



Verizon's \$23 Billion Mousetrap Just Caught a Big One

By Steven S. Ross ■ *Editor-in-Chief*

More than a year ago – in April 2007 – this page took a snarky “look back from 2012.” One key prediction was that Verizon would become the “CLEC from Hell,” overbuilding (and cherrypicking) AT&T and Qwest with FiOS where it made business sense.

Over the past year I've often repeated that prediction in the speeches I've been making to telcos and other broadband service providers. I've been saying Verizon's CLEC phase would begin after the bulk of Verizon's own footprint is served by FiOS, around 2010. My audiences have tended to discount my hyperbole. It would be suicide, many said, for Verizon to overbuild AT&T.

In fact, *I was wrong about 2010. Verizon's "CLEC" phase began May 15*, with a quiet request to the Texas Public Utilities Commission for citywide FiOS video franchises in Frisco and Allen. AT&T already offers U-verse IPTV service to more than 50,000 households in those Dallas suburbs. The state approved the franchise amendment on June 9, and FiOS should be up and running there in about a year. This is not a small incidental overbuild.

There's an important lesson here for any ILEC, small or large, that thinks deploying fiber-to-the-home can be put off for long: True, Verizon is already offering FiOS in nearby communities, including Keller, Plano, and Watauga. So its extra cost to promote FiOS to residents of Frisco and Allen is fairly low. But that situation exists in any community close to a FiOS build – and half the country's households qualify or soon will.

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But the bigger lesson is this: Verizon can make money with FiOS at an astonish-

ingly low take rate. Last month in this magazine, the company's chief economist, Dennis Weller, said FiOS would be EBITDA-positive this year, and profitable next year.

Sure, Verizon is predicting a take rate of 35 to 40 percent after 2010. But those astonishingly positive numbers are coming with a take rate that is still south of 30 percent. In fact, take rate overall for the FiOS triple play has to be under 20 percent; Verizon this spring was claiming about 1.2 million FiOS video customers, from more than 8 million homes marketed – but not all of them have yet to be offered video. But around these “overbuild” communities, the average revenue per FiOS customer is around \$120. If Verizon can entice customers with mobile service as well, ARPU goes to \$200 or more.

Even more astonishing, those positive numbers come from a network that cost about 20 percent more per household to build. Today, interest rates (and thus the targets for internal rate of return; Verizon has the cash flow to avoid borrowing if it wishes) are lower, and so is the cost of the technology itself. Verizon's crews have also learned from experience, and are ever more productive over time.

Bottom line: Verizon needs only about a 20 percent take rate to make money in AT&T's territory. The downside risk is minimal, given the FiOS edge in bandwidth (50 Mbps now, versus 10 Mbps), reliability, and service offerings. Verizon has a premium service, and it commands premium pricing. Yes, it will have to come down a bit on its base price, but it will have hundreds of add-on services to offer, protecting the ARPU.

Fiber to the home is that good.

In contrast, AT&T admitted this month that it is considering an extra fee for those who use a large amount of bandwidth – from 1 to 5 percent of its customers. Think of what that means for customers who use TiVo, or Apple's video store, or Netflix downloads.

COMPETITORS' RESPONSES

What will other providers do? Qwest looks beyond hope. Its only strategy at this point seems to be lobbying against statewide franchising in its footprint, to delay the juggernaut. AT&T still has a chance if it starts its own FTTH build.

This issue's extensive Dallas Broadband Summit coverage offers attractive business cases for rural and dense urban builds.

More than 300 smaller telcos that have already embarked on FTTH builds look even smarter this month.

By the way, that area of Texas is also served by satellite TV of course, and by Time Warner Cable, which is being spun out of the giant publishing company. In the process, TWC is being saddled with more than \$20 billion in debt. In that same editor's note, I predicted that TWC would be a Google division by 2012, even though it was firmly planted inside Time-Warner when the note was written in April 2007. (Read the editor's note online at www.broadbandproperties.com/2007issues/april07issues/editor_apr07.pdf.)

The traps are just beginning to be sprung.

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