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October 31, 2014

VIA ECFS

Marlene H. Dortch, Esq.
Secretary
Federal Communications Commission
445 Twelfth Street, SW
Washington, D.C. 20554

Re: ***Applications of Comcast Corp., Time Warner Cable Inc., Charter Communications, Inc., Time Warner Entertainment-Advance/Newhouse Partnership, and SpinCo for Consent to Assign or Transfer Control of Licenses and Authorizations,* MB Docket No. 14-57**
REDACTED – FOR PUBLIC INSPECTION

Dear Ms. Dortch:

AT&T Inc. ("AT&T") provides the attached response (the "Response") to the letter dated October 7, 2014 from William T. Lake, Chief of the Media Bureau of the Federal Communications Commission (the "FCC" or the "Commission"), and the Information Request for AT&T attached thereto (collectively, the "Request").[1]

With respect to certain Requests, AT&T identified responsive documents using keyword searches of AT&T documents submitted to the Commission in the AT&T-DIRECTV proceeding, MB Docket 14-90. Where the Request seeks charts, spreadsheets, or similar graphic or tabular information, responsive information is provided in exhibits to the Response. An Index of Exhibits is appended to the attached Response as Exhibit A. A description of the deduplication methodology is appended as Exhibit B.

The Request calls for AT&T to submit certain information and documents that are sensitive from a commercial, competitive, or financial perspective, and that AT&T would not

[1] *Applications of Comcast Corp., Time Warner Cable Inc., Charter Communications, Inc., Time Warner Entertainment-Advance/Newhouse Partnership, and SpinCo for Consent to Assign or Transfer Control of Licenses and Authorizations* (MB Docket No. 14-57), Letter from William T. Lake, Chief, Media Bureau, to Robert W. Quinn, Jr. (Oct. 7, 2014).

reveal in the ordinary course of business to the public or its competitors. AT&T is submitting information and documents on a Confidential and Highly Confidential basis pursuant to the Modified Joint Protective Order for this proceeding that was issued on October 7, 2014. The inadvertent inclusion of any material that is subject to an assertion of the attorney-client, attorney work-product, or other applicable privilege is not intended as a waiver of such privilege.

Pursuant to discussions with the Commission staff, AT&T is submitting responses to the data requests in the Information Request (Request No. 1) in the same manner and subject to the same modifications as in AT&T's responses to corresponding requests in the AT&T/DIRECTV Information Request.[2] AT&T is also submitting its Response consistent with the following modifications:

1. Notwithstanding the definition of "Internet Access Service," AT&T need not provide information or data relating to services delivered over a mobile wireless broadband network or satellite broadband network in its Response to the Information Request.

2. Notwithstanding the definition of "MVPD Service," AT&T need not provide information or data relating to such services delivered over a mobile wireless network, including but not limited to the Mobile TV service offered through AT&T's Mobility organization, in its Response to the Information Request.

3. To the extent a Request seeks information for a particular geographic area or areas, AT&T may limit its Responses to areas within AT&T's 22-state ILEC wireline footprint.

4. AT&T may exclude from its Response data on business subscribers and business rate plans or packages.

5. With respect to any Request that calls for data to be provided separately by service plan or package, AT&T may instead respond with data at the service level for legacy telephony service (*i.e.*, for legacy telephony as a whole).

6. AT&T may rely on service-level subscriber billing information rather than line item subscriber billing information in preparing its Responses as they relate to DSL and legacy telephony services.

[2] *See* Letter from Maureen R. Jeffreys, Counsel for AT&T Inc., to Marlene H. Dortch, Secretary, Federal Communications Commission, MB Docket No. 14-57 (filed October 15, 2014).

Pursuant to the *Modified Joint Protective Order*[3] AT&T is filing an unredacted Highly Confidential copy of the Response with your office and a redacted public version in ECFS. Additional copies of the unredacted Response are being delivered to the Media Bureau, while DVD-ROMs containing the unredacted document production are being delivered to the Commission's document review vendor for use by the Staff.

Please contact me at (202) 942-6608 or Maureen.Jeffreys@aporter.com if you have any questions regarding the information submitted today. Thank you for your assistance.

Respectfully submitted,

Maureen R. Jeffreys

Maureen R. Jeffreys
Counsel for AT&T Inc.

Enclosures
cc (via e-mail): Best Copy and Printing, Inc.
Vanessa Lemmé
Marcia Glauberman
William Dever
Jim Bird

[3] *Applications of Comcast Corp., Time Warner Cable Inc., Charter Communications, Inc., Time Warner Entertainment-Advance/Newhouse Partnership, and SpinCo for Consent to Assign or Transfer Control of Licenses and Authorizations*, Modified Joint Protective Order, DA 14-1464 (MB rel. Oct. 7, 2014) ("*Modified Joint Protective Order*").

RESPONSE OF AT&T INC. TO
INFORMATION REQUEST DATED OCTOBER 7, 2014

October 31, 2014

AT&T's responses to the Request are as follows.

1. REQUEST:

For the period beginning January 1, 2013 through June 30, 2014, provide:

RESPONSE:

Subject to the modifications set forth in the letter accompanying this Response, AT&T is providing the data as specified in the Attachments to the extent such data are available. Pursuant to discussions with the Commission staff, AT&T is submitting the response to this data request in the same manner and subject to the same modifications as in AT&T's responses to corresponding requests in the AT&T/DIRECTV Information Request. Some of the requested data are not maintained in the requested form in the ordinary course of AT&T's business and may be incomplete or contain inaccuracies. Exceptions to AT&T's ability to report data in the manner requested are indicated below.

a. plan level subscriber data by zip code for the period beginning June 1, 2013 through June 30, 2014, as requested in the Billing Plan Data Table (attached);

RESPONSE:

For its response to Request No. 1.a, AT&T has provided in Exhibits 1.a.1 and 1.a.2[4] the information requested in the instructions and template for the "Billing Plan Data Table" as requested, subject to certain limitations as follows: AT&T defines plans for standalone products

[4] Exhibit 1.a.3 contains notes and definitions of terms used in Exhibits 1.a.1 and 1.a.2. Exhibit 1.a.4 contains descriptions of each MVPD package listed. Exhibit 1.a.5 contains descriptions of each Internet Access tier listed. Exhibit 1.a.6 contains descriptions of each VoIP package listed.

only. Bundles are accounted for as a promotional discount for customers who purchase a service plan of their choice for two or more different services. Notwithstanding this, AT&T has provided information in Exhibits 1.a.1 and 1.a.2 for all unique combinations of standalone products. Pursuant to discussions with Commission Staff, AT&T has not provided plan or package names for legacy telephony services, but does indicate whether a combination of plans or packages includes legacy telephony service. Further, pursuant to discussions with Commission Staff, AT&T may respond with data at the service level for legacy telephony service. As such, AT&T has not provided information for legacy telephony for the variable "unlimited_voice."

[BEGIN AT&T CONFIDENTIAL INFORMATION] **[END AT&T CONFIDENTIAL INFORMATION]** Exhibit 1.a.1 reports the variables requested in the "Billing Plan Data Table" including **[BEGIN AT&T CONFIDENTIAL INFORMATION]** **[END AT&T CONFIDENTIAL INFORMATION]** for all U-verse plans and packages, and combinations of U-verse plans and packages. Exhibit 1.a.2 reports the variables requested in the "Billing Plan Data Table" except for the data related to **[BEGIN AT&T CONFIDENTIAL INFORMATION]** **[END**

[5] **[BEGIN AT&T CONFIDENTIAL INFORMATION]**

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AT&T CONFIDENTIAL INFORMATION] Exhibit 1.a.2 includes both U-verse and legacy plans and packages, as well as combinations of U-verse and legacy plans and packages. AT&T provides the requested data on a monthly basis from July 2013 to July 2014. Disconnects data in Exhibits 1.a.1 and 1.a.2 are provided on a monthly basis from September 2013 to July 2014.

b. the residential locations for which the Company's Internet Access Service is available and provide the number of residential subscribers by census block, technology and bandwidth as requested by the Internet Access Table (attached);

RESPONSE:

For its response to Request No. 1.b, in Exhibits 1.b.1, 1.b.2, and 1.b.3,[6] AT&T is providing data on customer locations where the Company offers service (ELUs) and subscribers for each census block within AT&T's 22-state wireline footprint, by technology type, and by Internet Access Service speed tier available within that census block. ELU data and subscriber data are not available for the requested months in AT&T's currently available automated systems before December 2011, and are provided starting in December 2011. Data are provided for July 2013 in lieu of June 2013 because DSL data is not available in AT&T's currently available automated systems for June 2013.

In Exhibit 1.b.1, AT&T provides speed tier information by census block for the current period only. September 2014 ELUs by speed tier and maximum speeds are provided alongside June 2014 subscriber counts for the response for June 2014. For earlier periods, Exhibit 1.b.1 reports ELU and subscriber data by technology type. AT&T does not advertise upload speeds for Internet

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[END AT&T CONFIDENTIAL INFORMATION]

[6] Exhibit 1.b.4 contains notes and definitions of terms used in Exhibits 1.b.1, 1.b.2, and 1.b.3.

service plans. AT&T provides Internet services on a best efforts basis, and states its speeds are based on what a customer is capable of attaining, not what a customer is guaranteed to obtain.

Exhibit 1.b.1 reports ELUs for Internet Access Service for the current period for xDSL (technology code 2), IPDSL (technology code 3), and FTTN with and without MVPD Service and FTTP combined (technology codes 4, 5 or 6). For historical periods, ELUs are reported for xDSL (technology code 2), and for IPDSL, FTTN with and without MVPD service, and FTTP combined (technology codes 3, 4, 5, or 6). Data limitations prevent reporting separately by technology code for some subscribers and locations; in such cases subscribers and locations are classified as "unknown." AT&T is unable to further distinguish among these technologies in its combined ELU and subscriber data. Exhibit 1.b.1 reports total ELUs, including both residential and other customer locations, **[BEGIN AT&T CONFIDENTIAL INFORMATION]** **[END AT&T CONFIDENTIAL INFORMATION]**

In Exhibit 1.b.2, AT&T provides subscriber data by technology type and census block and gives the download and upload speed taken by each subscriber. Exhibit 1.b.2 reports subscribers for Internet Access Service for xDSL (technology code 2), IPDSL (technology code 3), and FTTN with and without MVPD Service and FTTP combined (technology codes 4, 5, or 6). AT&T is unable to further distinguish among these technologies in its subscriber data.

In Exhibit 1.b.3, AT&T provides ELU data by technology type and census block. Exhibit 1.b.3 reports ELUs for Internet Access Service for xDSL (technology code 2), IPDSL and FTTN without MVPD service combined (technology code 3 or 4), and FTTN with MVPD Service and FTTP combined (technology codes 5 or 6). AT&T is unable to further distinguish among these technologies in its ELU data. Data limitations prevent reporting separately by technology code for some locations; in such cases locations are classified as "unknown." Exhibit 1.b.3 reports total ELUs, including both residential and other customer locations, **[BEGIN AT&T CONFIDENTIAL INFORMATION]**

[END AT&T CONFIDENTIAL INFORMATION]

c. separately, for each person from whom the Company purchases Transit Service or provides Peering, provide the data requested in the Purchases of Transit Service Table, Sales of Paid Peering Table, and Settlement-Free Peering Traffic Table (attached).

RESPONSE:

AT&T exchanges traffic with 23 peers in the United States on a settlement-free basis. AT&T has completed the "Free Peer Traffic" table template in the Microsoft Excel file entitled "Exhibit 1.c." Column A provides the relevant month and year. Columns B and C provide name of the peer and the name that the peer uses when doing business with AT&T. Columns D and E identify the total capacity of AT&T's links with each peer in megabits per second ("Mbps"), from January 2013 to June 2014.[7] Because all links are bi-directional, the capacity in Columns D and E are the same. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] Columns F and G provide the 95th percentile utilization in Mbps inbound and outbound to AT&T's network for each month from January 2013 to June 2014.[8] Columns H and I provide the amount of money paid (1) by AT&T to

[7] In some cases, the Exhibit shows capacity for a few months and then no capacity for subsequent months. This typically occurs because peers sometimes set up links at an interconnection site and find that they do not use or need it, and then cancel the capacity.

[8] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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peers and (2) by peers to AT&T for penalties or fees. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

Columns J and K identify the start and end date for each contract. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

2. REQUEST:

Explain or provide documents discussing:

a. the Company's ability, as a provider of Internet Access Service over DSL technologies, to compete with other Internet Access Service providers that offer that service at the same or faster speeds;

RESPONSE:

Documents responsive to this Request may be found at Exhibits 2.a.1-2.a.146 and are included in AT&T's document production.

b. whether and to what extent increases in the speed of the Company's DSL-based Internet Access Service have allowed or would allow the Company to compete more effectively for Internet Access Service subscribers;

RESPONSE:

Documents responsive to this Request may be found at Exhibits 2.b.1-2.b.140 and are included in AT&T's document production.

c. whether and to what extent the Company's ability to compete for Internet Access Service subscribers has been or would be increased if it were able to offer Internet Access Service using FTTP;

RESPONSE:

Documents responsive to this Request may be found at Exhibits 2.c.1-2.c.120 and are included in AT&T's document production.

d. the Company's plans for capital investments that would increase the speed of the DSL-based Internet Access Service it offers, and the Company's reasons to make those investments;

RESPONSE:

Documents responsive to this request may be found at Exhibits 2.d.1-2.d.64 and are included in AT&T's document production.

e. the plans of the Company to replace Internet Access Service that it currently provides over DSL with Internet Access Service over fiber to the premises (FTTP) and the Company's rationales in favor of or against such replacements;

RESPONSE:

Documents responsive to this request may be found at Exhibits 2.e.1-2.e.189 and are included in AT&T's document production.

f. what download and upload speeds the Company believes are required to support internet usage for video consumption by the average individual and by the average household, both at present and in the future; and

RESPONSE:

There is no defined industry standard for video consumption by the average individual or average household. Download and upload speeds required to support Internet usage for video consumption for an individual or household will vary depending on a number of factors, including the video and audio quality required and the usage by customers of the broadband technologies available to those customers and their households, which in turn will depend on the network technologies utilized by Internet Service Providers ("ISPs") and programmers to deliver video over Internet connections. Documents responsive to this Request, in that they refer to download or upload speeds in connection with video streaming, may be found at Exhibits 2.f.1-2.f.81 and are included in AT&T's document production.

g. churn, subscriber acquisition and retention costs, including the Company's subscriber costs incurred in switching to another provider of Internet Access Service; and

Documents responsive to this Request may be found at Exhibits 2.g.1-2.g.64 and are included in AT&T's document production.

h. the reasons subscribers disconnect Internet Access Service or switch providers thereof, including but not limited to, pricing, quality of service and disputes between the Company and Edge Providers, CDNs or transit service providers.

Documents responsive to this Request may be found at Exhibits 2.g.1-2.g.64, as referenced above, and are included in AT&T's document production.

3. REQUEST:

Explain or provide documents sufficient to show the Company's policies or procedures with respect to decisions to establish or augment interconnection capacity with any CDNs, Internet backbone services, edge providers, Internet Access Service providers, and all other persons with whom the Company may engage in Internet Traffic Exchange.

RESPONSE:

AT&T offers three services that allow third parties to directly interconnect with AT&T's network: (1) peering; (2) Managed Internet Service ("MIS"); and (3) the Content Interconnection Platform ("CIP").

Peering. Large ISPs can often interconnect with AT&T through peering. Peering is a private commercial arrangement under which two "peer" ISPs connect and exchange traffic. Each peer provides the other with access only to its own customers – not to the entire Internet.

Although peering arrangements are "settlement-free," in the sense that the two parties typically do not exchange monetary payment, peering is not "free." These arrangements are barter transactions under which each peer network agrees to exchange roughly equal amounts of traffic, and comply with certain other terms (relating, for example, to traffic volumes and the number and locations of points at which they will exchange traffic). When the ratio of traffic exchanged between the parties is roughly equal (and other criteria are met), these relationships benefit both parties by enabling them to avoid the cost of billing each other for transporting and terminating roughly equivalent traffic.

AT&T's peering policy is publicly available at http://www.corp.att.com/peering/. AT&T's peering policy is typical of those in the industry (and more generous than some). AT&T's policy allows a peer to transmit up to two times more traffic to AT&T than it receives from AT&T. It thus allows peering even where there is a substantial traffic imbalance in favor of AT&T's peer. For existing peers, even if the imbalance modestly exceeds 2:1, AT&T's peering policy provides that it will work with the peer to find other ways to make the settlement-free peering arrangement equitable and sustainable, such as implementing routing arrangements that reduce AT&T's costs of carrying the additional traffic. But where the imbalance of traffic substantially exceeds 2:1, an Internet access service or other type of paid arrangement (*e.g.*, MIS or CIP, discussed below) is more appropriate.

[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]

[9] *See* "AT&T Global IP Network Settlement-Free Peering Policy," *available at* http://www.corp.att.com/peering/ ("AT&T Peering Policy") ("Peer must maintain a balanced traffic ratio between its network and AT&T. In particular, a new peer must have: a. No more than a 2.00:1 ratio of traffic into AT&T: out of AT&T, on average each month. b. A reasonably low peak-to-average ratio").

[END AT&T HIGHLY CONFIDENTIAL INFORMATION] Most participants in the Internet backbone marketplace use "hot potato" routing. Under this approach, each peer hands traffic to the other at the first possible interconnection point. The result is that the receiving peer may have to carry the traffic long distances (sometimes across the country) to deliver the traffic to the end user. By contrast, a peer using "best exit" routing delivers traffic at the interconnection point closest to the end user, thus reducing the distance the traffic must be carried on the receiving peer's network.

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[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

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[10] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

[11] *See* AT&T Peering Policy ("Existing peers whose in: out ratio rises above 2.00:1 will be expected to work with AT&T to implement best-exit routing or to take other suitable actions to balance transport costs").

If the peer's traffic imbalance rises to a level significantly above 2:1, AT&T considers the peer to be out of compliance with AT&T's peering policies, even if the peer is using best-exit routing. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

MIS and CIP. AT&T's MIS service allows customers to choose the capacity of their connections and to deliver as much traffic to AT&T's network as those connections will permit. AT&T's MIS service is used by large content providers **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION]** content delivery networks **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]** **[END AT&T HIGHLY CONFIDENTIAL INFORMATION],** enterprises, and large and small businesses. AT&T's MIS service can be "on-net" services or transit services. An on-net service provides access only to AT&T's customers. Transit services are Internet Access Services in which AT&T will deliver traffic to virtually any point on the Internet (directly or through its peering arrangements with other ISPs).

AT&T's recently developed CIP service allows customers to collocate servers in AT&T's network at locations closer to the AT&T end users who will be accessing the content on those servers. CIP customers purchase the space, power, cooling, transport, and other capabilities needed to operate their servers in AT&T's network. **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

4. REQUEST:

Provide the most recent regularly prepared network planning documents including but not limited to budgets and financial projections regarding the expansion, development, deployment, and improvement of the Company's Internet Access Service.

RESPONSE:

Documents responsive to this request may be found at Exhibits 4.1-4.8 and are included in AT&T's document production.

5. REQUEST:

Provide examples of or documents sufficient to demonstrate examples of negotiations between the Company and another person that did not result in an agreement for the Company to acquire any rights (linear or non-linear) to distribute broadcast or non-broadcast, video programming from that other person and, if possible, explain the Company's view as to whether such negotiations failed because of: (i) any economic or non-economic Most-Favored-Nation clause in a contract with another person; (ii) grants to distribute programming exclusively to another person; or (iii) any other limits by another person on the distribution of the programming being negotiated.

RESPONSE:

Exhibit 5 contains information responsive to this Request. To respond to this Request, AT&T is providing information related to negotiations since January 1, 2012 between AT&T and video programmers in which the terms had been reduced to a long-form agreement but has yet to result in an agreement for AT&T to purchase the video programming.[12] To address concerns related to Video Programmer Confidential Information, the Exhibit omits the names of the video programmers.

