $33,000; the following year, it fell to $27,000.
1945 Annual revenue reaches $82,000.
1946 Company takes over the only other independent phone company in the region, Ashby Lee Telephone System; revenues jump to $116,350.
1954 State regulators note that the company is woefully undercapitalized, and providing poor service as a result. Company begins conversion to dial service (from manual switchboards). There are 3,342 customers sharing party lines with, typically 10 subscribers on a line.
1955 Rural Electrification Administration funds expansion.
1960 Company becomes a true public utility, Shenandoah Telephone Company. As a mutual system owned by its customers, it had been exempt from federal income tax.
1961 Shenandoah customers become the first in the state to be able to dial their own person-to-person long distance calls.
1965 Company boasts 9,000 subscribers, of whom 1,919 still had 10-party lines. Modernization was coming fast.
1968 Large manufacturer expands data center in Edinburg; good communications is a factor; others soon do the same.
1969 Company gets 10,000th customer. Continues to modernize with REA loans. Annual revenues now more than $1 million.
1972 Modernization of lines continues; first pagers and answering machines sold by Shenandoah.
1980 Shenandoah gets FCC waiver to start cable TV service. By 1998, 9,000 of the 16,000 phone subscribers also bought cable.
1981 Holding company, Shenandoa Telecommunications, created to run both businesses.
1984 Shentel Service Company created to resell long distance services, and Shentel Mobile created to sell cellular. Now the 78th largest phone company in the US.
1987 Conversion to digital switching complete.
1988 First fiber trunk completed.
1989 First rural cellular services in Virginia.
1994 Offered Internet data services. Also became first PCS provider in the United States.
1995 20,000th access line installed.
2004 Purchases the 84 percent of NTC it didn't already own. NTC supplies triple-play services to MDU communities throughout the Southeast.

Shentel management team gathered with Broadband Properties for lunch. Clockwise around the table: Rich Church, business development manager; Rob Walton, corporate counsel; Jeff Pompeo, VP technology; Chris Kyle, director of planning; Larry Paxton, VP information technology; Dwight Smith, product marketing manager; Dave MacDonald, VP operations; Carol Melcher, product marketing manager; Marlene Williams, controller; David Ferguson, VP customer service; Jessica Rhea, regulatory affairs specialist; Willy Pirtle, VP sales.

sign up for higher tiers of Internet and television service when they're viewing the options online and don't feel they're being "sold" by customer service reps.

Rely on Known Resources

The company is big enough to build its own solutions or adapt outside solutions. For example, the new system that allows students to self-provision services online was largely developed in-house, but is based on standard back-end database software. To maintain new fiber-to-the-home infrastructure, the company will retrain its own technicians, rather than counting on being able to find workers already trained in this technology.

Stay Close to Home

Shentel is not tempted to move beyond the Southeast region, which it knows well and has served successfully. With newer technologies, such as fiber to the home, it stays even closer to home. "There are so many opportunities in our own back yard," says Willy Pirtle, vice president of sales.

The major reason for the company to limit its reach is so that it can leverage its considerable assets. For example, Shentel owns a fiber optic backbone network in its core service area; for the time being, it is only marketing FTTH to developments within easy reach of this fiber network, affording good cost savings.

Another major asset is the customer service infrastructure. Shentel is reluctant to serve MDUs outside the Southeast, because it would be difficult to serve them effectively with the customer service unit it has in place. Similarly, it would like to leverage its existing relationships with DISH network and the content providers its cable company deals with, rather than have to develop altogether new content agreements.

In that regard Shentel, despite its size, is remarkably similar to well-run private cable operators. The best PCOs budget one technician for every 500 to 1,000 customers. Rolling a truck for a service call two hours away is simply not efficient. Either service suffers, more employees have to be hired, or local service has to be outsourced.

Of course, Shentel is willing to step outside the comfort zone when there is good reason to do so. For example, when it decided to provide cellular service, the company pursued an affiliate agreement with Sprint, on the grounds that the Sprint brand provided both credibility and the buying power necessary to deliver services economically. It was also the largest cellular provider not owned by a giant RBOC. But Sprint wasn't interested in serving only Shentel's ILEC ter-

Willy Pirtle, VP sales (left) and Rich Church, business development manager, at Shentel's switch room.

ritory, so Shentel expanded its wireless territory to cover parts of four states.

Do a Few Things Well

"We won't spread ourselves too thin," MacKenzie says. "You can only do a few things well. We'll pick two or three things and we'll be the best of breed." He says Shentel's decisions about where to focus its efforts are based on hardheaded assessments of what customers want, where its expertise lies and where profits and growth are likely to occur.

Wireline telephone service, even in a growing region like Shentel's, is not a growth area. WiFi hot spots supplement other services well for certain types of customers, but they aren't generally profitable. Applications like gaming services are unrelated to the company's core competencies. ("We're not a content player," MacKenzie says.)

On the other hand, providing competitive triple-play services to greenfield developments and MDUs seems to offer the best opportunities to satisfy customers, deliver services economically and earn a profit. Along with the standard triple play, Shentel will consider offering services that leverage its networking expertise, such as security, videoconferencing and medical response.

Of course, Shentel doesn't assume that all the projects matching its preferred profile will be profitable. Each project is subjected to rigorous analysis. Often, the company makes much more conservative assumptions about property sales and take rates than the property owner. It also makes sure that it can deploy infrastructure in phases so that revenues will at least come close to matching capital outlays.

Fiber for Future-Proofing

Shentel is concerned about "future-proofing" its new infrastructure. Because the company expects FTTH cable laid today will be viable for the next 40 to 50 years, it markets this technology aggressively in greenfield developments.

The worsening market for housing does require adjustment, even in the DC area. In February, the company entered into an agreement with RCMS/Legacy Custom Homes to build a FTTH network for Legacy's newest community, Tackley Mill in Ranson, West Virginia, where it will provide local and long distance phone service, video, broadband Internet access and security monitoring to 1,080 single-family homes and 650 town houses and apartments. The development simply will not be sold as quickly as originally expected, so Shentel is cautious. Negotiations for other FTTH developments are in various stages of progress.

The company is also cautious about being too far out in front in terms of technology. One of the reasons it selected its FTTH vendor, Wave7 Optics, was Wave7's native support for RF video. "The pace of change in video is on hyperspeed – it's terrifyingly fast," says Jeff Pompeo, Shentel's VP for technology, explaining why he doesn't want to convert his video service to IPTV until the technology has been thoroughly shaken out.

Nor does Shentel see the need to introduce the differential pricing techniques being proposed by some of the larger telcos. The company expects that traditional bandwidth-management techniques that it uses to meet quality-of-service requirements will continue to be sufficient.

Managing traffic on a customer-specific basis, Pompeo says, "goes against the whole principle of the Internet. As an industry, we need to not be greedy. We need to take the long view."

"What we do is get good customers and manage them properly," says Pompeo, summing up Shentel's management philosophy succinctly. **BBP**

About the Author

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