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[12] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

Tab 1 identifies the type of video programming pertinent to the negotiation and the date of the proposal. Tabs 2 through 4 identify provisions from these negotiations responsive to subparts (i) through (iii) of Request No. 5, to the extent such issues were raised in the long-form agreements under negotiation. Some agreements contain multiple relevant provisions that could be affected by negotiations between the programmer and another person responsive to subparts (i) through (iii). Therefore, Tabs 2 through 4 will contain lists longer or shorter than the list of long-form agreements identified in Tab 1. Each of these tabs includes the contract section and the provisions that were being negotiated based on redlines in the draft long-form agreements and which party proposed those redlines. Tab 2 identifies any proposed relevant price-related MFN and non-discrimination provisions to respond to subpart (i). Tab 3 identifies any proposed carriage rights or launch obligations. Tab 4 identifies any proposed authentication provisions. These tabs provide information responsive to subparts (ii) and (iii).

AT&T is frequently in negotiations regarding the acquisition of video programming.

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[13] **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

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[END AT&T HIGHLY CONFIDENTIAL INFORMATION] [BEGIN AT&T VIDEO PROGRAMMING CONFIDENTIAL INFORMATION] [END AT&T VIDEO PROGRAMMING CONFIDENTIAL INFORMATION]

6. REQUEST:

Explain the Company's use of data caps or usage allowances, including future plans for such data caps or usage allowances, and how such plans are or would be affected by the decisions of competing cable providers and competing DSL providers to impose data caps or usage allowances.

RESPONSE:

Pursuant to the modifications to the Requests described above, this Response is limited to wireline consumer broadband data usage allowances. Subject to that modification, AT&T responds that in May 2011 AT&T first implemented a usage-based pricing allowance on Digital Subscriber Line ("DSL") services or High Speed Internet Service. The first bills reflecting this policy were sent on or about October 2011, and the data allowance for DSL subscribers under this policy is 150

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[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

Gigabytes ("GB") per month for subscribers to DSL service. Under this policy the overage fee is $10 per each 50 GB of data usage in excess of the data plan.[14]

Note that as part of this policy a DSL customer typically receives up to seven email notifications prior to billing. The first time a subscriber's usage exceeds the data plan he or she receives a notice and is not billed. In subsequent months, AT&T sends additional notices any time usage exceeds 65% and 90% of the data plan, and the second time usage exceeds 150 GB the subscriber will again be notified but not billed. In subsequent billing periods, in addition to notices regarding 65% and 90% usage, AT&T will provide an additional 50 GB of data for $10, and the subscriber is charged $10 for every incremental 50 GB of usage beyond the plan.

AT&T currently offers its U-verse high speed Internet access ("HSIA") subscribers a data allowance of 250 GB/month for the lowest price data plan option; that allowance increases with the speed of the service the customer buys.[15] Although AT&T currently describes the allowance under the various HSIA plans on its website and incorporates the allowance as part of its standard terms and conditions, **[BEGIN AT&T HIGHLY CONFIDENTIAL INFORMATION]**

[END AT&T HIGHLY CONFIDENTIAL INFORMATION]

[14] *See* http://www.att.com/esupport/article.jsp?sid=KB409045&cv=803#fbid=CNQoG0t0Jvy (Broadband usage FAQs).

[15] *See* http://www.att.com/esupport/article.jsp?sid=KB409045&cv=803#fbid=CNQoG0t0Jvy (Broadband usage FAQs).

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[END AT&T CONFIDENTIAL INFORMATION]

EXHIBIT A: INDEX OF EXHIBITS

EXHIBIT A: INDEX OF EXHIBITS

EXHIBIT B: DESCRIPTION OF DEDUPLICATION METHODOLOGY

In preparing the documents collected from custodians for production, AT&T has asked its vendor ("Vendor") to deduplicate them both "vertically" within each custodian's files and "horizontally" across custodians. In performing the deduplication, Vendor has compared the encryption signatures, also known as the hash values, of responsive files. If the hash values for two different items are identical, the content of the two files is deemed to be identical. "Key generation" refers to the process of creating an encryption signature for a file so that files can be easily compared. File hashing and metadata hashing are the two primary methods used to generate keys. Vendor used the MD5 algorithm to determine duplicates.

Electronic Documents: The key value is generated using the entire file as the input, so Vendor used both file hashing and metadata hashing on these files.

Email: Vendor used only metadata hashing on email files. Specifically, Vendor generated the key value for a file by inputting the values of certain metadata after having extracted the metadata fields when importing the file into its database. By using post-processed metadata, Vendor will be able to replicate the key using the metadata that is stored with the file in Vendor's database whenever Vendor needs to perform further deduplication. Vendor used this method for both email messages contained in mail stores and loose email messages.[1]

The fields shown in the following table are used to generate the deduplication key for both stored and loose email messages:

Email fields used by deduplication keys
BCC
Body
CC
From
IntMsgID
Email_Subject
To
Attach – These are first-level attachments in the email.

[1] Microsoft Outlook stores emails in two different file formats with two different file extensions, .pst and .msg. The file extension .pst is used to identify all emails and their folder structure (including attachments) stored by a particular user. The file extension .msg is used to store individual messages or "loose email" outside of an email mailbox. Other types of loose email files include .eml files and other RFC822-format emails.

Exhibits 1.a.1-1.a.6, 1.b.1-1.b.4, 1.c, 2.a.1-2.a.146, 2.b.1-2.b.4, 2.b.6-2.b.140, 2.c.1-2.c.4, 2.c.6-2.c.120, 2.d.1-2.d.64, 2.e.1-2.e.189, 2.f.1-2.f.81, 2.g.1-2.g.64, 4.1-4.8, and 5 Have Been Redacted in Their Entirety as Confidential and Highly Confidential Information

Time Warner Cable Management Discusses Q4 2012 Results - Earnings Call Transcript

Jan. 31, 2013 1:20 PM ET | About: TWC by: SA Transcripts

Executives

Tom Robey

Glenn A. Britt - Chairman and Chief Executive Officer

Robert D. Marcus - President and Chief Operating Officer

Irene M. Esteves - Chief Financial Officer and Executive Vice President

Analysts

Douglas D. Mitchelson - Deutsche Bank AG, Research Division

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

Philip Cusick - JP Morgan Chase & Co, Research Division

Laura A. Martin - Needham & Company, LLC, Research Division

Jason B. Bazinet - Citigroup Inc, Research Division

Marci Ryvicker - Wells Fargo Securities, LLC, Research Division

Jason Armstrong - Goldman Sachs Group Inc., Research Division

Benjamin Swinburne - Morgan Stanley, Research Division

Richard Greenfield - BTIG, LLC, Research Division

John C. Hodulik - UBS Investment Bank, Research Division

Time Warner Cable (TWC) Q4 2012 Earnings Call January 31, 2013 8:30 AM ET

Operator

Hello, and welcome to the Time Warner Cable Fourth Quarter 2012 Earnings Conference Call. [Operator Instructions] Today's conference is being recorded. If you have any objections, you

may disconnect at this time. Now, I will turn the call over to Mr. Tom Robey, Senior Vice President of Time Warner Cable Investor Relations.

Tom Robey

Thanks, Candy. And good morning, everyone. Welcome to Time Warner Cable's 2012 Fourth Quarter and Full Year Earnings Conference Call. This morning, we issued 2 press releases, one detailing our 2012 fourth quarter and full year results and the other, announcing an increase in our regular quarterly dividend.

Before we begin, there are a couple of items I want to cover. First, we refer to certain non-GAAP measures. Definitions and schedules, setting out reconciliations of these historical non-GAAP financial measures to the most directly comparable GAAP financial measures, are included in our earnings release and trending schedules.

And second, today's announcement includes certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which are based on management's current expectations and beliefs and are subject to uncertainty and changes in circumstances. Actual results may vary materially from those expressed or implied by the statements herein due to various factors, which are discussed in detail in our SEC filings. Time Warner Cable is under no obligation to, and in fact, expressly disclaims any such obligation to update or alter its forward-looking statements whether as a result of new information, future events or otherwise.

And finally, today's press releases, trending schedules, presentation slides and related reconciliation schedules are available on our website at twc.com/investors.

With that covered, I'll thank you and turn the call over to Glenn Britt. Glenn?

Glenn A. Britt

Good morning, and thanks for joining us. As we look back on 2012, we have much to be proud of. It was a year in which we grew revenue by almost 9%, powered by our acquisition and successful integration of Insight Communications, continued success in business services and the best-ever year in advertising.

Broadband continues to be our strongest product. We added another 0.5 million subs in 2012 and improved the mix even as we raised prices, a powerful combination. But considering that the average customer used roughly 40% more capacity last year, and we increased our standard speed by 50%, yet our pricing increased by less than 10%, our broadband product is still a terrific value for customers.

We met or exceeded all elements of our guidance in 2012. In addition, we honored our commitment to return capital to shareholders. We repurchased 22 million shares for $1.9 billion in 2012, raising the total since initiation late in 2010 to over $5 billion.

And through our regular dividend, we returned $700 million to shareholders last year. This morning, we announced a 16% increase of dividend to an annualized rate of $2.60 per share, demonstrating our continued confidence in our ability to generate very strong free cash flow.

Before I turn the call over to Rob and Irene though, I want to spend a couple of minutes on residential video, our most mature and highly penetrated business. It faces challenges on 2 fronts. The first is competition. The telcos and satellite companies are tough competitors and in a world where we are the original incumbent, the pressure on our net adds is intense. Rob will speak to the many ways we're working to compete better.

The second challenge is in video programming costs. Let me frame the issue for you. Our programming costs per subscriber has grown 32% in the last 4 years. Over that same period, the Consumer Price Index has risen by 9%. So the math is pretty simple, programming costs have been rising at more than 3x the rate of inflation. Our residential video ARPU increased 16% over that same period, so we've effectively raised pricing a little faster than inflation but only half as fast as programming costs have risen.

This situation is caused by a complicated set of structural imbalances within the video entertainment industry. It's clear that this is not in the best interest of the consumer, and it's also clear that it can't continue forever. What is less clear is what will happen to change the situation or when. For our part, we will examine each network with an expiring contract and attempt to drop or reposition those that in our judgment do not add to the price value relationship of our packages. For the rest, we'll continue to negotiate the best deals we're able to get.

In the case of sports, we've taken some steps towards managing and stabilizing costs through our Lakers and Dodgers deals. That doesn't mean these deals are inexpensive, but we do think they are better than the potential alternatives. We're feeling very positive about the growth of our business services and broadband businesses. We're doing an awful lot to improve customer service, products and marketing, and we're pleased with our progress on all those fronts. Rob will talk about specific actions in a few minutes.

So we have our challenges, but we're investing to capture long-term opportunities, and our business remains strong and stable.

Now I'll turn the call over to Rob and then Irene to dive into the details.

Robert D. Marcus

Thanks, Glenn. Good morning, everyone. This morning, I'd like to divide my comments in 2 parts. In the first, I'll give you my assessment of 2012 and following that, I'll share our priorities for the new year. So to begin with. I would count 6 accomplishments in 2012 that we're particularly proud of that will provide a solid foundation for 2013. First, we made smart investments to enhance the capacity of our network and improve our critical infrastructure. We completed our DOCSIS 3.0 rollout in 2012 and also began a process of reclaiming bandwidth previously dedicated to the delivery of analog video. These 2 steps enable us to dedicate more

network capacity to our high-speed data offerings. That means we can handle more traffic and deliver higher speeds.

In November, we opened our first National Data Center in Charlotte, which will enable us to begin the consolidation of video sourcing and infrastructure for high-speed data, cloud services, phone and our internal enterprise systems. In addition, we've built out our own Content Delivery Network, or CDN, so we can efficiently deliver our managed IP video service without reliance on third parties. These investments are already paying dividends, but as importantly, they position us well for the long term.

Second, we made our products better in 2012. Our Internet customers now have much more choice. Optional usage-based tiers are available across virtually our entire footprint, and we're offering faster speeds than ever before.

As Glenn mentioned, we increased the speed of our standard tier of service by 50%, to 15 megabits per second. And in a couple of cities, we've added 75 and 100 megabits per second offerings to our existing tiers. We also added around 10,000 WiFi access points during the year, which when combined with the thousands of hotspots activated by our cable WiFi partners, give most of our Internet customers access to one of the most robust WiFi networks in the U.S. at no incremental charge.

On the video front, we continued to upgrade our TWC TV apps, which we believe represent the most advanced linear IP video product in the industry. As many as 300 channels are now available on a wide range of consumer devices in the home. And in December, we added 4,000 On Demand assets to the iOS app, a number that will only grow over time.

And with our Roku announcement at the Consumer Electronics Show earlier this month, our customers soon will be able to watch Time Warner Cable TV on their television without a leased set-top box. The really good news is that our customers are starting to make use of and appreciate the apps. In December, over 0.75 million unique customers used the TWC TV app and they used it almost 4 million times. We're now focused on adding out-of-home capabilities to the apps to make them even more valuable to customers.

Before I leave video, I have to point out that we also beefed up our programming lineup in 2012. Glenn noted that we are becoming increasingly vigilant about ensuring that the money we spend on programming yields real value to our customers. But that doesn't mean we're not interested in carrying new networks that enhance the value of our video product. So in 2012, we added some key sports programming to our lineup, most notably NFL Network and RedZone, as well as the Pac-12 Networks.

Finally, we continued to innovate in the voice space as well. In November, we launched the Global Penny Plan, an international calling plan that enables voice customers to call over 40 countries for $0.01 a minute.

The third area I want to talk about is customer service. We made real tangible progress in 2012. For example, we introduced 1-hour service windows in almost everywhere in our footprint. In a

number of cities, including New York City, we have something that may be even better, a 30-minute window for the first appointment of the day.

And we've even begun experimenting with real-time appointments. In addition, over the last year, we more than doubled our self-installation rate. Last month, almost 30% of installations were performed by our customers. That's a huge benefit, both to our customers in terms of convenience and to us in terms of truck rolls.

And we also completely overhauled our customer-facing web presence in 2012, enabling more of our customers to complete more transactions online or from their smartphones.

Fourth, business services. What more can I say about business services? We posted organic growth of more than 20% again in 2012. Powered by an expanded sales force, more buildings on net and some new products, we think we can achieve that kind of growth yet again in 2013.

Couple of quick business services metrics. In 2012, we added more than 1,500 people to our business services headcount, that's a 35% increase. And we nearly doubled the number of commercial buildings connected with fiber.

Fifth, the Insight integration has gone very smoothly. The former Insight systems now look and perform like Time Warner Cable systems. And although there's still work to be done, we fully expect to realize $100 million in annual run rate for synergies that we identified before we closed the deal last year.

And sixth, we took full advantage of the 2012 election to post a record year in advertising sales. Despite the success of a number of important initiatives in 2012, including those I just mentioned, our full year residential subscriber results were somewhat mixed. And that's true of the fourth quarter sub numbers as well.

If you take a look at Slide 3 in our presentation materials, you can review the details for both Q4 and the full year. Video stats were a disappointment. We really hoped that 2012 was going to be the year in which residential video net losses improved year-over-year. In fact, while our Enjoy Better campaign and aggressive packages fueled strong connect volumes, increases in disconnects led to net losses that were worse than in 2011.

I am somewhat encouraged that the year-over-year trend improved in each quarter -- each of the last 3 quarters. In Q4, video sub losses were essentially flat versus Q4 of 2011. But we still lost 129,000 residential video subs in the fourth quarter, and that's just not acceptable. So we've got much more work to do.

Internet, typically our star performer, delivered 75,000 net adds in Q4. That's fewer net adds than in Q4 of 2011. But the shortfall here was a conscious trade. Our modem fee drove a 6.3% increase in residential HSD ARPU in the fourth quarter, but undoubtedly had the effect of elevating disconnects. I will point out that our HSD subscriber mix continues to improve. More than 100% of our Q4 net adds were to our 30 and 50 megabits per second tiers. And we

continued to compete well against the telcos. Fourth quarter net adds were still more than triple the net adds of AT&T and Verizon combined.

Voice net adds for the full year were much better than in 2011, driven largely by our emphasis on Triple Plays. Q4 voice net adds came in at 34,000, just about where they came out in Q4 of 2011.

One other point worth noting is that Southern California led the company in subscriber performance in the fourth quarter. Part of that, undoubtedly, is related to our addition of TWC SportsNet and Pac-12 to the SoCal lineup. But in broader terms, I think our operations there are hitting their stride.

Some of our subscriber performance issues are related to the environment. Competition continues to be tough, and the economy is still challenging for many consumers in our footprint. But I believe there are other factors that are very much within our control.

So let me share with you what we're focused on in 2013. I mentioned that last year, we did a very good job driving connects but didn't do as well on customer retention. In 2013, we're redoubling our efforts to get, grow and keep customers. Just last week, we launched a new pricing and packaging architecture designed to ensure that the phones continue to ring and consumers continue to visit our website, but also to facilitate aggressive up-selling by our newly retrained sales teams.

And most importantly, we're making significant investments in retention capabilities that should help us keep the customers we have. A lot of this is simply about execution. It starts with ensuring that retention calls are routed to retention specialists, and then, it's about arming those specialists with training, processes and tools so they can handle issues that have been problems for us in the past.

We've been losing too many customers when their promotions expire. To fix this issue, we will adopt a much more disciplined and consistent approach to managing post promotion pricing. We can also do far better working with customers who fall into non-pay status. We think there are meaningful benefits to taking a more customer segment-specific approach to handling late payers.

And we know we can be more effective at retaining customers who are moving within our footprint. Of course, the best approach to reducing churn is to minimize the number of customers that call to disconnect in the first place. That means we need to keep our customers happy. So in 2013, we'll continue to improve customer service by refining the initiatives we launched in 2012, by improving the reliability of our network, increasing first-call resolution and reducing repeat trouble calls. All of that requires painstaking attention to detail, but we're committed to making it happen.

And we'll further enhance products, too. Our customers will see a series of updates to our apps that will bring even more content and functionality to more devices. In addition, our cloud-based

user interface, running on IP set-top boxes and next-generation DVRs, will deliver the biggest change to the video experience that our customers have experienced in a decade.

These are scheduled for introduction in the second half of the year. In HSD, we are planning to more than double our network of WiFi Hotspots, with an emphasis on New York City. As Irene will highlight shortly, we expect that business services will continue to drive a disproportionate amount of growth in 2013. So we'll continue to focus on and invest in B2B. That means additional expansion of our sales force and more buildings on net, as well as more new products.

Underlying our 2013 priorities are greater focus and better and faster decision making. To that end, we announced organizational changes last week to mark the final step in our evolution from decentralized geographic operating units to a more centralized structure that we're internally calling One Time Warner Cable.

We expect that over time, this more streamlined organization will deliver new products faster and better in addition to more reliable service. It will give our employees greater clarity on their roles and responsibilities. And of course, we believe these changes will help us to deliver the operational efficiency and profitable growth that our shareholders demand.

So in summary, we're gratified by our many successes in 2012, and we recognize the need to continually step up our game to meet the challenges of a world in which technology changes faster each year and competition continues to be intense.

We come to battle well prepared with a fabulous high-capacity network, more than 50,000 dedicated employees and an org structure that is tailored to address the opportunities and challenges we face. As I look forward, I am confident that we will succeed.

Thank you. And with that, I'll turn it over to Irene to discuss our financials.

Irene M. Esteves

Thanks, Rob. And good morning, everyone. I'll start with the fourth quarter highlights on Slide 4.

In the fourth quarter, we grew revenue about 10%, and we drove operating income and adjusted diluted EPS growth just under 14%. We increased the amount of capital returned to shareholders through dividends and share repurchases to $742 million.

In the following slides, I'll give you more insight into fourth quarter trends, point out some of the key drivers of our performance and provide some of our expectations for 2013.

So let's jump right into our financial results on the next slide. Revenue growth for the fourth quarter was driven primarily by acquisitions, business services and political advertising. Excluding acquisitions, revenue growth was 4.2%.

As you can see on the slide, we continue to drive revenue by increasing total ARPU per customer relationship, which increased 4% over last year and is approaching $120 per month.

We move on to Slide 6, fourth quarter business services revenue was up 26% or $106 million. Excluding $17 million from Insight during the quarter, business services revenue grew 22% year-over-year. That's our 11th consecutive quarter of at least 20% organic growth.

And looking at our organic growth, the $89 million increase was driven by a 21% growth in HSD from shared and dedicated Internet access, as well as Metro Ethernet. 46% growth in phone, 29% growth in managed and outsourced IT solutions and cloud services and 16% growth in wholesale transport revenue, mostly cell tower backhaul.

And we continue to invest in this growth opportunity and expect these investments to drive 2013 total business services revenue growth in the 20% to 25% range.

For residential services, let's start with revenue on Slide 7. We remain focused on driving both subscriber volume, as well as revenue and profit per household. Fourth quarter revenue grew 7%, and excluding the impact of acquisitions, revenue grew 1% driven by a robust 11% growth in HSD while video revenue was down 3% and voice revenue was down 1%.

Our total residential subscription ARPU per customer relationship increased to $103.79 in the fourth quarter, up 1.7% from last year's fourth quarter.

Residential HSD ARPU increased year-over-year for the 15th consecutive quarter, rising 6.3%, double the year-over-year growth rate from Q3 '12. The introduction of a modem fee accounted for about 3/4 of the ARPU growth. Improved subscriber mix also contributed to this ARPU growth, as we migrate subscribers to higher-priced tiers of service.

At quarter end, Turbo, Extreme and Ultimate subscribers comprised over 23% of our residential HSD customer base, up from 19% a year ago and just 11% 3 years ago. Video ARPU increased 0.7%, driven by price increases, a more favorable video subscriber mix and increased equipment rentals. These factors were partially offset by a decline in video-on-demand and premium channel revenue per sub. Voice ARPU declined 4.1%. Of course, all of these ARPU numbers are affected by the allocation of the bundle discounts.

On our next slide, in the fourth quarter, political ad revenue accounted for over 3/4 of our total advertising growth of 29%. Excluding political, fourth quarter advertising was up a strong 7%, driven by the acquisition of Insight and the additional ad inventory on the L.A. RSNs. In advertising, we achieved a new milestone by crossing the $1 billion mark in annual revenue.

So let's turn to Slide 9. Adjusted OIBDA increased 5.6% in the fourth quarter compared to last year. Fourth quarter total operating expense grew 12.5%, largely driven by acquisitions, L.A. RSN costs, including the Lakers rights fees and our hiring in business services. In Q4, the combined net costs from the Lakers and other new initiatives were about $60 million, putting our full year net cost at $110 million.

But before we move on to operating income, let me pause for a second to tell you what neighborhood we think we'll be in for the 2013 revenue and adjusted OIBDA. We expect organic revenue growth to be around 3% to 4%, comparable to the 3.5% growth rate in 2012. In addition to organic growth, we will have 12 months of Insight revenue in 2013 compared to 10 months in 2012. So we expect total reported revenue growth to be in the 4% to 5% range.

However, we expect adjusted OIBDA margin contraction of 50 to 100 basis points, driven primarily by programming cost growth per sub of around 10% related to adding new programming services and rate increases, the absence of high-margin political advertising revenue and approximately 20% higher pension expense.

In order to offset some of this impact, we continue to pursue operational efficiencies throughout the company, and Rob touched on some of those initiatives. But as you know, our efforts to in-source the back-office of our phone service will yield only modest benefits in 2013, the more significant savings come in 2014.

As you build your 2013 quarterly models, recall that first quarter margins typically step down from Q4 levels due to a variety of factors, including the timing of employee-related expenses like payroll taxes and merit increases. In addition, first quarter 2013 margins will be negatively impacted by the absence of high-margin political advertising revenue booked in Q4, as well as the timing of the Lakers rights fees.

Moving on to Slide 10, operating income increased 13.6% to $1.2 billion in the fourth quarter of '12, reflecting a higher adjusted OIBDA in the fourth quarter 2011 wireless asset impairments, partially offset by increases in depreciation and amortization.

Higher D&A from Insight was partially offset by lower depreciation related to the roll-off of Adelphia and Comcast assets. We incurred $17 million of merger-related and restructuring costs in the quarter compared to $34 million in the fourth quarter of 2011.

So turning to Slide 11, our fourth quarter diluted EPS was $1.68. Adjusted diluted EPS, which excludes a number of items affecting comparability, increased 14% to $1.57. And these items affecting comparability for both periods are detailed in Note 1 to our press release. We expect that in 2013, we'll deliver 10% to 15% adjusted diluted EPS growth.

Turning to capital spending on Slide 12. Capital spending finished the year as planned, including about $100 million of Insight-related CapEx. We invested $3.1 billion in total CapEx in 2012 or 14.5% of revenue, a 40-basis-point decrease from 2011. Business services' capital intensity was 31.9%, and residential, advertising and other capital spending was at 12.8% of revenue.

Fourth quarter CapEx was down 4% from a year ago to $904 million, and was 16.5% of revenue, which was a 240-basis-point reduction from the fourth quarter of 2011. Overall, we expect capital intensity will continue to decline modestly, with full year capital spending around $3.2 billion in 2013.

And moving on to free cash flow, excluding bonus depreciation, free cash flow for the year was up 25%, primarily due to higher adjusted OIBDA, lower pension contributions and lower income tax payments due to Insight NOLs and other onetime deductions. This was partially offset by higher interest payments and CapEx.

Before I share with you our free cash flow expectations for 2013, let's flip to our favorite Slide 14 to give you a quick update on the impact of stimulus programs over the next several years. As you know, the federal government extended 50% bonus depreciation for 2013 as part of the American Taxpayer Relief Act of 2012. This act effectively delays the large step-down of bonus depreciation and tax deferrals for another year.

Assuming around $3.2 billion in 2013 CapEx, we expect that the impact of bonus depreciation deductions and reversals of prior-year benefits on cash taxes in 2013 will be around the same as in 2012. The chart on this slide highlights the net expected cash tax impact from bonus depreciation as adjusted for the new act for 2017.

But we still expect to pay higher overall taxes this year than we did last year, given the non-stimulus-related tax benefits we received in 2012. As a result, we expect 2013 total free cash flow, including stimulus impacts, to decline to around $2.3 billion.

Let's move on to our capital return slide. We ended the year with net debt and preferred equity totaling $23.5 billion, a $2 billion increase from year-end 2011, and our reported leverage ratio was 3.01x our last 12 months adjusted OIBDA.

Including the normal adjustments, which include items like the underfunded pension obligations and facility leases, and adjusted for a full year of Insight results, the leverage ratio is closer to our target. And despite higher net debt year-over-year, our success at raising capital at lower rates and managing our average costs through interest rate swaps resulted in a decline in our net interest cost in the fourth quarter.

Our average cost of debt has dropped from 6.5% to 6.0% over the last 2 years. That's a 50-basis-point drop on $26.7 billion of total debt or roughly $130 million of annual interest savings. In the fourth quarter, we returned over 125% of free cash flow or $742 million in total to shareholders, $171 million in dividends and $571 million in share repurchases. This was an increase of 14% in share repurchases compared to Q3 and 56% over a year ago.

And given our strong and sustainable cash flow generation, we announced another 16% increase in our quarterly dividend to $0.65 a share or $2.60 on an annualized basis. And let me remind you that our share repurchases are really an outcome of our balance sheet philosophy. We're a large borrower, and we're committed to maintaining our solid investment-grade rating. To do that, we manage to 3.25 leverage ratio with the normal adjustments over time.

So in summary, with these fourth quarter results, we have delivered another year of steady financial performance and we continued to return excess financial capacity to our shareholders, a total of $2.6 billion in dividends and share repurchases in 2012. We extended our track record today by raising our quarterly dividend for the third consecutive year.

Thank you. And with that, I'll turn it over to Tom for the Q&A portion of the call.

Tom Robey

Thanks, Irene. Candy, we're ready to begin the Q&A portion of the call. [Operator Instructions] First question please, Candy?

Question-and-Answer Session

Operator

First question is Doug Mitchelson, Deutsche Bank.

Douglas D. Mitchelson - Deutsche Bank AG, Research Division

I guess a question for Rob. How meaningfully and how quickly can the initiatives you outlined impact customer churn?

Robert D. Marcus

Doug, it's a great question, and my expectation is that certain of these initiatives that are very execution oriented could have an impact right away. Others will take some time to actually manifest themselves. Things that relate to customer satisfaction, reducing churn volume or churn calls in the first instance will unquestionably take a longer time to have an impact. Execution-related changes, I think, can have a more immediate impact. But the goal is to work it on both fronts, and my hope is that we see a better outcome throughout 2013.

Douglas D. Mitchelson - Deutsche Bank AG, Research Division

Yes, I mean, the follow-up would be -- I mean, I know you don't like talking about potential future video subscriber levels. But given the comment that you've had improvements each of the last 3 quarters, you've got the initiatives you have underway, I mean I think people are going to leave this call with the expectation that video sub losses are going to start to improve in 2013. Is that fair or is it really too early to gauge that?

Robert D. Marcus

It's what we're striving for, but it's early to gauge any full year results.

Operator

The next question is Jessica Reif Cohen of Bank of America Merrill Lynch.

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

I was hoping you could give us some color on your newest RSN. What can you say about the economics of the Dodgers RSN? And how different is it from the Lakers economics, which you actually own?

Irene M. Esteves

Hi, Jessica, it's Irene. The Dodgers deal is similar in economics to the Lakers deal in that we're guaranteed access to important sports programming over a long period of time. And our objective here, as it was with the Lakers, is to ensure that access to programming at a certain cost. And we think over the long-term, this will be a lower cost alternative than if we had not guaranteed those rights for the 25-year period.

Glenn A. Britt

Jessica, this Glenn. I just want to emphasize one thing that Irene just said. We do not pretend that these deals are inexpensive or cheap. And our sense is that if we're going to carry these games, they're going to be expensive when we get them. So what we think we've done with these deals is to minimize and stabilize the cost over a long time period. But we're not trying to pretend the first year is really, really cheap or anything.

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

But is this why margins are coming down in 2013?

Irene M. Esteves

It really doesn't impact us, Jessica, until 2014.

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

All right. Okay. So can you say anything about the first year impact?

Irene M. Esteves

It should be minimal. We might have a little bit of startup cost, but it's really a '14 impact.

Operator

Next question is Phil Cusick, JPMorgan.

Philip Cusick - JP Morgan Chase & Co, Research Division

I guess, just following up on Jessica's question, can you help us think about the -- are the Lakers and Dodgers RSN deals sort of more dilutive up front and so dragging margins even more than might have been in a normal or sort of a -- you buying from the previous contract? But then we

expect margins to improve over time. So are we seeing more pressure from these given the structure, but again, you think it's better this way to do it?

Glenn A. Britt

Phil, the answer is no. Again, we think we're stabilizing and minimizing costs over a long time period. These -- in both cases, these rights were up for auction in a sense and they were going to be expensive no matter what happened. We think we've done the best of the alternatives.

Irene M. Esteves

And with the experience we've had with the Lakers, we'd say that given the net cost of that deal compared to where sports rights programming is going, that we're confident that we made the right decision with the Lakers and we're hopeful we made -- we'll find the same with the Dodgers.

Robert D. Marcus

Even in the short term.

Philip Cusick - JP Morgan Chase & Co, Research Division

Can you give us any early indication on what this should do to '14 margins as well?

Irene M. Esteves

It's too early to say.

Operator

Next question, Laura Martin, Needham & Company.

Laura A. Martin - Needham & Company, LLC, Research Division

Let's leave sports and talk about the Google overbuild in Kansas City. Can you guys give us any update as to what's happening to your subscribers and cost down there? And then I thought the most interesting thing to come out of CES was the Roku app, and I'd be interested in you guys sizing what that might mean to your capital spending. Could that take that down? And Glenn, strategically, should we expect to see to roll that out over other platforms other than the Roku platform?

Glenn A. Britt

Let me answer the last part, Laura, and then, Rob will do the first part. I think I've said this before, but I'll repeat it, our goal is to have our video services on every device that is capable of displaying them and carrying them. So there's all sizes and shapes and varieties of devices, but

you should assume we're actively talking to everybody and that's our objective. So over time, you will see a series of announcements such as Roku. Bob?

Robert D. Marcus

Yes, and just to amplify what Glenn said, Roku is just one example of many. Whether the actual experience will be attractive to a broad number of customers, I think, remains to be seen. So I wouldn't anticipate meaningful impact on our set-top box cost in the near term. I think this is more about the philosophy and direction we're headed. So going to Google, just at the risk of repeating what we've said before to put the Google overbuild in context, they have talked about what will ultimately be a 600,000 home build, I think 300,000 of those homes are in our footprint. And if you get to the subscriber level, it's something like 100,000 video customers and 100,000 HSD customers. So a very small percentage of our total subscriber base. And the reality is most of the action is going to happen towards the back half of this year. So they really haven't built out very much, and the customer impact we've seen, so far, is essentially de minimis. That said, we're hard at work ensuring that our customer relationships are strong, that our product set is good. We recently increased the tiers of service on HSD that we have available in the Google footprint. And we're now offering 100 megabits a second service, which is the fastest we're making available anywhere. So like with any overbuilder, we're ready for the competition.

Glenn A. Britt

And Laura, if I could just add one more thing. I think that there's a lot of PR and a lot of hype about this whole thing. The reality is, today, there are not really applications that require 1 gigabit per second. So our philosophy has been to keep our speeds in line with what the market demands and what it needs. There's no doubt in my mind that the speeds will, over time, get faster and faster as they have since we started this in 1996. So I expect some time in the future, we'll have 1 gig, maybe 2 gigs. But other than PR and hype, this is not a real need for anybody right now.

Operator

Next question is Jason Bazinet, Citi.

Jason B. Bazinet - Citigroup Inc, Research Division

Just had a question either for Mr. Marcus or Mr. Britt. I guess, the entire cable industry is now at a point where they've gone all digital and most of the executives seem to extol the virtues of that decision and claim that it's helped their fundamental results fairly significantly. Do you still believe that not going all digital is the right move? And if so, do you mind just elaborating on what it is that you think makes your footprint or operational strategy fundamentally different from the rest of the industry?

Glenn A. Britt

Sure. I think if you cut through it all, going all digital is something that cable operators did to increase the usable capacity in their plan by getting rid of analog. So in that sense, it was something done for the benefit of the cable operator, not particularly for the consumer. And it's somewhat disruptive to consumers. What we've done is to initially create more capacity by using switch video, and that's stood us in very good stead. We most certainly, over time, will be going more and more towards all digital, but we're doing it on an evolutionary basis. I actually think the ultimate all digital is going to be IP digital, not MPEG-2, which is what everybody's stuck with. So I think that as we evolve to that, we'll be doing all things IP and not sort of in this intermediate phase. So we actually feel very good about what we've been doing and I think the future it's going to pay big dividends.

Robert D. Marcus

Let me just clarify one thing that I mentioned in my prepared remarks. We are, in fact, in the process of reclaiming bandwidth that's previously been dedicated to analog video. And the way we're going about doing that is, as Glenn mentioned, rather than doing a flash cut and ceasing to deliver all of the networks in analog, we're starting really with the most -- the least viewed networks and kind of chipping away at the lineup and ceasing to deliver those networks in analog when a customer, who likes to watch those networks but doesn't have a set-top box, raises their hand, then we provide them with the D-to-A converter. So we can increase the usable bandwidth, to use Glenn's term, without some of the related disruption that generally is associated with these transitions. So we think we've struck the right balance, and it's working quite well.

Glenn A. Britt

I think just to be clear also, we have gone all digital in some markets where we needed the capacity. So New York City is one of them and parts of L.A. and then maybe some other places.

Operator

Next question, Marci Ryvicker, Wells Fargo.

Marci Ryvicker - Wells Fargo Securities, LLC, Research Division

I just had a quick question for Irene. Can you share with us your thoughts on share repurchase activity for 2013? I know last year, you had told us that it should be more than free cash flow. Should we expect the same thing again?

Irene M. Esteves

Hi, Marci. On free cash flow, what we've said is we're guided by our 3.25 leverage ratio, and we've been very consistent talking about that, and we will continue to use that as a guiding principle. I'm not giving specific guidance on the pace, but as you look back on our history, you can see that we've consistently increased the pace, and that we are fully committed to 3.25 leverage ratio over time.

Marci Ryvicker - Wells Fargo Securities, LLC, Research Division

And can you just clarify for free cash flow guidance there. I've seen a couple of different calculations between $2.3 billion and $2.5 billion. Is there a definitive number for 2013?

Irene M. Esteves

We said it will be around $2.3 billion.

Operator

Next question is a Jason Armstrong, Goldman Sachs.

Jason Armstrong - Goldman Sachs Group Inc., Research Division

Rob, you mentioned, I think, in your upfront remarks that Southern California is the bright spot operationally. I realize we've obviously talked about the Dodgers deal a decent amount. You were early in that market with WiFi initiatives, early obviously with RSN ownership relative to the rest of the footprint. Are those the key drivers that are impacting performance there? And to what extent, do you think, that can service sort of a broader blueprint?

Robert D. Marcus

Yes. So I think that the programming benefits we got out of the TWC SportsNet and maybe as significantly, Pac-12 Networks, did definitely help subscriber performance in SoCal in Q4. WiFi, I think it's still early days. We've got a nice network of WiFi Hotspots in L.A., and the evidence we have so far certainly suggest the correlation between churn reduction and WiFi utilization. But candidly, the usage is still at a level that I can't point to it having a meaningful impact on overall subscriber performance. We believe in the benefits of WiFi to our customers, but I think it's a little early to say that, that's a big driver of the subscriber performance. I think more than anything else, what I would attribute it to is superior execution. We've spent a lot of energy and it's been a long road since the acquisition of the Adelphia and Comcast properties to hardening the network, ensuring that the products that we delivered were reliable and state-of-the-art, and ensuring that our marketing and sales machine and our service organization were firing on all cylinders. And I think we're getting to that point, and that's manifesting itself in better subscriber performance.

Operator

Next, Ben Swinburne, Morgan Stanley.

Benjamin Swinburne - Morgan Stanley, Research Division

I have, I guess, 2 questions for Rob. Rob, as you look at the subscriber metrics over the last few years, one of the areas that did get worse in '12 was Double Play, which I'm presuming the vast majority is probably data and phone. But would love any color on that line since it seems like an

area where you're operating from a position of strength and it was pretty solid in '10 and '11. And then just on the margins in '13, the programming cost number isn't too surprising, and it feels like there's other stuff going on around maybe marketing, I know there's been some press around some new marketing initiatives you guys have. And I don't know if you'd be willing to talk about the startup losses, which were, I think, 110 for '12. Is there a number in '13 that we should be thinking about? Because it seems that a lot of the things you've done around CDN and data centers, the consolidation and reorg, would be margin enhancers but doesn't seem like that's kicking in, in '13. So any color would be helpful.

Robert D. Marcus

Yes, so let me start with the question on doubles. I'll make a brief comment on marketing then, I'll flip it over to Irene to handle the rest of the margins. So Double Play -- first of all, you mentioned -- you made reference to data and phone. In fact, the vast majority of our Double Plays are video, data doubles, and that's where we saw the most softness in 2012. This is an area I think I highlighted on our Q3 call and it's an area that we're going to focus on going into this year. I think we can do a better job competing with U-verse in particular on the Double Play front. They've been very aggressive in their Double Play promotions, most notably in Texas and to some extent, in the Midwest. The focus has been on customers who reside in MDUs and generally don't take landline phone at all from anyone. They tend to be wireless-only customers. It's a younger, typically unmarried base, and we just need to re-craft some of our offerings to be more responsive to their needs. We haven't yet talked much about our Verizon Wireless relationship, but I feel that, that's a place where our Verizon Wireless relationship can actually position us well. So more to come on that front, but it's an area of focus. I guess, one mechanical thing that goes without saying, and it doesn't take away at all from the fact that we're focused on doubles, one of the reasons that doubles have been weaker is our emphasis has been on triples. And we probably sold in some triples to customers that otherwise in the past would have taken doubles. So some of this is just trading among bundled subs. But nonetheless, it's an area of focus for us in '13.

Irene M. Esteves

And then on the margins, if you think about programming, which was $4.6 billion, if that's growing at 10% a sub, that's a huge impact on our margins. We also mentioned 2 other piece, the pension expense which is with historically low interest rates, that expense line goes up. And we're -- it's a nonpolitical year in '13, so we're missing that very high-margin political revenue. In prior years, we also had offsets to some of the programming expenses with large Go It Alone savings in our phone business, which we're not expecting as much of this year. And you asked about the new initiatives and what we spent in 2012. We will continue to invest behind those businesses, but because it's a multi-year investment, we don't think it makes sense to break them out anymore. But suffice it to say, we are continuing to invest behind things like IntelligentHome rollout and our business services expansion, and Rob mentioned, the WiFi. So we'll continue to invest behind those businesses because we think it's right for the long-term profitability of the company. So those are the main drivers of that margin decline that we're expecting.

Robert D. Marcus

And just specifically to address your question on marketing, it's true that marketing was up in Q4 year-over-year, but I don't anticipate that being a meaningful driver of margin contraction in '13. In fact, due to the -- some of organizational changes we've made and actually a trend that started probably last year, we're getting more efficient with our marketing dollars. I think we're getting more bang for the buck in everything we spend. We're dedicating more of our dollars to working dollars, in other words, buying media as opposed to some of the administrative and production costs. And I think we're actually doing a better job spending marketing dollars more wisely. So I don't anticipate that being a factor.

Glenn A. Britt

Yes, one thing I'd remind you about margins is that it's a good conversation about costs, and it's a good measure of whether we're managing costs. But at the end of the day, it's a mixture of a whole bunch of stuff and different products with different characteristics. And we actually don't run the business for margin, we run it for the bottom line. So if we can sell more of a lower margin product but add to the bottom line, we'll do that. So I just -- I know everybody needs it for modeling, that we pay attention to it, but it's not our primary focus. We're focused on the bottom line.

Operator

Next, Richard Greenfield, BTIG.

Richard Greenfield - BTIG, LLC, Research Division

You talked about reducing programming costs, but you've been out of contract, I believe, with Starz Encore for a number of years. Just wondering if that's an opportunity for you to make a dent in the programming cost line that you mentioned several times during the call? And then on broadband, it's becoming an increasingly profitable business, I mean the modem fee is going to have a, say, a notable impact on 2013's growth. Do you worry or how do you think about the risk to broadband sub fees emerging like what you pay in ESPN 3 today? Could that proliferate over time and chew into any of that revenue that you're generating?

Glenn A. Britt

Rich, I'll take a shot at both those. First of all, individual programming deals, I don't -- I'd be remiss making any comments at this point. But suffice it to say, we're going to look at everything hard. On the broadband subject, I think you raised an interesting issue because in a world where there's net neutrality and a push for net neutrality, which is essentially applications and content people saying they don't want anybody to be favored, there's the potential for reverse network neutrality. And I think perhaps an illustration of the government trying to put rules in place too early without really thinking through everything that happened. The essence of Internet is that you provide access to the web and people will go wherever they want and do whatever they want and what we sell is the access. So I think we need to be very careful about turning that into a business where some application or content providers seek favor or demand favor. It's not kind of what this is all about.

Operator

Next, John Hodulik, UBS.

John C. Hodulik - UBS Investment Bank, Research Division

First, maybe a quick clarification on the programming cost. You're seeing some real acceleration per sub in terms of growth. Maybe Glenn, are the initiatives to drive some of these channels -- I mean, should we keep that number at about 10% going forward or do you think the initiative to drive some of these channels can put some pressure on that as we move beyond 2013? And then maybe from Rob, can we just get some more detail or could you elaborate on a couple of the initiatives you talked about? First, the rollout of the cloud-based IP guide and you talked about developing more video apps and extending those beyond the home. When -- what -- can you give us a little bit more detail there and when we can see those?

Glenn A. Britt

On the first one, I think it's -- beyond what we said, I don't want to say much, numerically. But the actions we're taking are not going to dramatically change the trajectory of programming cost. I do hope that we can, over time, improve the perceived price value relationship though and then, clearly, consumers, particularly people who are under economic duress, are looking at these big packages and they're saying, it costs more than I can afford, number one. And number two, there's too many networks I never watch and I don't care about. And that's kind of what we're trying to address. Obviously, sports and other really popular programming keep getting more and more expensive, and that's where most of the money is. But these networks that hang on, I think they have a birthrate of carriage even though hardly anybody watches them. Those are the ones we're going to be taking a look at.

Robert D. Marcus

And John, with respect to the cloud-based guide, I mean I guess the first thing that's worth mentioning, and we've mentioned it before, is that we already have a cloud-based guide that's in front of a couple of hundred thousand customers in a couple of markets and we've had it out there for a while, and we've learned from it. The cloud-based guide I was referring to, is what we call our hosted navigation product. It will be available back half of this year. It will work on our new IP set-top boxes. It will work on what is essentially a souped-up DVR. Some people have referred to it as a Gateway device, which has 1 terabyte of storage, 6 tuners and has the ability to transcode video into IP, so it can be consumed not only by the IP set-top boxes but by other devices in the home. So we're looking forward to that. I think the experience will be markedly better than the set-top box-based guide experience. There will be easier navigation, more box art, better search, all of the things that viewers have come to expect based on their interaction with video on the web. So I think that's going to be a really exciting change. Refresh, what was your question on the video apps?

John C. Hodulik - UBS Investment Bank, Research Division

Yes, first, is that new guide? And that media guide, will it going to be available in all your markets in the second half? And then you said, extending the apps not just so that they're useful inside the home but potentially I guess, with maybe the...

Robert D. Marcus

So on the guide, look, it will not -- the guide will initially only function on these new pieces of hardware that I'm referring to. So on one level, the proliferation of the guide will be dependent upon the rollout of the hardware. Whether or not it's available in every single market, I think it's still too early to say what the exact rollout schedule is. So we'll give you more as the year progresses. On video apps, we already have a pretty healthy portfolio of rights to deliver video product outside the home. But so far, customers access to those -- the video product, has been dependent on their visiting the programmers' website. What I expect later this year, and in fact late first quarter, early second quarter, is that those video products will find their way into our apps even when you're outside the home. So the experience will be better in the sense that the programming will be aggregated and easier to navigate. So I think we've listed these before but obviously, we have the ESPN suite of services, we have rights with respect to Viacom's products, Big Ten Network, we have some professional sports product from the leagues. It's a pretty decent list, and I think the experience will be a lot better once we incorporate them in our apps.

I see that it's half past the hour, so that's probably all we have time for this morning. Thanks, everyone, for joining us. And to give a little bit of advanced notice, our next quarterly conference call will be held on Thursday, April 25 at 8:30 a.m. Eastern Time. Thanks for joining us, and have a great day.

Operator

Thank you. That does conclude today's conference. You may disconnect at this time.

Executives

Tom Robey

Glenn A. Britt - Chairman and Chief Executive Officer

Robert D. Marcus - President and Chief Operating Officer

Irene M. Esteves - Chief Financial Officer and Executive Vice President

Analysts

Douglas D. Mitchelson - Deutsche Bank AG, Research Division

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

Philip Cusick - JP Morgan Chase & Co, Research Division

Laura A. Martin - Needham & Company, LLC, Research Division

Jason B. Bazinet - Citigroup Inc, Research Division

Marci Ryvicker - Wells Fargo Securities, LLC, Research Division

Jason Armstrong - Goldman Sachs Group Inc., Research Division

Benjamin Swinburne - Morgan Stanley, Research Division

Richard Greenfield - BTIG, LLC, Research Division

John C. Hodulik - UBS Investment Bank, Research Division

Time Warner Cable (TWC) Q4 2012 Earnings Call January 31, 2013 8:30 AM ET

Operator

Hello, and welcome to the Time Warner Cable Fourth Quarter 2012 Earnings Conference Call. [Operator Instructions] Today's conference is being recorded. If you have any objections, you

may disconnect at this time. Now, I will turn the call over to Mr. Tom Robey, Senior Vice President of Time Warner Cable Investor Relations.

Tom Robey

Thanks, Candy. And good morning, everyone. Welcome to Time Warner Cable's 2012 Fourth Quarter and Full Year Earnings Conference Call. This morning, we issued 2 press releases, one detailing our 2012 fourth quarter and full year results and the other, announcing an increase in our regular quarterly dividend.

Before we begin, there are a couple of items I want to cover. First, we refer to certain non-GAAP measures. Definitions and schedules, setting out reconciliations of these historical non-GAAP financial measures to the most directly comparable GAAP financial measures, are included in our earnings release and trending schedules.

And second, today's announcement includes certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which are based on management's current expectations and beliefs and are subject to uncertainty and changes in circumstances. Actual results may vary materially from those expressed or implied by the statements herein due to various factors, which are discussed in detail in our SEC filings. Time Warner Cable is under no obligation to, and in fact, expressly disclaims any such obligation to update or alter its forward-looking statements whether as a result of new information, future events or otherwise.

And finally, today's press releases, trending schedules, presentation slides and related reconciliation schedules are available on our website at twc.com/investors.

With that covered, I'll thank you and turn the call over to Glenn Britt. Glenn?

Glenn A. Britt - Chairman and Chief Executive Officer

Good morning, and thanks for joining us. As we look back on 2012, we have much to be proud of. It was a year in which we grew revenue by almost 9%, powered by our acquisition and successful integration of Insight Communications, continued success in business services and the best-ever year in advertising.

Broadband continues to be our strongest product. We added another 0.5 million subs in 2012 and improved the mix even as we raised prices, a powerful combination. But considering that the average customer used roughly 40% more capacity last year, and we increased our standard speed by 50%, yet our pricing increased by less than 10%, our broadband product is still a terrific value for customers.

We met or exceeded all elements of our guidance in 2012. In addition, we honored our commitment to return capital to shareholders. We repurchased 22 million shares for $1.9 billion in 2012, raising the total since initiation late in 2010 to over $5 billion.

And through our regular dividend, we returned $700 million to shareholders last year. This morning, we announced a 16% increase of dividend to an annualized rate of $2.60 per share, demonstrating our continued confidence in our ability to generate very strong free cash flow.

Before I turn the call over to Rob and Irene though, I want to spend a couple of minutes on residential video, our most mature and highly penetrated business. It faces challenges on 2 fronts. The first is competition. The telcos and satellite companies are tough competitors and in a world where we are the original incumbent, the pressure on our net adds is intense. Rob will speak to the many ways we're working to compete better.

The second challenge is in video programming costs. Let me frame the issue for you. Our programming costs per subscriber has grown 32% in the last 4 years. Over that same period, the Consumer Price Index has risen by 9%. So the math is pretty simple, programming costs have been rising at more than 3x the rate of inflation. Our residential video ARPU increased 16% over that same period, so we've effectively raised pricing a little faster than inflation but only half as fast as programming costs have risen.

This situation is caused by a complicated set of structural imbalances within the video entertainment industry. It's clear that this is not in the best interest of the consumer, and it's also clear that it can't continue forever. What is less clear is what will happen to change the situation or when. For our part, we will examine each network with an expiring contract and attempt to drop or reposition those that in our judgment do not add to the price value relationship of our packages. For the rest, we'll continue to negotiate the best deals we're able to get.

In the case of sports, we've taken some steps towards managing and stabilizing costs through our Lakers and Dodgers deals. That doesn't mean these deals are inexpensive, but we do think they are better than the potential alternatives. We're feeling very positive about the growth of our business services and broadband businesses. We're doing an awful lot to improve customer service, products and marketing, and we're pleased with our progress on all those fronts. Rob will talk about specific actions in a few minutes.

So we have our challenges, but we're investing to capture long-term opportunities, and our business remains strong and stable.

Now I'll turn the call over to Rob and then Irene to dive into the details.

Robert D. Marcus - President and Chief Operating Officer

Thanks, Glenn. Good morning, everyone. This morning, I'd like to divide my comments in 2 parts. In the first, I'll give you my assessment of 2012 and following that, I'll share our priorities for the new year. So to begin with. I would count 6 accomplishments in 2012 that we're particularly proud of that will provide a solid foundation for 2013. First, we made smart investments to enhance the capacity of our network and improve our critical infrastructure. We completed our DOCSIS 3.0 rollout in 2012 and also began a process of reclaiming bandwidth previously dedicated to the delivery of analog video. These 2 steps enable us to dedicate more

network capacity to our high-speed data offerings. That means we can handle more traffic and deliver higher speeds.

In November, we opened our first National Data Center in Charlotte, which will enable us to begin the consolidation of video sourcing and infrastructure for high-speed data, cloud services, phone and our internal enterprise systems. In addition, we've built out our own Content Delivery Network, or CDN, so we can efficiently deliver our managed IP video service without reliance on third parties. These investments are already paying dividends, but as importantly, they position us well for the long term.

Second, we made our products better in 2012. Our Internet customers now have much more choice. Optional usage-based tiers are available across virtually our entire footprint, and we're offering faster speeds than ever before.

As Glenn mentioned, we increased the speed of our standard tier of service by 50%, to 15 megabits per second. And in a couple of cities, we've added 75 and 100 megabits per second offerings to our existing tiers. We also added around 10,000 WiFi access points during the year, which when combined with the thousands of hotspots activated by our cable WiFi partners, give most of our Internet customers access to one of the most robust WiFi networks in the U.S. at no incremental charge.

On the video front, we continued to upgrade our TWC TV apps, which we believe represent the most advanced linear IP video product in the industry. As many as 300 channels are now available on a wide range of consumer devices in the home. And in December, we added 4,000 On Demand assets to the iOS app, a number that will only grow over time.

And with our Roku announcement at the Consumer Electronics Show earlier this month, our customers soon will be able to watch Time Warner Cable TV on their television without a leased set-top box. The really good news is that our customers are starting to make use of and appreciate the apps. In December, over 0.75 million unique customers used the TWC TV app and they used it almost 4 million times. We're now focused on adding out-of-home capabilities to the apps to make them even more valuable to customers.

Before I leave video, I have to point out that we also beefed up our programming lineup in 2012. Glenn noted that we are becoming increasingly vigilant about ensuring that the money we spend on programming yields real value to our customers. But that doesn't mean we're not interested in carrying new networks that enhance the value of our video product. So in 2012, we added some key sports programming to our lineup, most notably NFL Network and RedZone, as well as the Pac-12 Networks.

Finally, we continued to innovate in the voice space as well. In November, we launched the Global Penny Plan, an international calling plan that enables voice customers to call over 40 countries for $0.01 a minute.

The third area I want to talk about is customer service. We made real tangible progress in 2012. For example, we introduced 1-hour service windows in almost everywhere in our footprint. In a

number of cities, including New York City, we have something that may be even better, a 30-minute window for the first appointment of the day.

And we've even begun experimenting with real-time appointments. In addition, over the last year, we more than doubled our self-installation rate. Last month, almost 30% of installations were performed by our customers. That's a huge benefit, both to our customers in terms of convenience and to us in terms of truck rolls.

And we also completely overhauled our customer-facing web presence in 2012, enabling more of our customers to complete more transactions online or from their smartphones.

Fourth, business services. What more can I say about business services? We posted organic growth of more than 20% again in 2012. Powered by an expanded sales force, more buildings on net and some new products, we think we can achieve that kind of growth yet again in 2013.

Couple of quick business services metrics. In 2012, we added more than 1,500 people to our business services headcount, that's a 35% increase. And we nearly doubled the number of commercial buildings connected with fiber.

Fifth, the Insight integration has gone very smoothly. The former Insight systems now look and perform like Time Warner Cable systems. And although there's still work to be done, we fully expect to realize $100 million in annual run rate for synergies that we identified before we closed the deal last year.

And sixth, we took full advantage of the 2012 election to post a record year in advertising sales. Despite the success of a number of important initiatives in 2012, including those I just mentioned, our full year residential subscriber results were somewhat mixed. And that's true of the fourth quarter sub numbers as well.

If you take a look at Slide 3 in our presentation materials, you can review the details for both Q4 and the full year. Video stats were a disappointment. We really hoped that 2012 was going to be the year in which residential video net losses improved year-over-year. In fact, while our Enjoy Better campaign and aggressive packages fueled strong connect volumes, increases in disconnects led to net losses that were worse than in 2011.

I am somewhat encouraged that the year-over-year trend improved in each quarter -- each of the last 3 quarters. In Q4, video sub losses were essentially flat versus Q4 of 2011. But we still lost 129,000 residential video subs in the fourth quarter, and that's just not acceptable. So we've got much more work to do.

Internet, typically our star performer, delivered 75,000 net adds in Q4. That's fewer net adds than in Q4 of 2011. But the shortfall here was a conscious trade. Our modem fee drove a 6.3% increase in residential HSD ARPU in the fourth quarter, but undoubtedly had the effect of elevating disconnects. I will point out that our HSD subscriber mix continues to improve. More than 100% of our Q4 net adds were to our 30 and 50 megabits per second tiers. And we

continued to compete well against the telcos. Fourth quarter net adds were still more than triple the net adds of AT&T and Verizon combined.

Voice net adds for the full year were much better than in 2011, driven largely by our emphasis on Triple Plays. Q4 voice net adds came in at 34,000, just about where they came out in Q4 of 2011.

One other point worth noting is that Southern California led the company in subscriber performance in the fourth quarter. Part of that, undoubtedly, is related to our addition of TWC SportsNet and Pac-12 to the SoCal lineup. But in broader terms, I think our operations there are hitting their stride.

Some of our subscriber performance issues are related to the environment. Competition continues to be tough, and the economy is still challenging for many consumers in our footprint. But I believe there are other factors that are very much within our control.

So let me share with you what we're focused on in 2013. I mentioned that last year, we did a very good job driving connects but didn't do as well on customer retention. In 2013, we're redoubling our efforts to get, grow and keep customers. Just last week, we launched a new pricing and packaging architecture designed to ensure that the phones continue to ring and consumers continue to visit our website, but also to facilitate aggressive up-selling by our newly retrained sales teams.

And most importantly, we're making significant investments in retention capabilities that should help us keep the customers we have. A lot of this is simply about execution. It starts with ensuring that retention calls are routed to retention specialists, and then, it's about arming those specialists with training, processes and tools so they can handle issues that have been problems for us in the past.

We've been losing too many customers when their promotions expire. To fix this issue, we will adopt a much more disciplined and consistent approach to managing post promotion pricing. We can also do far better working with customers who fall into non-pay status. We think there are meaningful benefits to taking a more customer segment-specific approach to handling late payers.

And we know we can be more effective at retaining customers who are moving within our footprint. Of course, the best approach to reducing churn is to minimize the number of customers that call to disconnect in the first place. That means we need to keep our customers happy. So in 2013, we'll continue to improve customer service by refining the initiatives we launched in 2012, by improving the reliability of our network, increasing first-call resolution and reducing repeat trouble calls. All of that requires painstaking attention to detail, but we're committed to making it happen.

And we'll further enhance products, too. Our customers will see a series of updates to our apps that will bring even more content and functionality to more devices. In addition, our cloud-based

user interface, running on IP set-top boxes and next-generation DVRs, will deliver the biggest change to the video experience that our customers have experienced in a decade.

These are scheduled for introduction in the second half of the year. In HSD, we are planning to more than double our network of WiFi Hotspots, with an emphasis on New York City. As Irene will highlight shortly, we expect that business services will continue to drive a disproportionate amount of growth in 2013. So we'll continue to focus on and invest in B2B. That means additional expansion of our sales force and more buildings on net, as well as more new products.

Underlying our 2013 priorities are greater focus and better and faster decision making. To that end, we announced organizational changes last week to mark the final step in our evolution from decentralized geographic operating units to a more centralized structure that we're internally calling One Time Warner Cable.

We expect that over time, this more streamlined organization will deliver new products faster and better in addition to more reliable service. It will give our employees greater clarity on their roles and responsibilities. And of course, we believe these changes will help us to deliver the operational efficiency and profitable growth that our shareholders demand.

So in summary, we're gratified by our many successes in 2012, and we recognize the need to continually step up our game to meet the challenges of a world in which technology changes faster each year and competition continues to be intense.

We come to battle well prepared with a fabulous high-capacity network, more than 50,000 dedicated employees and an org structure that is tailored to address the opportunities and challenges we face. As I look forward, I am confident that we will succeed.

Thank you. And with that, I'll turn it over to Irene to discuss our financials.

Irene M. Esteves - Chief Financial Officer and Executive Vice President

Thanks, Rob. And good morning, everyone. I'll start with the fourth quarter highlights on Slide 4.

In the fourth quarter, we grew revenue about 10%, and we drove operating income and adjusted diluted EPS growth just under 14%. We increased the amount of capital returned to shareholders through dividends and share repurchases to $742 million.

In the following slides, I'll give you more insight into fourth quarter trends, point out some of the key drivers of our performance and provide some of our expectations for 2013.

So let's jump right into our financial results on the next slide. Revenue growth for the fourth quarter was driven primarily by acquisitions, business services and political advertising. Excluding acquisitions, revenue growth was 4.2%.

As you can see on the slide, we continue to drive revenue by increasing total ARPU per customer relationship, which increased 4% over last year and is approaching $120 per month.

We move on to Slide 6, fourth quarter business services revenue was up 26% or $106 million. Excluding $17 million from Insight during the quarter, business services revenue grew 22% year-over-year. That's our 11th consecutive quarter of at least 20% organic growth.

And looking at our organic growth, the $89 million increase was driven by a 21% growth in HSD from shared and dedicated Internet access, as well as Metro Ethernet. 46% growth in phone, 29% growth in managed and outsourced IT solutions and cloud services and 16% growth in wholesale transport revenue, mostly cell tower backhaul.

And we continue to invest in this growth opportunity and expect these investments to drive 2013 total business services revenue growth in the 20% to 25% range.

For residential services, let's start with revenue on Slide 7. We remain focused on driving both subscriber volume, as well as revenue and profit per household. Fourth quarter revenue grew 7%, and excluding the impact of acquisitions, revenue grew 1% driven by a robust 11% growth in HSD while video revenue was down 3% and voice revenue was down 1%.

Our total residential subscription ARPU per customer relationship increased to $103.79 in the fourth quarter, up 1.7% from last year's fourth quarter.

Residential HSD ARPU increased year-over-year for the 15th consecutive quarter, rising 6.3%, double the year-over-year growth rate from Q3 '12. The introduction of a modem fee accounted for about 3/4 of the ARPU growth. Improved subscriber mix also contributed to this ARPU growth, as we migrate subscribers to higher-priced tiers of service.

At quarter end, Turbo, Extreme and Ultimate subscribers comprised over 23% of our residential HSD customer base, up from 19% a year ago and just 11% 3 years ago. Video ARPU increased 0.7%, driven by price increases, a more favorable video subscriber mix and increased equipment rentals. These factors were partially offset by a decline in video-on-demand and premium channel revenue per sub. Voice ARPU declined 4.1%. Of course, all of these ARPU numbers are affected by the allocation of the bundle discounts.

On our next slide, in the fourth quarter, political ad revenue accounted for over 3/4 of our total advertising growth of 29%. Excluding political, fourth quarter advertising was up a strong 7%, driven by the acquisition of Insight and the additional ad inventory on the L.A. RSNs. In advertising, we achieved a new milestone by crossing the $1 billion mark in annual revenue.

So let's turn to Slide 9. Adjusted OIBDA increased 5.6% in the fourth quarter compared to last year. Fourth quarter total operating expense grew 12.5%, largely driven by acquisitions, L.A. RSN costs, including the Lakers rights fees and our hiring in business services. In Q4, the combined net costs from the Lakers and other new initiatives were about $60 million, putting our full year net cost at $110 million.

But before we move on to operating income, let me pause for a second to tell you what neighborhood we think we'll be in for the 2013 revenue and adjusted OIBDA. We expect organic revenue growth to be around 3% to 4%, comparable to the 3.5% growth rate in 2012. In addition to organic growth, we will have 12 months of Insight revenue in 2013 compared to 10 months in 2012. So we expect total reported revenue growth to be in the 4% to 5% range.

However, we expect adjusted OIBDA margin contraction of 50 to 100 basis points, driven primarily by programming cost growth per sub of around 10% related to adding new programming services and rate increases, the absence of high-margin political advertising revenue and approximately 20% higher pension expense.

In order to offset some of this impact, we continue to pursue operational efficiencies throughout the company, and Rob touched on some of those initiatives. But as you know, our efforts to in-source the back-office of our phone service will yield only modest benefits in 2013, the more significant savings come in 2014.

As you build your 2013 quarterly models, recall that first quarter margins typically step down from Q4 levels due to a variety of factors, including the timing of employee-related expenses like payroll taxes and merit increases. In addition, first quarter 2013 margins will be negatively impacted by the absence of high-margin political advertising revenue booked in Q4, as well as the timing of the Lakers rights fees.

Moving on to Slide 10, operating income increased 13.6% to $1.2 billion in the fourth quarter of '12, reflecting a higher adjusted OIBDA in the fourth quarter 2011 wireless asset impairments, partially offset by increases in depreciation and amortization.

Higher D&A from Insight was partially offset by lower depreciation related to the roll-off of Adelphia and Comcast assets. We incurred $17 million of merger-related and restructuring costs in the quarter compared to $34 million in the fourth quarter of 2011.

So turning to Slide 11, our fourth quarter diluted EPS was $1.68. Adjusted diluted EPS, which excludes a number of items affecting comparability, increased 14% to $1.57. And these items affecting comparability for both periods are detailed in Note 1 to our press release. We expect that in 2013, we'll deliver 10% to 15% adjusted diluted EPS growth.

Turning to capital spending on Slide 12. Capital spending finished the year as planned, including about $100 million of Insight-related CapEx. We invested $3.1 billion in total CapEx in 2012 or 14.5% of revenue, a 40-basis-point decrease from 2011. Business services' capital intensity was 31.9%, and residential, advertising and other capital spending was at 12.8% of revenue.

Fourth quarter CapEx was down 4% from a year ago to $904 million, and was 16.5% of revenue, which was a 240-basis-point reduction from the fourth quarter of 2011. Overall, we expect capital intensity will continue to decline modestly, with full year capital spending around $3.2 billion in 2013.

And moving on to free cash flow, excluding bonus depreciation, free cash flow for the year was up 25%, primarily due to higher adjusted OIBDA, lower pension contributions and lower income tax payments due to Insight NOLs and other onetime deductions. This was partially offset by higher interest payments and CapEx.

Before I share with you our free cash flow expectations for 2013, let's flip to our favorite Slide 14 to give you a quick update on the impact of stimulus programs over the next several years. As you know, the federal government extended 50% bonus depreciation for 2013 as part of the American Taxpayer Relief Act of 2012. This act effectively delays the large step-down of bonus depreciation and tax deferrals for another year.

Assuming around $3.2 billion in 2013 CapEx, we expect that the impact of bonus depreciation deductions and reversals of prior-year benefits on cash taxes in 2013 will be around the same as in 2012. The chart on this slide highlights the net expected cash tax impact from bonus depreciation as adjusted for the new act for 2017.

But we still expect to pay higher overall taxes this year than we did last year, given the non-stimulus-related tax benefits we received in 2012. As a result, we expect 2013 total free cash flow, including stimulus impacts, to decline to around $2.3 billion.

Let's move on to our capital return slide. We ended the year with net debt and preferred equity totaling $23.5 billion, a $2 billion increase from year-end 2011, and our reported leverage ratio was 3.01x our last 12 months adjusted OIBDA.

Including the normal adjustments, which include items like the underfunded pension obligations and facility leases, and adjusted for a full year of Insight results, the leverage ratio is closer to our target. And despite higher net debt year-over-year, our success at raising capital at lower rates and managing our average costs through interest rate swaps resulted in a decline in our net interest cost in the fourth quarter.

Our average cost of debt has dropped from 6.5% to 6.0% over the last 2 years. That's a 50-basis-point drop on $26.7 billion of total debt or roughly $130 million of annual interest savings. In the fourth quarter, we returned over 125% of free cash flow or $742 million in total to shareholders, $171 million in dividends and $571 million in share repurchases. This was an increase of 14% in share repurchases compared to Q3 and 56% over a year ago.

And given our strong and sustainable cash flow generation, we announced another 16% increase in our quarterly dividend to $0.65 a share or $2.60 on an annualized basis. And let me remind you that our share repurchases are really an outcome of our balance sheet philosophy. We're a large borrower, and we're committed to maintaining our solid investment-grade rating. To do that, we manage to 3.25 leverage ratio with the normal adjustments over time.

So in summary, with these fourth quarter results, we have delivered another year of steady financial performance and we continued to return excess financial capacity to our shareholders, a total of $2.6 billion in dividends and share repurchases in 2012. We extended our track record today by raising our quarterly dividend for the third consecutive year.

Thank you. And with that, I'll turn it over to Tom for the Q&A portion of the call.

Tom Robey

Thanks, Irene. Candy, we're ready to begin the Q&A portion of the call. [Operator Instructions] First question please, Candy?

Question-and-Answer Session

Operator

First question is Doug Mitchelson, Deutsche Bank.

Douglas D. Mitchelson - Deutsche Bank AG, Research Division

I guess a question for Rob. How meaningfully and how quickly can the initiatives you outlined impact customer churn?

Robert D. Marcus - President and Chief Operating Officer

Doug, it's a great question, and my expectation is that certain of these initiatives that are very execution oriented could have an impact right away. Others will take some time to actually manifest themselves. Things that relate to customer satisfaction, reducing churn volume or churn calls in the first instance will unquestionably take a longer time to have an impact. Execution-related changes, I think, can have a more immediate impact. But the goal is to work it on both fronts, and my hope is that we see a better outcome throughout 2013.

Douglas D. Mitchelson - Deutsche Bank AG, Research Division

Yes, I mean, the follow-up would be -- I mean, I know you don't like talking about potential future video subscriber levels. But given the comment that you've had improvements each of the last 3 quarters, you've got the initiatives you have underway, I mean I think people are going to leave this call with the expectation that video sub losses are going to start to improve in 2013. Is that fair or is it really too early to gauge that?

Robert D. Marcus - President and Chief Operating Officer

It's what we're striving for, but it's early to gauge any full year results.

Operator

The next question is Jessica Reif Cohen of Bank of America Merrill Lynch.

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

I was hoping you could give us some color on your newest RSN. What can you say about the economics of the Dodgers RSN? And how different is it from the Lakers economics, which you actually own?

Irene M. Esteves - Chief Financial Officer and Executive Vice President

Hi, Jessica, it's Irene. The Dodgers deal is similar in economics to the Lakers deal in that we're guaranteed access to important sports programming over a long period of time. And our objective here, as it was with the Lakers, is to ensure that access to programming at a certain cost. And we think over the long-term, this will be a lower cost alternative than if we had not guaranteed those rights for the 25-year period.

Glenn A. Britt - Chairman and Chief Executive Officer

Jessica, this Glenn. I just want to emphasize one thing that Irene just said. We do not pretend that these deals are inexpensive or cheap. And our sense is that if we're going to carry these games, they're going to be expensive when we get them. So what we think we've done with these deals is to minimize and stabilize the cost over a long time period. But we're not trying to pretend the first year is really, really cheap or anything.

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

But is this why margins are coming down in 2013?

Irene M. Esteves - Chief Financial Officer and Executive Vice President

It really doesn't impact us, Jessica, until 2014.

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

All right. Okay. So can you say anything about the first year impact?

Irene M. Esteves - Chief Financial Officer and Executive Vice President

It should be minimal. We might have a little bit of startup cost, but it's really a '14 impact.

Operator

Next question is Phil Cusick, JPMorgan.

Philip Cusick - JP Morgan Chase & Co, Research Division

I guess, just following up on Jessica's question, can you help us think about the -- are the Lakers and Dodgers RSN deals sort of more dilutive up front and so dragging margins even more than might have been in a normal or sort of a -- you buying from the previous contract? But then we

expect margins to improve over time. So are we seeing more pressure from these given the structure, but again, you think it's better this way to do it?

Glenn A. Britt - Chairman and Chief Executive Officer

Phil, the answer is no. Again, we think we're stabilizing and minimizing costs over a long time period. These -- in both cases, these rights were up for auction in a sense and they were going to be expensive no matter what happened. We think we've done the best of the alternatives.

Irene M. Esteves - Chief Financial Officer and Executive Vice President

And with the experience we've had with the Lakers, we'd say that given the net cost of that deal compared to where sports rights programming is going, that we're confident that we made the right decision with the Lakers and we're hopeful we made -- we'll find the same with the Dodgers.

Robert D. Marcus - President and Chief Operating Officer

Even in the short term.

Philip Cusick - JP Morgan Chase & Co, Research Division

Can you give us any early indication on what this should do to '14 margins as well?

Irene M. Esteves - Chief Financial Officer and Executive Vice President

It's too early to say.

Operator

Next question, Laura Martin, Needham & Company.

Laura A. Martin - Needham & Company, LLC, Research Division

Let's leave sports and talk about the Google overbuild in Kansas City. Can you guys give us any update as to what's happening to your subscribers and cost down there? And then I thought the most interesting thing to come out of CES was the Roku app, and I'd be interested in you guys sizing what that might mean to your capital spending. Could that take that down? And Glenn, strategically, should we expect to see to roll that out over other platforms other than the Roku platform?

Glenn A. Britt - Chairman and Chief Executive Officer

Let me answer the last part, Laura, and then, Rob will do the first part. I think I've said this before, but I'll repeat it, our goal is to have our video services on every device that is capable of displaying them and carrying them. So there's all sizes and shapes and varieties of devices, but

you should assume we're actively talking to everybody and that's our objective. So over time, you will see a series of announcements such as Roku. Bob?

Robert D. Marcus - President and Chief Operating Officer

Yes, and just to amplify what Glenn said, Roku is just one example of many. Whether the actual experience will be attractive to a broad number of customers, I think, remains to be seen. So I wouldn't anticipate meaningful impact on our set-top box cost in the near term. I think this is more about the philosophy and direction we're headed. So going to Google, just at the risk of repeating what we've said before to put the Google overbuild in context, they have talked about what will ultimately be a 600,000 home build, I think 300,000 of those homes are in our footprint. And if you get to the subscriber level, it's something like 100,000 video customers and 100,000 HSD customers. So a very small percentage of our total subscriber base. And the reality is most of the action is going to happen towards the back half of this year. So they really haven't built out very much, and the customer impact we've seen, so far, is essentially de minimis. That said, we're hard at work ensuring that our customer relationships are strong, that our product set is good. We recently increased the tiers of service on HSD that we have available in the Google footprint. And we're now offering 100 megabits a second service, which is the fastest we're making available anywhere. So like with any overbuilder, we're ready for the competition.

Glenn A. Britt - Chairman and Chief Executive Officer

And Laura, if I could just add one more thing. I think that there's a lot of PR and a lot of hype about this whole thing. The reality is, today, there are not really applications that require 1 gigabit per second. So our philosophy has been to keep our speeds in line with what the market demands and what it needs. There's no doubt in my mind that the speeds will, over time, get faster and faster as they have since we started this in 1996. So I expect some time in the future, we'll have 1 gig, maybe 2 gigs. But other than PR and hype, this is not a real need for anybody right now.

Operator

Next question is Jason Bazinet, Citi.

Jason B. Bazinet - Citigroup Inc, Research Division

Just had a question either for Mr. Marcus or Mr. Britt. I guess, the entire cable industry is now at a point where they've gone all digital and most of the executives seem to extol the virtues of that decision and claim that it's helped their fundamental results fairly significantly. Do you still believe that not going all digital is the right move? And if so, do you mind just elaborating on what it is that you think makes your footprint or operational strategy fundamentally different from the rest of the industry?

Glenn A. Britt - Chairman and Chief Executive Officer

Sure. I think if you cut through it all, going all digital is something that cable operators did to increase the usable capacity in their plan by getting rid of analog. So in that sense, it was something done for the benefit of the cable operator, not particularly for the consumer. And it's somewhat disruptive to consumers. What we've done is to initially create more capacity by using switch video, and that's stood us in very good stead. We most certainly, over time, will be going more and more towards all digital, but we're doing it on an evolutionary basis. I actually think the ultimate all digital is going to be IP digital, not MPEG-2, which is what everybody's stuck with. So I think that as we evolve to that, we'll be doing all things IP and not sort of in this intermediate phase. So we actually feel very good about what we've been doing and I think the future it's going to pay big dividends.

Robert D. Marcus - President and Chief Operating Officer

Let me just clarify one thing that I mentioned in my prepared remarks. We are, in fact, in the process of reclaiming bandwidth that's previously been dedicated to analog video. And the way we're going about doing that is, as Glenn mentioned, rather than doing a flash cut and ceasing to deliver all of the networks in analog, we're starting really with the most -- the least viewed networks and kind of chipping away at the lineup and ceasing to deliver those networks in analog when a customer, who likes to watch those networks but doesn't have a set-top box, raises their hand, then we provide them with the D-to-A converter. So we can increase the usable bandwidth, to use Glenn's term, without some of the related disruption that generally is associated with these transitions. So we think we've struck the right balance, and it's working quite well.

Glenn A. Britt - Chairman and Chief Executive Officer

I think just to be clear also, we have gone all digital in some markets where we needed the capacity. So New York City is one of them and parts of L.A. and then maybe some other places.

Operator

Next question, Marci Ryvicker, Wells Fargo.

Marci Ryvicker - Wells Fargo Securities, LLC, Research Division

I just had a quick question for Irene. Can you share with us your thoughts on share repurchase activity for 2013? I know last year, you had told us that it should be more than free cash flow. Should we expect the same thing again?

Irene M. Esteves - Chief Financial Officer and Executive Vice President

Hi, Marci. On free cash flow, what we've said is we're guided by our 3.25 leverage ratio, and we've been very consistent talking about that, and we will continue to use that as a guiding principle. I'm not giving specific guidance on the pace, but as you look back on our history, you can see that we've consistently increased the pace, and that we are fully committed to 3.25 leverage ratio over time.

Marci Ryvicker - Wells Fargo Securities, LLC, Research Division

And can you just clarify for free cash flow guidance there. I've seen a couple of different calculations between $2.3 billion and $2.5 billion. Is there a definitive number for 2013?

Irene M. Esteves - Chief Financial Officer and Executive Vice President

We said it will be around $2.3 billion.

Operator

Next question is a Jason Armstrong, Goldman Sachs.

Jason Armstrong - Goldman Sachs Group Inc., Research Division

Rob, you mentioned, I think, in your upfront remarks that Southern California is the bright spot operationally. I realize we've obviously talked about the Dodgers deal a decent amount. You were early in that market with WiFi initiatives, early obviously with RSN ownership relative to the rest of the footprint. Are those the key drivers that are impacting performance there? And to what extent, do you think, that can service sort of a broader blueprint?

Robert D. Marcus - President and Chief Operating Officer

Yes. So I think that the programming benefits we got out of the TWC SportsNet and maybe as significantly, Pac-12 Networks, did definitely help subscriber performance in SoCal in Q4. WiFi, I think it's still early days. We've got a nice network of WiFi Hotspots in L.A., and the evidence we have so far certainly suggest the correlation between churn reduction and WiFi utilization. But candidly, the usage is still at a level that I can't point to it having a meaningful impact on overall subscriber performance. We believe in the benefits of WiFi to our customers, but I think it's a little early to say that, that's a big driver of the subscriber performance. I think more than anything else, what I would attribute it to is superior execution. We've spent a lot of energy and it's been a long road since the acquisition of the Adelphia and Comcast properties to hardening the network, ensuring that the products that we delivered were reliable and state-of-the-art, and ensuring that our marketing and sales machine and our service organization were firing on all cylinders. And I think we're getting to that point, and that's manifesting itself in better subscriber performance.

Operator

Next, Ben Swinburne, Morgan Stanley.

Benjamin Swinburne - Morgan Stanley, Research Division

I have, I guess, 2 questions for Rob. Rob, as you look at the subscriber metrics over the last few years, one of the areas that did get worse in '12 was Double Play, which I'm presuming the vast majority is probably data and phone. But would love any color on that line since it seems like an

area where you're operating from a position of strength and it was pretty solid in '10 and '11. And then just on the margins in '13, the programming cost number isn't too surprising, and it feels like there's other stuff going on around maybe marketing, I know there's been some press around some new marketing initiatives you guys have. And I don't know if you'd be willing to talk about the startup losses, which were, I think, 110 for '12. Is there a number in '13 that we should be thinking about? Because it seems that a lot of the things you've done around CDN and data centers, the consolidation and reorg, would be margin enhancers but doesn't seem like that's kicking in, in '13. So any color would be helpful.

Robert D. Marcus - President and Chief Operating Officer

Yes, so let me start with the question on doubles. I'll make a brief comment on marketing then, I'll flip it over to Irene to handle the rest of the margins. So Double Play -- first of all, you mentioned -- you made reference to data and phone. In fact, the vast majority of our Double Plays are video, data doubles, and that's where we saw the most softness in 2012. This is an area I think I highlighted on our Q3 call and it's an area that we're going to focus on going into this year. I think we can do a better job competing with U-verse in particular on the Double Play front. They've been very aggressive in their Double Play promotions, most notably in Texas and to some extent, in the Midwest. The focus has been on customers who reside in MDUs and generally don't take landline phone at all from anyone. They tend to be wireless-only customers. It's a younger, typically unmarried base, and we just need to re-craft some of our offerings to be more responsive to their needs. We haven't yet talked much about our Verizon Wireless relationship, but I feel that, that's a place where our Verizon Wireless relationship can actually position us well. So more to come on that front, but it's an area of focus. I guess, one mechanical thing that goes without saying, and it doesn't take away at all from the fact that we're focused on doubles, one of the reasons that doubles have been weaker is our emphasis has been on triples. And we probably sold in some triples to customers that otherwise in the past would have taken doubles. So some of this is just trading among bundled subs. But nonetheless, it's an area of focus for us in '13.

Irene M. Esteves - Chief Financial Officer and Executive Vice President

And then on the margins, if you think about programming, which was $4.6 billion, if that's growing at 10% a sub, that's a huge impact on our margins. We also mentioned 2 other piece, the pension expense which is with historically low interest rates, that expense line goes up. And we're -- it's a nonpolitical year in '13, so we're missing that very high-margin political revenue. In prior years, we also had offsets to some of the programming expenses with large Go It Alone savings in our phone business, which we're not expecting as much of this year. And you asked about the new initiatives and what we spent in 2012. We will continue to invest behind those businesses, but because it's a multi-year investment, we don't think it makes sense to break them out anymore. But suffice it to say, we are continuing to invest behind things like IntelligentHome rollout and our business services expansion, and Rob mentioned, the WiFi. So we'll continue to invest behind those businesses because we think it's right for the long-term profitability of the company. So those are the main drivers of that margin decline that we're expecting.

Robert D. Marcus - President and Chief Operating Officer

And just specifically to address your question on marketing, it's true that marketing was up in Q4 year-over-year, but I don't anticipate that being a meaningful driver of margin contraction in '13. In fact, due to the -- some of organizational changes we've made and actually a trend that started probably last year, we're getting more efficient with our marketing dollars. I think we're getting more bang for the buck in everything we spend. We're dedicating more of our dollars to working dollars, in other words, buying media as opposed to some of the administrative and production costs. And I think we're actually doing a better job spending marketing dollars more wisely. So I don't anticipate that being a factor.

Glenn A. Britt - Chairman and Chief Executive Officer

Yes, one thing I'd remind you about margins is that it's a good conversation about costs, and it's a good measure of whether we're managing costs. But at the end of the day, it's a mixture of a whole bunch of stuff and different products with different characteristics. And we actually don't run the business for margin, we run it for the bottom line. So if we can sell more of a lower margin product but add to the bottom line, we'll do that. So I just -- I know everybody needs it for modeling, that we pay attention to it, but it's not our primary focus. We're focused on the bottom line.

Operator

Next, Richard Greenfield, BTIG.

Richard Greenfield - BTIG, LLC, Research Division

You talked about reducing programming costs, but you've been out of contract, I believe, with Starz Encore for a number of years. Just wondering if that's an opportunity for you to make a dent in the programming cost line that you mentioned several times during the call? And then on broadband, it's becoming an increasingly profitable business, I mean the modem fee is going to have a, say, a notable impact on 2013's growth. Do you worry or how do you think about the risk to broadband sub fees emerging like what you pay in ESPN 3 today? Could that proliferate over time and chew into any of that revenue that you're generating?

Glenn A. Britt - Chairman and Chief Executive Officer

Rich, I'll take a shot at both those. First of all, individual programming deals, I don't -- I'd be remiss making any comments at this point. But suffice it to say, we're going to look at everything hard. On the broadband subject, I think you raised an interesting issue because in a world where there's net neutrality and a push for net neutrality, which is essentially applications and content people saying they don't want anybody to be favored, there's the potential for reverse network neutrality. And I think perhaps an illustration of the government trying to put rules in place too early without really thinking through everything that happened. The essence of Internet is that you provide access to the web and people will go wherever they want and do whatever they want and what we sell is the access. So I think we need to be very careful about turning that into a business where some application or content providers seek favor or demand favor. It's not kind of what this is all about.

Operator

Next, John Hodulik, UBS.

John C. Hodulik - UBS Investment Bank, Research Division

First, maybe a quick clarification on the programming cost. You're seeing some real acceleration per sub in terms of growth. Maybe Glenn, are the initiatives to drive some of these channels -- I mean, should we keep that number at about 10% going forward or do you think the initiative to drive some of these channels can put some pressure on that as we move beyond 2013? And then maybe from Rob, can we just get some more detail or could you elaborate on a couple of the initiatives you talked about? First, the rollout of the cloud-based IP guide and you talked about developing more video apps and extending those beyond the home. When -- what -- can you give us a little bit more detail there and when we can see those?

Glenn A. Britt - Chairman and Chief Executive Officer

On the first one, I think it's -- beyond what we said, I don't want to say much, numerically. But the actions we're taking are not going to dramatically change the trajectory of programming cost. I do hope that we can, over time, improve the perceived price value relationship though and then, clearly, consumers, particularly people who are under economic duress, are looking at these big packages and they're saying, it costs more than I can afford, number one. And number two, there's too many networks I never watch and I don't care about. And that's kind of what we're trying to address. Obviously, sports and other really popular programming keep getting more and more expensive, and that's where most of the money is. But these networks that hang on, I think they have a birthrate of carriage even though hardly anybody watches them. Those are the ones we're going to be taking a look at.

Robert D. Marcus - President and Chief Operating Officer

And John, with respect to the cloud-based guide, I mean I guess the first thing that's worth mentioning, and we've mentioned it before, is that we already have a cloud-based guide that's in front of a couple of hundred thousand customers in a couple of markets and we've had it out there for a while, and we've learned from it. The cloud-based guide I was referring to, is what we call our hosted navigation product. It will be available back half of this year. It will work on our new IP set-top boxes. It will work on what is essentially a souped-up DVR. Some people have referred to it as a Gateway device, which has 1 terabyte of storage, 6 tuners and has the ability to transcode video into IP, so it can be consumed not only by the IP set-top boxes but by other devices in the home. So we're looking forward to that. I think the experience will be markedly better than the set-top box-based guide experience. There will be easier navigation, more box art, better search, all of the things that viewers have come to expect based on their interaction with video on the web. So I think that's going to be a really exciting change. Refresh, what was your question on the video apps?

John C. Hodulik - UBS Investment Bank, Research Division

Yes, first, is that new guide? And that media guide, will it going to be available in all your markets in the second half? And then you said, extending the apps not just so that they're useful inside the home but potentially I guess, with maybe the...

Robert D. Marcus - President and Chief Operating Officer

So on the guide, look, it will not -- the guide will initially only function on these new pieces of hardware that I'm referring to. So on one level, the proliferation of the guide will be dependent upon the rollout of the hardware. Whether or not it's available in every single market, I think it's still too early to say what the exact rollout schedule is. So we'll give you more as the year progresses. On video apps, we already have a pretty healthy portfolio of rights to deliver video product outside the home. But so far, customers access to those -- the video product, has been dependent on their visiting the programmers' website. What I expect later this year, and in fact late first quarter, early second quarter, is that those video products will find their way into our apps even when you're outside the home. So the experience will be better in the sense that the programming will be aggregated and easier to navigate. So I think we've listed these before but obviously, we have the ESPN suite of services, we have rights with respect to Viacom's products, Big Ten Network, we have some professional sports product from the leagues. It's a pretty decent list, and I think the experience will be a lot better once we incorporate them in our apps.

I see that it's half past the hour, so that's probably all we have time for this morning. Thanks, everyone, for joining us. And to give a little bit of advanced notice, our next quarterly conference call will be held on Thursday, April 25 at 8:30 a.m. Eastern Time. Thanks for joining us, and have a great day.

Operator

Thank you. That does conclude today's conference. You may disconnect at this time.

Time Warner Cable Management Discusses Q4 2012 Results - Earnings Call Transcript

Jan. 31, 2013 1:20 PM ET | About: TWC by: SA Transcripts

Executives

Tom Robey

Glenn A. Britt - Chairman and Chief Executive Officer

Robert D. Marcus - President and Chief Operating Officer

Irene M. Esteves - Chief Financial Officer and Executive Vice President

Analysts

Douglas D. Mitchelson - Deutsche Bank AG, Research Division

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

Philip Cusick - JP Morgan Chase & Co, Research Division

Laura A. Martin - Needham & Company, LLC, Research Division

Jason B. Bazinet - Citigroup Inc, Research Division

Marci Ryvicker - Wells Fargo Securities, LLC, Research Division

Jason Armstrong - Goldman Sachs Group Inc., Research Division

Benjamin Swinburne - Morgan Stanley, Research Division

Richard Greenfield - BTIG, LLC, Research Division

John C. Hodulik - UBS Investment Bank, Research Division

Time Warner Cable (TWC) Q4 2012 Earnings Call January 31, 2013 8:30 AM ET

Operator

Hello, and welcome to the Time Warner Cable Fourth Quarter 2012 Earnings Conference Call. [Operator Instructions] Today's conference is being recorded. If you have any objections, you

may disconnect at this time. Now, I will turn the call over to Mr. Tom Robey, Senior Vice President of Time Warner Cable Investor Relations.

Tom Robey

Thanks, Candy. And good morning, everyone. Welcome to Time Warner Cable's 2012 Fourth Quarter and Full Year Earnings Conference Call. This morning, we issued 2 press releases, one detailing our 2012 fourth quarter and full year results and the other, announcing an increase in our regular quarterly dividend.

Before we begin, there are a couple of items I want to cover. First, we refer to certain non-GAAP measures. Definitions and schedules, setting out reconciliations of these historical non-GAAP financial measures to the most directly comparable GAAP financial measures, are included in our earnings release and trending schedules.

And second, today's announcement includes certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which are based on management's current expectations and beliefs and are subject to uncertainty and changes in circumstances. Actual results may vary materially from those expressed or implied by the statements herein due to various factors, which are discussed in detail in our SEC filings. Time Warner Cable is under no obligation to, and in fact, expressly disclaims any such obligation to update or alter its forward-looking statements whether as a result of new information, future events or otherwise.

And finally, today's press releases, trending schedules, presentation slides and related reconciliation schedules are available on our website at twc.com/investors.

With that covered, I'll thank you and turn the call over to Glenn Britt. Glenn?

Glenn A. Britt

Good morning, and thanks for joining us. As we look back on 2012, we have much to be proud of. It was a year in which we grew revenue by almost 9%, powered by our acquisition and successful integration of Insight Communications, continued success in business services and the best-ever year in advertising.

Broadband continues to be our strongest product. We added another 0.5 million subs in 2012 and improved the mix even as we raised prices, a powerful combination. But considering that the average customer used roughly 40% more capacity last year, and we increased our standard speed by 50%, yet our pricing increased by less than 10%, our broadband product is still a terrific value for customers.

We met or exceeded all elements of our guidance in 2012. In addition, we honored our commitment to return capital to shareholders. We repurchased 22 million shares for $1.9 billion in 2012, raising the total since initiation late in 2010 to over $5 billion.

And through our regular dividend, we returned $700 million to shareholders last year. This morning, we announced a 16% increase of dividend to an annualized rate of $2.60 per share, demonstrating our continued confidence in our ability to generate very strong free cash flow.

Before I turn the call over to Rob and Irene though, I want to spend a couple of minutes on residential video, our most mature and highly penetrated business. It faces challenges on 2 fronts. The first is competition. The telcos and satellite companies are tough competitors and in a world where we are the original incumbent, the pressure on our net adds is intense. Rob will speak to the many ways we're working to compete better.

The second challenge is in video programming costs. Let me frame the issue for you. Our programming costs per subscriber has grown 32% in the last 4 years. Over that same period, the Consumer Price Index has risen by 9%. So the math is pretty simple, programming costs have been rising at more than 3x the rate of inflation. Our residential video ARPU increased 16% over that same period, so we've effectively raised pricing a little faster than inflation but only half as fast as programming costs have risen.

This situation is caused by a complicated set of structural imbalances within the video entertainment industry. It's clear that this is not in the best interest of the consumer, and it's also clear that it can't continue forever. What is less clear is what will happen to change the situation or when. For our part, we will examine each network with an expiring contract and attempt to drop or reposition those that in our judgment do not add to the price value relationship of our packages. For the rest, we'll continue to negotiate the best deals we're able to get.

In the case of sports, we've taken some steps towards managing and stabilizing costs through our Lakers and Dodgers deals. That doesn't mean these deals are inexpensive, but we do think they are better than the potential alternatives. We're feeling very positive about the growth of our business services and broadband businesses. We're doing an awful lot to improve customer service, products and marketing, and we're pleased with our progress on all those fronts. Rob will talk about specific actions in a few minutes.

So we have our challenges, but we're investing to capture long-term opportunities, and our business remains strong and stable.

Now I'll turn the call over to Rob and then Irene to dive into the details.

Robert D. Marcus

Thanks, Glenn. Good morning, everyone. This morning, I'd like to divide my comments in 2 parts. In the first, I'll give you my assessment of 2012 and following that, I'll share our priorities for the new year. So to begin with. I would count 6 accomplishments in 2012 that we're particularly proud of that will provide a solid foundation for 2013. First, we made smart investments to enhance the capacity of our network and improve our critical infrastructure. We completed our DOCSIS 3.0 rollout in 2012 and also began a process of reclaiming bandwidth previously dedicated to the delivery of analog video. These 2 steps enable us to dedicate more

network capacity to our high-speed data offerings. That means we can handle more traffic and deliver higher speeds.

In November, we opened our first National Data Center in Charlotte, which will enable us to begin the consolidation of video sourcing and infrastructure for high-speed data, cloud services, phone and our internal enterprise systems. In addition, we've built out our own Content Delivery Network, or CDN, so we can efficiently deliver our managed IP video service without reliance on third parties. These investments are already paying dividends, but as importantly, they position us well for the long term.

Second, we made our products better in 2012. Our Internet customers now have much more choice. Optional usage-based tiers are available across virtually our entire footprint, and we're offering faster speeds than ever before.

As Glenn mentioned, we increased the speed of our standard tier of service by 50%, to 15 megabits per second. And in a couple of cities, we've added 75 and 100 megabits per second offerings to our existing tiers. We also added around 10,000 WiFi access points during the year, which when combined with the thousands of hotspots activated by our cable WiFi partners, give most of our Internet customers access to one of the most robust WiFi networks in the U.S. at no incremental charge.

On the video front, we continued to upgrade our TWC TV apps, which we believe represent the most advanced linear IP video product in the industry. As many as 300 channels are now available on a wide range of consumer devices in the home. And in December, we added 4,000 On Demand assets to the iOS app, a number that will only grow over time.

And with our Roku announcement at the Consumer Electronics Show earlier this month, our customers soon will be able to watch Time Warner Cable TV on their television without a leased set-top box. The really good news is that our customers are starting to make use of and appreciate the apps. In December, over 0.75 million unique customers used the TWC TV app and they used it almost 4 million times. We're now focused on adding out-of-home capabilities to the apps to make them even more valuable to customers.

Before I leave video, I have to point out that we also beefed up our programming lineup in 2012. Glenn noted that we are becoming increasingly vigilant about ensuring that the money we spend on programming yields real value to our customers. But that doesn't mean we're not interested in carrying new networks that enhance the value of our video product. So in 2012, we added some key sports programming to our lineup, most notably NFL Network and RedZone, as well as the Pac-12 Networks.

Finally, we continued to innovate in the voice space as well. In November, we launched the Global Penny Plan, an international calling plan that enables voice customers to call over 40 countries for $0.01 a minute.

The third area I want to talk about is customer service. We made real tangible progress in 2012. For example, we introduced 1-hour service windows in almost everywhere in our footprint. In a

number of cities, including New York City, we have something that may be even better, a 30-minute window for the first appointment of the day.

And we've even begun experimenting with real-time appointments. In addition, over the last year, we more than doubled our self-installation rate. Last month, almost 30% of installations were performed by our customers. That's a huge benefit, both to our customers in terms of convenience and to us in terms of truck rolls.

And we also completely overhauled our customer-facing web presence in 2012, enabling more of our customers to complete more transactions online or from their smartphones.

Fourth, business services. What more can I say about business services? We posted organic growth of more than 20% again in 2012. Powered by an expanded sales force, more buildings on net and some new products, we think we can achieve that kind of growth yet again in 2013.

Couple of quick business services metrics. In 2012, we added more than 1,500 people to our business services headcount, that's a 35% increase. And we nearly doubled the number of commercial buildings connected with fiber.

Fifth, the Insight integration has gone very smoothly. The former Insight systems now look and perform like Time Warner Cable systems. And although there's still work to be done, we fully expect to realize $100 million in annual run rate for synergies that we identified before we closed the deal last year.

And sixth, we took full advantage of the 2012 election to post a record year in advertising sales. Despite the success of a number of important initiatives in 2012, including those I just mentioned, our full year residential subscriber results were somewhat mixed. And that's true of the fourth quarter sub numbers as well.

If you take a look at Slide 3 in our presentation materials, you can review the details for both Q4 and the full year. Video stats were a disappointment. We really hoped that 2012 was going to be the year in which residential video net losses improved year-over-year. In fact, while our Enjoy Better campaign and aggressive packages fueled strong connect volumes, increases in disconnects led to net losses that were worse than in 2011.

I am somewhat encouraged that the year-over-year trend improved in each quarter -- each of the last 3 quarters. In Q4, video sub losses were essentially flat versus Q4 of 2011. But we still lost 129,000 residential video subs in the fourth quarter, and that's just not acceptable. So we've got much more work to do.

Internet, typically our star performer, delivered 75,000 net adds in Q4. That's fewer net adds than in Q4 of 2011. But the shortfall here was a conscious trade. Our modem fee drove a 6.3% increase in residential HSD ARPU in the fourth quarter, but undoubtedly had the effect of elevating disconnects. I will point out that our HSD subscriber mix continues to improve. More than 100% of our Q4 net adds were to our 30 and 50 megabits per second tiers. And we

continued to compete well against the telcos. Fourth quarter net adds were still more than triple the net adds of AT&T and Verizon combined.

Voice net adds for the full year were much better than in 2011, driven largely by our emphasis on Triple Plays. Q4 voice net adds came in at 34,000, just about where they came out in Q4 of 2011.

One other point worth noting is that Southern California led the company in subscriber performance in the fourth quarter. Part of that, undoubtedly, is related to our addition of TWC SportsNet and Pac-12 to the SoCal lineup. But in broader terms, I think our operations there are hitting their stride.

Some of our subscriber performance issues are related to the environment. Competition continues to be tough, and the economy is still challenging for many consumers in our footprint. But I believe there are other factors that are very much within our control.

So let me share with you what we're focused on in 2013. I mentioned that last year, we did a very good job driving connects but didn't do as well on customer retention. In 2013, we're redoubling our efforts to get, grow and keep customers. Just last week, we launched a new pricing and packaging architecture designed to ensure that the phones continue to ring and consumers continue to visit our website, but also to facilitate aggressive up-selling by our newly retrained sales teams.

And most importantly, we're making significant investments in retention capabilities that should help us keep the customers we have. A lot of this is simply about execution. It starts with ensuring that retention calls are routed to retention specialists, and then, it's about arming those specialists with training, processes and tools so they can handle issues that have been problems for us in the past.

We've been losing too many customers when their promotions expire. To fix this issue, we will adopt a much more disciplined and consistent approach to managing post promotion pricing. We can also do far better working with customers who fall into non-pay status. We think there are meaningful benefits to taking a more customer segment-specific approach to handling late payers.

And we know we can be more effective at retaining customers who are moving within our footprint. Of course, the best approach to reducing churn is to minimize the number of customers that call to disconnect in the first place. That means we need to keep our customers happy. So in 2013, we'll continue to improve customer service by refining the initiatives we launched in 2012, by improving the reliability of our network, increasing first-call resolution and reducing repeat trouble calls. All of that requires painstaking attention to detail, but we're committed to making it happen.

And we'll further enhance products, too. Our customers will see a series of updates to our apps that will bring even more content and functionality to more devices. In addition, our cloud-based

user interface, running on IP set-top boxes and next-generation DVRs, will deliver the biggest change to the video experience that our customers have experienced in a decade.

These are scheduled for introduction in the second half of the year. In HSD, we are planning to more than double our network of WiFi Hotspots, with an emphasis on New York City. As Irene will highlight shortly, we expect that business services will continue to drive a disproportionate amount of growth in 2013. So we'll continue to focus on and invest in B2B. That means additional expansion of our sales force and more buildings on net, as well as more new products.

Underlying our 2013 priorities are greater focus and better and faster decision making. To that end, we announced organizational changes last week to mark the final step in our evolution from decentralized geographic operating units to a more centralized structure that we're internally calling One Time Warner Cable.

We expect that over time, this more streamlined organization will deliver new products faster and better in addition to more reliable service. It will give our employees greater clarity on their roles and responsibilities. And of course, we believe these changes will help us to deliver the operational efficiency and profitable growth that our shareholders demand.

So in summary, we're gratified by our many successes in 2012, and we recognize the need to continually step up our game to meet the challenges of a world in which technology changes faster each year and competition continues to be intense.

We come to battle well prepared with a fabulous high-capacity network, more than 50,000 dedicated employees and an org structure that is tailored to address the opportunities and challenges we face. As I look forward, I am confident that we will succeed.

Thank you. And with that, I'll turn it over to Irene to discuss our financials.

Irene M. Esteves

Thanks, Rob. And good morning, everyone. I'll start with the fourth quarter highlights on Slide 4.

In the fourth quarter, we grew revenue about 10%, and we drove operating income and adjusted diluted EPS growth just under 14%. We increased the amount of capital returned to shareholders through dividends and share repurchases to $742 million.

In the following slides, I'll give you more insight into fourth quarter trends, point out some of the key drivers of our performance and provide some of our expectations for 2013.

So let's jump right into our financial results on the next slide. Revenue growth for the fourth quarter was driven primarily by acquisitions, business services and political advertising. Excluding acquisitions, revenue growth was 4.2%.

As you can see on the slide, we continue to drive revenue by increasing total ARPU per customer relationship, which increased 4% over last year and is approaching $120 per month.

We move on to Slide 6, fourth quarter business services revenue was up 26% or $106 million. Excluding $17 million from Insight during the quarter, business services revenue grew 22% year-over-year. That's our 11th consecutive quarter of at least 20% organic growth.

And looking at our organic growth, the $89 million increase was driven by a 21% growth in HSD from shared and dedicated Internet access, as well as Metro Ethernet. 46% growth in phone, 29% growth in managed and outsourced IT solutions and cloud services and 16% growth in wholesale transport revenue, mostly cell tower backhaul.

And we continue to invest in this growth opportunity and expect these investments to drive 2013 total business services revenue growth in the 20% to 25% range.

For residential services, let's start with revenue on Slide 7. We remain focused on driving both subscriber volume, as well as revenue and profit per household. Fourth quarter revenue grew 7%, and excluding the impact of acquisitions, revenue grew 1% driven by a robust 11% growth in HSD while video revenue was down 3% and voice revenue was down 1%.

Our total residential subscription ARPU per customer relationship increased to $103.79 in the fourth quarter, up 1.7% from last year's fourth quarter.

Residential HSD ARPU increased year-over-year for the 15th consecutive quarter, rising 6.3%, double the year-over-year growth rate from Q3 '12. The introduction of a modem fee accounted for about 3/4 of the ARPU growth. Improved subscriber mix also contributed to this ARPU growth, as we migrate subscribers to higher-priced tiers of service.

At quarter end, Turbo, Extreme and Ultimate subscribers comprised over 23% of our residential HSD customer base, up from 19% a year ago and just 11% 3 years ago. Video ARPU increased 0.7%, driven by price increases, a more favorable video subscriber mix and increased equipment rentals. These factors were partially offset by a decline in video-on-demand and premium channel revenue per sub. Voice ARPU declined 4.1%. Of course, all of these ARPU numbers are affected by the allocation of the bundle discounts.

On our next slide, in the fourth quarter, political ad revenue accounted for over 3/4 of our total advertising growth of 29%. Excluding political, fourth quarter advertising was up a strong 7%, driven by the acquisition of Insight and the additional ad inventory on the L.A. RSNs. In advertising, we achieved a new milestone by crossing the $1 billion mark in annual revenue.

So let's turn to Slide 9. Adjusted OIBDA increased 5.6% in the fourth quarter compared to last year. Fourth quarter total operating expense grew 12.5%, largely driven by acquisitions, L.A. RSN costs, including the Lakers rights fees and our hiring in business services. In Q4, the combined net costs from the Lakers and other new initiatives were about $60 million, putting our full year net cost at $110 million.

But before we move on to operating income, let me pause for a second to tell you what neighborhood we think we'll be in for the 2013 revenue and adjusted OIBDA. We expect organic revenue growth to be around 3% to 4%, comparable to the 3.5% growth rate in 2012. In addition to organic growth, we will have 12 months of Insight revenue in 2013 compared to 10 months in 2012. So we expect total reported revenue growth to be in the 4% to 5% range.

However, we expect adjusted OIBDA margin contraction of 50 to 100 basis points, driven primarily by programming cost growth per sub of around 10% related to adding new programming services and rate increases, the absence of high-margin political advertising revenue and approximately 20% higher pension expense.

In order to offset some of this impact, we continue to pursue operational efficiencies throughout the company, and Rob touched on some of those initiatives. But as you know, our efforts to in-source the back-office of our phone service will yield only modest benefits in 2013, the more significant savings come in 2014.

As you build your 2013 quarterly models, recall that first quarter margins typically step down from Q4 levels due to a variety of factors, including the timing of employee-related expenses like payroll taxes and merit increases. In addition, first quarter 2013 margins will be negatively impacted by the absence of high-margin political advertising revenue booked in Q4, as well as the timing of the Lakers rights fees.

Moving on to Slide 10, operating income increased 13.6% to $1.2 billion in the fourth quarter of '12, reflecting a higher adjusted OIBDA in the fourth quarter 2011 wireless asset impairments, partially offset by increases in depreciation and amortization.

Higher D&A from Insight was partially offset by lower depreciation related to the roll-off of Adelphia and Comcast assets. We incurred $17 million of merger-related and restructuring costs in the quarter compared to $34 million in the fourth quarter of 2011.

So turning to Slide 11, our fourth quarter diluted EPS was $1.68. Adjusted diluted EPS, which excludes a number of items affecting comparability, increased 14% to $1.57. And these items affecting comparability for both periods are detailed in Note 1 to our press release. We expect that in 2013, we'll deliver 10% to 15% adjusted diluted EPS growth.

Turning to capital spending on Slide 12. Capital spending finished the year as planned, including about $100 million of Insight-related CapEx. We invested $3.1 billion in total CapEx in 2012 or 14.5% of revenue, a 40-basis-point decrease from 2011. Business services' capital intensity was 31.9%, and residential, advertising and other capital spending was at 12.8% of revenue.

Fourth quarter CapEx was down 4% from a year ago to $904 million, and was 16.5% of revenue, which was a 240-basis-point reduction from the fourth quarter of 2011. Overall, we expect capital intensity will continue to decline modestly, with full year capital spending around $3.2 billion in 2013.

And moving on to free cash flow, excluding bonus depreciation, free cash flow for the year was up 25%, primarily due to higher adjusted OIBDA, lower pension contributions and lower income tax payments due to Insight NOLs and other onetime deductions. This was partially offset by higher interest payments and CapEx.

Before I share with you our free cash flow expectations for 2013, let's flip to our favorite Slide 14 to give you a quick update on the impact of stimulus programs over the next several years. As you know, the federal government extended 50% bonus depreciation for 2013 as part of the American Taxpayer Relief Act of 2012. This act effectively delays the large step-down of bonus depreciation and tax deferrals for another year.

Assuming around $3.2 billion in 2013 CapEx, we expect that the impact of bonus depreciation deductions and reversals of prior-year benefits on cash taxes in 2013 will be around the same as in 2012. The chart on this slide highlights the net expected cash tax impact from bonus depreciation as adjusted for the new act for 2017.

But we still expect to pay higher overall taxes this year than we did last year, given the non-stimulus-related tax benefits we received in 2012. As a result, we expect 2013 total free cash flow, including stimulus impacts, to decline to around $2.3 billion.

Let's move on to our capital return slide. We ended the year with net debt and preferred equity totaling $23.5 billion, a $2 billion increase from year-end 2011, and our reported leverage ratio was 3.01x our last 12 months adjusted OIBDA.

Including the normal adjustments, which include items like the underfunded pension obligations and facility leases, and adjusted for a full year of Insight results, the leverage ratio is closer to our target. And despite higher net debt year-over-year, our success at raising capital at lower rates and managing our average costs through interest rate swaps resulted in a decline in our net interest cost in the fourth quarter.

Our average cost of debt has dropped from 6.5% to 6.0% over the last 2 years. That's a 50-basis-point drop on $26.7 billion of total debt or roughly $130 million of annual interest savings. In the fourth quarter, we returned over 125% of free cash flow or $742 million in total to shareholders, $171 million in dividends and $571 million in share repurchases. This was an increase of 14% in share repurchases compared to Q3 and 56% over a year ago.

And given our strong and sustainable cash flow generation, we announced another 16% increase in our quarterly dividend to $0.65 a share or $2.60 on an annualized basis. And let me remind you that our share repurchases are really an outcome of our balance sheet philosophy. We're a large borrower, and we're committed to maintaining our solid investment-grade rating. To do that, we manage to 3.25 leverage ratio with the normal adjustments over time.

So in summary, with these fourth quarter results, we have delivered another year of steady financial performance and we continued to return excess financial capacity to our shareholders, a total of $2.6 billion in dividends and share repurchases in 2012. We extended our track record today by raising our quarterly dividend for the third consecutive year.

Thank you. And with that, I'll turn it over to Tom for the Q&A portion of the call.

Tom Robey

Thanks, Irene. Candy, we're ready to begin the Q&A portion of the call. [Operator Instructions] First question please, Candy?

Question-and-Answer Session

Operator

First question is Doug Mitchelson, Deutsche Bank.

Douglas D. Mitchelson - Deutsche Bank AG, Research Division

I guess a question for Rob. How meaningfully and how quickly can the initiatives you outlined impact customer churn?

Robert D. Marcus

Doug, it's a great question, and my expectation is that certain of these initiatives that are very execution oriented could have an impact right away. Others will take some time to actually manifest themselves. Things that relate to customer satisfaction, reducing churn volume or churn calls in the first instance will unquestionably take a longer time to have an impact. Execution-related changes, I think, can have a more immediate impact. But the goal is to work it on both fronts, and my hope is that we see a better outcome throughout 2013.

Douglas D. Mitchelson - Deutsche Bank AG, Research Division

Yes, I mean, the follow-up would be -- I mean, I know you don't like talking about potential future video subscriber levels. But given the comment that you've had improvements each of the last 3 quarters, you've got the initiatives you have underway, I mean I think people are going to leave this call with the expectation that video sub losses are going to start to improve in 2013. Is that fair or is it really too early to gauge that?

Robert D. Marcus

It's what we're striving for, but it's early to gauge any full year results.

Operator

The next question is Jessica Reif Cohen of Bank of America Merrill Lynch.

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

I was hoping you could give us some color on your newest RSN. What can you say about the economics of the Dodgers RSN? And how different is it from the Lakers economics, which you actually own?

Irene M. Esteves

Hi, Jessica, it's Irene. The Dodgers deal is similar in economics to the Lakers deal in that we're guaranteed access to important sports programming over a long period of time. And our objective here, as it was with the Lakers, is to ensure that access to programming at a certain cost. And we think over the long-term, this will be a lower cost alternative than if we had not guaranteed those rights for the 25-year period.

Glenn A. Britt

Jessica, this Glenn. I just want to emphasize one thing that Irene just said. We do not pretend that these deals are inexpensive or cheap. And our sense is that if we're going to carry these games, they're going to be expensive when we get them. So what we think we've done with these deals is to minimize and stabilize the cost over a long time period. But we're not trying to pretend the first year is really, really cheap or anything.

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

But is this why margins are coming down in 2013?

Irene M. Esteves

It really doesn't impact us, Jessica, until 2014.

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

All right. Okay. So can you say anything about the first year impact?

Irene M. Esteves

It should be minimal. We might have a little bit of startup cost, but it's really a '14 impact.

Operator

Next question is Phil Cusick, JPMorgan.

Philip Cusick - JP Morgan Chase & Co, Research Division

I guess, just following up on Jessica's question, can you help us think about the -- are the Lakers and Dodgers RSN deals sort of more dilutive up front and so dragging margins even more than might have been in a normal or sort of a -- you buying from the previous contract? But then we

expect margins to improve over time. So are we seeing more pressure from these given the structure, but again, you think it's better this way to do it?

Glenn A. Britt

Phil, the answer is no. Again, we think we're stabilizing and minimizing costs over a long time period. These -- in both cases, these rights were up for auction in a sense and they were going to be expensive no matter what happened. We think we've done the best of the alternatives.

Irene M. Esteves

And with the experience we've had with the Lakers, we'd say that given the net cost of that deal compared to where sports rights programming is going, that we're confident that we made the right decision with the Lakers and we're hopeful we made -- we'll find the same with the Dodgers.

Robert D. Marcus

Even in the short term.

Philip Cusick - JP Morgan Chase & Co, Research Division

Can you give us any early indication on what this should do to '14 margins as well?

Irene M. Esteves

It's too early to say.

Operator

Next question, Laura Martin, Needham & Company.

Laura A. Martin - Needham & Company, LLC, Research Division

Let's leave sports and talk about the Google overbuild in Kansas City. Can you guys give us any update as to what's happening to your subscribers and cost down there? And then I thought the most interesting thing to come out of CES was the Roku app, and I'd be interested in you guys sizing what that might mean to your capital spending. Could that take that down? And Glenn, strategically, should we expect to see to roll that out over other platforms other than the Roku platform?

Glenn A. Britt

Let me answer the last part, Laura, and then, Rob will do the first part. I think I've said this before, but I'll repeat it, our goal is to have our video services on every device that is capable of displaying them and carrying them. So there's all sizes and shapes and varieties of devices, but

you should assume we're actively talking to everybody and that's our objective. So over time, you will see a series of announcements such as Roku. Bob?

Robert D. Marcus

Yes, and just to amplify what Glenn said, Roku is just one example of many. Whether the actual experience will be attractive to a broad number of customers, I think, remains to be seen. So I wouldn't anticipate meaningful impact on our set-top box cost in the near term. I think this is more about the philosophy and direction we're headed. So going to Google, just at the risk of repeating what we've said before to put the Google overbuild in context, they have talked about what will ultimately be a 600,000 home build, I think 300,000 of those homes are in our footprint. And if you get to the subscriber level, it's something like 100,000 video customers and 100,000 HSD customers. So a very small percentage of our total subscriber base. And the reality is most of the action is going to happen towards the back half of this year. So they really haven't built out very much, and the customer impact we've seen, so far, is essentially de minimis. That said, we're hard at work ensuring that our customer relationships are strong, that our product set is good. We recently increased the tiers of service on HSD that we have available in the Google footprint. And we're now offering 100 megabits a second service, which is the fastest we're making available anywhere. So like with any overbuilder, we're ready for the competition.

Glenn A. Britt

And Laura, if I could just add one more thing. I think that there's a lot of PR and a lot of hype about this whole thing. The reality is, today, there are not really applications that require 1 gigabit per second. So our philosophy has been to keep our speeds in line with what the market demands and what it needs. There's no doubt in my mind that the speeds will, over time, get faster and faster as they have since we started this in 1996. So I expect some time in the future, we'll have 1 gig, maybe 2 gigs. But other than PR and hype, this is not a real need for anybody right now.

Operator

Next question is Jason Bazinet, Citi.

Jason B. Bazinet - Citigroup Inc, Research Division

Just had a question either for Mr. Marcus or Mr. Britt. I guess, the entire cable industry is now at a point where they've gone all digital and most of the executives seem to extol the virtues of that decision and claim that it's helped their fundamental results fairly significantly. Do you still believe that not going all digital is the right move? And if so, do you mind just elaborating on what it is that you think makes your footprint or operational strategy fundamentally different from the rest of the industry?

Glenn A. Britt

Sure. I think if you cut through it all, going all digital is something that cable operators did to increase the usable capacity in their plan by getting rid of analog. So in that sense, it was something done for the benefit of the cable operator, not particularly for the consumer. And it's somewhat disruptive to consumers. What we've done is to initially create more capacity by using switch video, and that's stood us in very good stead. We most certainly, over time, will be going more and more towards all digital, but we're doing it on an evolutionary basis. I actually think the ultimate all digital is going to be IP digital, not MPEG-2, which is what everybody's stuck with. So I think that as we evolve to that, we'll be doing all things IP and not sort of in this intermediate phase. So we actually feel very good about what we've been doing and I think the future it's going to pay big dividends.

Robert D. Marcus

Let me just clarify one thing that I mentioned in my prepared remarks. We are, in fact, in the process of reclaiming bandwidth that's previously been dedicated to analog video. And the way we're going about doing that is, as Glenn mentioned, rather than doing a flash cut and ceasing to deliver all of the networks in analog, we're starting really with the most -- the least viewed networks and kind of chipping away at the lineup and ceasing to deliver those networks in analog when a customer, who likes to watch those networks but doesn't have a set-top box, raises their hand, then we provide them with the D-to-A converter. So we can increase the usable bandwidth, to use Glenn's term, without some of the related disruption that generally is associated with these transitions. So we think we've struck the right balance, and it's working quite well.

Glenn A. Britt

I think just to be clear also, we have gone all digital in some markets where we needed the capacity. So New York City is one of them and parts of L.A. and then maybe some other places.

Operator

Next question, Marci Ryvicker, Wells Fargo.

Marci Ryvicker - Wells Fargo Securities, LLC, Research Division

I just had a quick question for Irene. Can you share with us your thoughts on share repurchase activity for 2013? I know last year, you had told us that it should be more than free cash flow. Should we expect the same thing again?

Irene M. Esteves

Hi, Marci. On free cash flow, what we've said is we're guided by our 3.25 leverage ratio, and we've been very consistent talking about that, and we will continue to use that as a guiding principle. I'm not giving specific guidance on the pace, but as you look back on our history, you can see that we've consistently increased the pace, and that we are fully committed to 3.25 leverage ratio over time.

Marci Ryvicker - Wells Fargo Securities, LLC, Research Division

And can you just clarify for free cash flow guidance there. I've seen a couple of different calculations between $2.3 billion and $2.5 billion. Is there a definitive number for 2013?

Irene M. Esteves

We said it will be around $2.3 billion.

Operator

Next question is a Jason Armstrong, Goldman Sachs.

Jason Armstrong - Goldman Sachs Group Inc., Research Division

Rob, you mentioned, I think, in your upfront remarks that Southern California is the bright spot operationally. I realize we've obviously talked about the Dodgers deal a decent amount. You were early in that market with WiFi initiatives, early obviously with RSN ownership relative to the rest of the footprint. Are those the key drivers that are impacting performance there? And to what extent, do you think, that can service sort of a broader blueprint?

Robert D. Marcus

Yes. So I think that the programming benefits we got out of the TWC SportsNet and maybe as significantly, Pac-12 Networks, did definitely help subscriber performance in SoCal in Q4. WiFi, I think it's still early days. We've got a nice network of WiFi Hotspots in L.A., and the evidence we have so far certainly suggest the correlation between churn reduction and WiFi utilization. But candidly, the usage is still at a level that I can't point to it having a meaningful impact on overall subscriber performance. We believe in the benefits of WiFi to our customers, but I think it's a little early to say that, that's a big driver of the subscriber performance. I think more than anything else, what I would attribute it to is superior execution. We've spent a lot of energy and it's been a long road since the acquisition of the Adelphia and Comcast properties to hardening the network, ensuring that the products that we delivered were reliable and state-of-the-art, and ensuring that our marketing and sales machine and our service organization were firing on all cylinders. And I think we're getting to that point, and that's manifesting itself in better subscriber performance.

Operator

Next, Ben Swinburne, Morgan Stanley.

Benjamin Swinburne - Morgan Stanley, Research Division

I have, I guess, 2 questions for Rob. Rob, as you look at the subscriber metrics over the last few years, one of the areas that did get worse in '12 was Double Play, which I'm presuming the vast majority is probably data and phone. But would love any color on that line since it seems like an

area where you're operating from a position of strength and it was pretty solid in '10 and '11. And then just on the margins in '13, the programming cost number isn't too surprising, and it feels like there's other stuff going on around maybe marketing, I know there's been some press around some new marketing initiatives you guys have. And I don't know if you'd be willing to talk about the startup losses, which were, I think, 110 for '12. Is there a number in '13 that we should be thinking about? Because it seems that a lot of the things you've done around CDN and data centers, the consolidation and reorg, would be margin enhancers but doesn't seem like that's kicking in, in '13. So any color would be helpful.

Robert D. Marcus

Yes, so let me start with the question on doubles. I'll make a brief comment on marketing then, I'll flip it over to Irene to handle the rest of the margins. So Double Play -- first of all, you mentioned -- you made reference to data and phone. In fact, the vast majority of our Double Plays are video, data doubles, and that's where we saw the most softness in 2012. This is an area I think I highlighted on our Q3 call and it's an area that we're going to focus on going into this year. I think we can do a better job competing with U-verse in particular on the Double Play front. They've been very aggressive in their Double Play promotions, most notably in Texas and to some extent, in the Midwest. The focus has been on customers who reside in MDUs and generally don't take landline phone at all from anyone. They tend to be wireless-only customers. It's a younger, typically unmarried base, and we just need to re-craft some of our offerings to be more responsive to their needs. We haven't yet talked much about our Verizon Wireless relationship, but I feel that, that's a place where our Verizon Wireless relationship can actually position us well. So more to come on that front, but it's an area of focus. I guess, one mechanical thing that goes without saying, and it doesn't take away at all from the fact that we're focused on doubles, one of the reasons that doubles have been weaker is our emphasis has been on triples. And we probably sold in some triples to customers that otherwise in the past would have taken doubles. So some of this is just trading among bundled subs. But nonetheless, it's an area of focus for us in '13.

Irene M. Esteves

And then on the margins, if you think about programming, which was $4.6 billion, if that's growing at 10% a sub, that's a huge impact on our margins. We also mentioned 2 other piece, the pension expense which is with historically low interest rates, that expense line goes up. And we're -- it's a nonpolitical year in '13, so we're missing that very high-margin political revenue. In prior years, we also had offsets to some of the programming expenses with large Go It Alone savings in our phone business, which we're not expecting as much of this year. And you asked about the new initiatives and what we spent in 2012. We will continue to invest behind those businesses, but because it's a multi-year investment, we don't think it makes sense to break them out anymore. But suffice it to say, we are continuing to invest behind things like IntelligentHome rollout and our business services expansion, and Rob mentioned, the WiFi. So we'll continue to invest behind those businesses because we think it's right for the long-term profitability of the company. So those are the main drivers of that margin decline that we're expecting.

Robert D. Marcus

And just specifically to address your question on marketing, it's true that marketing was up in Q4 year-over-year, but I don't anticipate that being a meaningful driver of margin contraction in '13. In fact, due to the -- some of organizational changes we've made and actually a trend that started probably last year, we're getting more efficient with our marketing dollars. I think we're getting more bang for the buck in everything we spend. We're dedicating more of our dollars to working dollars, in other words, buying media as opposed to some of the administrative and production costs. And I think we're actually doing a better job spending marketing dollars more wisely. So I don't anticipate that being a factor.

Glenn A. Britt

Yes, one thing I'd remind you about margins is that it's a good conversation about costs, and it's a good measure of whether we're managing costs. But at the end of the day, it's a mixture of a whole bunch of stuff and different products with different characteristics. And we actually don't run the business for margin, we run it for the bottom line. So if we can sell more of a lower margin product but add to the bottom line, we'll do that. So I just -- I know everybody needs it for modeling, that we pay attention to it, but it's not our primary focus. We're focused on the bottom line.

Operator

Next, Richard Greenfield, BTIG.

Richard Greenfield - BTIG, LLC, Research Division

You talked about reducing programming costs, but you've been out of contract, I believe, with Starz Encore for a number of years. Just wondering if that's an opportunity for you to make a dent in the programming cost line that you mentioned several times during the call? And then on broadband, it's becoming an increasingly profitable business, I mean the modem fee is going to have a, say, a notable impact on 2013's growth. Do you worry or how do you think about the risk to broadband sub fees emerging like what you pay in ESPN 3 today? Could that proliferate over time and chew into any of that revenue that you're generating?

Glenn A. Britt

Rich, I'll take a shot at both those. First of all, individual programming deals, I don't -- I'd be remiss making any comments at this point. But suffice it to say, we're going to look at everything hard. On the broadband subject, I think you raised an interesting issue because in a world where there's net neutrality and a push for net neutrality, which is essentially applications and content people saying they don't want anybody to be favored, there's the potential for reverse network neutrality. And I think perhaps an illustration of the government trying to put rules in place too early without really thinking through everything that happened. The essence of Internet is that you provide access to the web and people will go wherever they want and do whatever they want and what we sell is the access. So I think we need to be very careful about turning that into a business where some application or content providers seek favor or demand favor. It's not kind of what this is all about.

Operator

Next, John Hodulik, UBS.

John C. Hodulik - UBS Investment Bank, Research Division

First, maybe a quick clarification on the programming cost. You're seeing some real acceleration per sub in terms of growth. Maybe Glenn, are the initiatives to drive some of these channels -- I mean, should we keep that number at about 10% going forward or do you think the initiative to drive some of these channels can put some pressure on that as we move beyond 2013? And then maybe from Rob, can we just get some more detail or could you elaborate on a couple of the initiatives you talked about? First, the rollout of the cloud-based IP guide and you talked about developing more video apps and extending those beyond the home. When -- what -- can you give us a little bit more detail there and when we can see those?

Glenn A. Britt

On the first one, I think it's -- beyond what we said, I don't want to say much, numerically. But the actions we're taking are not going to dramatically change the trajectory of programming cost. I do hope that we can, over time, improve the perceived price value relationship though and then, clearly, consumers, particularly people who are under economic duress, are looking at these big packages and they're saying, it costs more than I can afford, number one. And number two, there's too many networks I never watch and I don't care about. And that's kind of what we're trying to address. Obviously, sports and other really popular programming keep getting more and more expensive, and that's where most of the money is. But these networks that hang on, I think they have a birthrate of carriage even though hardly anybody watches them. Those are the ones we're going to be taking a look at.

Robert D. Marcus

And John, with respect to the cloud-based guide, I mean I guess the first thing that's worth mentioning, and we've mentioned it before, is that we already have a cloud-based guide that's in front of a couple of hundred thousand customers in a couple of markets and we've had it out there for a while, and we've learned from it. The cloud-based guide I was referring to, is what we call our hosted navigation product. It will be available back half of this year. It will work on our new IP set-top boxes. It will work on what is essentially a souped-up DVR. Some people have referred to it as a Gateway device, which has 1 terabyte of storage, 6 tuners and has the ability to transcode video into IP, so it can be consumed not only by the IP set-top boxes but by other devices in the home. So we're looking forward to that. I think the experience will be markedly better than the set-top box-based guide experience. There will be easier navigation, more box art, better search, all of the things that viewers have come to expect based on their interaction with video on the web. So I think that's going to be a really exciting change. Refresh, what was your question on the video apps?

John C. Hodulik - UBS Investment Bank, Research Division

Yes, first, is that new guide? And that media guide, will it going to be available in all your markets in the second half? And then you said, extending the apps not just so that they're useful inside the home but potentially I guess, with maybe the...

Robert D. Marcus

So on the guide, look, it will not -- the guide will initially only function on these new pieces of hardware that I'm referring to. So on one level, the proliferation of the guide will be dependent upon the rollout of the hardware. Whether or not it's available in every single market, I think it's still too early to say what the exact rollout schedule is. So we'll give you more as the year progresses. On video apps, we already have a pretty healthy portfolio of rights to deliver video product outside the home. But so far, customers access to those -- the video product, has been dependent on their visiting the programmers' website. What I expect later this year, and in fact late first quarter, early second quarter, is that those video products will find their way into our apps even when you're outside the home. So the experience will be better in the sense that the programming will be aggregated and easier to navigate. So I think we've listed these before but obviously, we have the ESPN suite of services, we have rights with respect to Viacom's products, Big Ten Network, we have some professional sports product from the leagues. It's a pretty decent list, and I think the experience will be a lot better once we incorporate them in our apps.

I see that it's half past the hour, so that's probably all we have time for this morning. Thanks, everyone, for joining us. And to give a little bit of advanced notice, our next quarterly conference call will be held on Thursday, April 25 at 8:30 a.m. Eastern Time. Thanks for joining us, and have a great day.

Operator

Thank you. That does conclude today's conference. You may disconnect at this time.

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If you have any additional questions about our online transcripts, please contact us at: transcripts@seekingalpha.com. Thank you!

Executives

Tom Robey

Glenn A. Britt - Chairman and Chief Executive Officer

Robert D. Marcus - President and Chief Operating Officer

Irene M. Esteves - Chief Financial Officer and Executive Vice President

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Jason Armstrong - Goldman Sachs Group Inc., Research Division

Benjamin Swinburne - Morgan Stanley, Research Division

Richard Greenfield - BTIG, LLC, Research Division

John C. Hodulik - UBS Investment Bank, Research Division

Time Warner Cable (TWC) Q4 2012 Earnings Call January 31, 2013 8:30 AM ET

Operator

Hello, and welcome to the Time Warner Cable Fourth Quarter 2012 Earnings Conference Call. [Operator Instructions] Today's conference is being recorded. If you have any objections, you

may disconnect at this time. Now, I will turn the call over to Mr. Tom Robey, Senior Vice President of Time Warner Cable Investor Relations.

Tom Robey

Thanks, Candy. And good morning, everyone. Welcome to Time Warner Cable's 2012 Fourth Quarter and Full Year Earnings Conference Call. This morning, we issued 2 press releases, one detailing our 2012 fourth quarter and full year results and the other, announcing an increase in our regular quarterly dividend.

Before we begin, there are a couple of items I want to cover. First, we refer to certain non-GAAP measures. Definitions and schedules, setting out reconciliations of these historical non-GAAP financial measures to the most directly comparable GAAP financial measures, are included in our earnings release and trending schedules.

And second, today's announcement includes certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which are based on management's current expectations and beliefs and are subject to uncertainty and changes in circumstances. Actual results may vary materially from those expressed or implied by the statements herein due to various factors, which are discussed in detail in our SEC filings. Time Warner Cable is under no obligation to, and in fact, expressly disclaims any such obligation to update or alter its forward-looking statements whether as a result of new information, future events or otherwise.

And finally, today's press releases, trending schedules, presentation slides and related reconciliation schedules are available on our website at twc.com/investors.

With that covered, I'll thank you and turn the call over to Glenn Britt. Glenn?

Glenn A. Britt - Chairman and Chief Executive Officer

Good morning, and thanks for joining us. As we look back on 2012, we have much to be proud of. It was a year in which we grew revenue by almost 9%, powered by our acquisition and successful integration of Insight Communications, continued success in business services and the best-ever year in advertising.

Broadband continues to be our strongest product. We added another 0.5 million subs in 2012 and improved the mix even as we raised prices, a powerful combination. But considering that the average customer used roughly 40% more capacity last year, and we increased our standard speed by 50%, yet our pricing increased by less than 10%, our broadband product is still a terrific value for customers.

We met or exceeded all elements of our guidance in 2012. In addition, we honored our commitment to return capital to shareholders. We repurchased 22 million shares for $1.9 billion in 2012, raising the total since initiation late in 2010 to over $5 billion.

And through our regular dividend, we returned $700 million to shareholders last year. This morning, we announced a 16% increase of dividend to an annualized rate of $2.60 per share, demonstrating our continued confidence in our ability to generate very strong free cash flow.

Before I turn the call over to Rob and Irene though, I want to spend a couple of minutes on residential video, our most mature and highly penetrated business. It faces challenges on 2 fronts. The first is competition. The telcos and satellite companies are tough competitors and in a world where we are the original incumbent, the pressure on our net adds is intense. Rob will speak to the many ways we're working to compete better.

The second challenge is in video programming costs. Let me frame the issue for you. Our programming costs per subscriber has grown 32% in the last 4 years. Over that same period, the Consumer Price Index has risen by 9%. So the math is pretty simple, programming costs have been rising at more than 3x the rate of inflation. Our residential video ARPU increased 16% over that same period, so we've effectively raised pricing a little faster than inflation but only half as fast as programming costs have risen.

This situation is caused by a complicated set of structural imbalances within the video entertainment industry. It's clear that this is not in the best interest of the consumer, and it's also clear that it can't continue forever. What is less clear is what will happen to change the situation or when. For our part, we will examine each network with an expiring contract and attempt to drop or reposition those that in our judgment do not add to the price value relationship of our packages. For the rest, we'll continue to negotiate the best deals we're able to get.

In the case of sports, we've taken some steps towards managing and stabilizing costs through our Lakers and Dodgers deals. That doesn't mean these deals are inexpensive, but we do think they are better than the potential alternatives. We're feeling very positive about the growth of our business services and broadband businesses. We're doing an awful lot to improve customer service, products and marketing, and we're pleased with our progress on all those fronts. Rob will talk about specific actions in a few minutes.

So we have our challenges, but we're investing to capture long-term opportunities, and our business remains strong and stable.

Now I'll turn the call over to Rob and then Irene to dive into the details.

Robert D. Marcus - President and Chief Operating Officer

Thanks, Glenn. Good morning, everyone. This morning, I'd like to divide my comments in 2 parts. In the first, I'll give you my assessment of 2012 and following that, I'll share our priorities for the new year. So to begin with, I would count 6 accomplishments in 2012 that we're particularly proud of that will provide a solid foundation for 2013. First, we made smart investments to enhance the capacity of our network and improve our critical infrastructure. We completed our DOCSIS 3.0 rollout in 2012 and also began a process of reclaiming bandwidth previously dedicated to the delivery of analog video. These 2 steps enable us to dedicate more

network capacity to our high-speed data offerings. That means we can handle more traffic and deliver higher speeds.

In November, we opened our first National Data Center in Charlotte, which will enable us to begin the consolidation of video sourcing and infrastructure for high-speed data, cloud services, phone and our internal enterprise systems. In addition, we've built out our own Content Delivery Network, or CDN, so we can efficiently deliver our managed IP video service without reliance on third parties. These investments are already paying dividends, but as importantly, they position us well for the long term.

Second, we made our products better in 2012. Our Internet customers now have much more choice. Optional usage-based tiers are available across virtually our entire footprint, and we're offering faster speeds than ever before.

As Glenn mentioned, we increased the speed of our standard tier of service by 50%, to 15 megabits per second. And in a couple of cities, we've added 75 and 100 megabits per second offerings to our existing tiers. We also added around 10,000 WiFi access points during the year, which when combined with the thousands of hotspots activated by our cable WiFi partners, give most of our Internet customers access to one of the most robust WiFi networks in the U.S. at no incremental charge.

On the video front, we continued to upgrade our TWC TV apps, which we believe represent the most advanced linear IP video product in the industry. As many as 300 channels are now available on a wide range of consumer devices in the home. And in December, we added 4,000 On Demand assets to the iOS app, a number that will only grow over time.

And with our Roku announcement at the Consumer Electronics Show earlier this month, our customers soon will be able to watch Time Warner Cable TV on their television without a leased set-top box. The really good news is that our customers are starting to make use of and appreciate the apps. In December, over 0.75 million unique customers used the TWC TV app and they used it almost 4 million times. We're now focused on adding out-of-home capabilities to the apps to make them even more valuable to customers.

Before I leave video, I have to point out that we also beefed up our programming lineup in 2012. Glenn noted that we are becoming increasingly vigilant about ensuring that the money we spend on programming yields real value to our customers. But that doesn't mean we're not interested in carrying new networks that enhance the value of our video product. So in 2012, we added some key sports programming to our lineup, most notably NFL Network and RedZone, as well as the Pac-12 Networks.

Finally, we continued to innovate in the voice space as well. In November, we launched the Global Penny Plan, an international calling plan that enables voice customers to call over 40 countries for $0.01 a minute.

The third area I want to talk about is customer service. We made real tangible progress in 2012. For example, we introduced 1-hour service windows in almost everywhere in our footprint. In a

number of cities, including New York City, we have something that may be even better, a 30-minute window for the first appointment of the day.

And we've even begun experimenting with real-time appointments. In addition, over the last year, we more than doubled our self-installation rate. Last month, almost 30% of installations were performed by our customers. That's a huge benefit, both to our customers in terms of convenience and to us in terms of truck rolls.

And we also completely overhauled our customer-facing web presence in 2012, enabling more of our customers to complete more transactions online or from their smartphones.

Fourth, business services. What more can I say about business services? We posted organic growth of more than 20% again in 2012. Powered by an expanded sales force, more buildings on net and some new products, we think we can achieve that kind of growth yet again in 2013.

Couple of quick business services metrics. In 2012, we added more than 1,500 people to our business services headcount, that's a 35% increase. And we nearly doubled the number of commercial buildings connected with fiber.

Fifth, the Insight integration has gone very smoothly. The former Insight systems now look and perform like Time Warner Cable systems. And although there's still work to be done, we fully expect to realize $100 million in annual run rate for synergies that we identified before we closed the deal last year.

And sixth, we took full advantage of the 2012 election to post a record year in advertising sales. Despite the success of a number of important initiatives in 2012, including those I just mentioned, our full year residential subscriber results were somewhat mixed. And that's true of the fourth quarter sub numbers as well.

If you take a look at Slide 3 in our presentation materials, you can review the details for both Q4 and the full year. Video stats were a disappointment. We really hoped that 2012 was going to be the year in which residential video net losses improved year-over-year. In fact, while our Enjoy Better campaign and aggressive packages fueled strong connect volumes, increases in disconnects led to net losses that were worse than in 2011.

I am somewhat encouraged that the year-over-year trend improved in each quarter -- each of the last 3 quarters. In Q4, video sub losses were essentially flat versus Q4 of 2011. But we still lost 129,000 residential video subs in the fourth quarter, and that's just not acceptable. So we've got much more work to do.

Internet, typically our star performer, delivered 75,000 net adds in Q4. That's fewer net adds than in Q4 of 2011. But the shortfall here was a conscious trade. Our modem fee drove a 6.3% increase in residential HSD ARPU in the fourth quarter, but undoubtedly had the effect of elevating disconnects. I will point out that our HSD subscriber mix continues to improve. More than 100% of our Q4 net adds were to our 30 and 50 megabits per second tiers. And we

continued to compete well against the telcos. Fourth quarter net adds were still more than triple the net adds of AT&T and Verizon combined.

Voice net adds for the full year were much better than in 2011, driven largely by our emphasis on Triple Plays. Q4 voice net adds came in at 34,000, just about where they came out in Q4 of 2011.

One other point worth noting is that Southern California led the company in subscriber performance in the fourth quarter. Part of that, undoubtedly, is related to our addition of TWC SportsNet and Pac-12 to the SoCal lineup. But in broader terms, I think our operations there are hitting their stride.

Some of our subscriber performance issues are related to the environment. Competition continues to be tough, and the economy is still challenging for many consumers in our footprint. But I believe there are other factors that are very much within our control.

So let me share with you what we're focused on in 2013. I mentioned that last year, we did a very good job driving connects but didn't do as well on customer retention. In 2013, we're redoubling our efforts to get, grow and keep customers. Just last week, we launched a new pricing and packaging architecture designed to ensure that the phones continue to ring and consumers continue to visit our website, but also to facilitate aggressive up-selling by our newly retrained sales teams.

And most importantly, we're making significant investments in retention capabilities that should help us keep the customers we have. A lot of this is simply about execution. It starts with ensuring that retention calls are routed to retention specialists, and then, it's about arming those specialists with training, processes and tools so they can handle issues that have been problems for us in the past.

We've been losing too many customers when their promotions expire. To fix this issue, we will adopt a much more disciplined and consistent approach to managing post promotion pricing. We can also do far better working with customers who fall into non-pay status. We think there are meaningful benefits to taking a more customer segment-specific approach to handling late payers.

And we know we can be more effective at retaining customers who are moving within our footprint. Of course, the best approach to reducing churn is to minimize the number of customers that call to disconnect in the first place. That means we need to keep our customers happy. So in 2013, we'll continue to improve customer service by refining the initiatives we launched in 2012, by improving the reliability of our network, increasing first-call resolution and reducing repeat trouble calls. All of that requires painstaking attention to detail, but we're committed to making it happen.

And we'll further enhance products, too. Our customers will see a series of updates to our apps that will bring even more content and functionality to more devices. In addition, our cloud-based

user interface, running on IP set-top boxes and next-generation DVRs, will deliver the biggest change to the video experience that our customers have experienced in a decade.

These are scheduled for introduction in the second half of the year. In HSD, we are planning to more than double our network of WiFi Hotspots, with an emphasis on New York City. As Irene will highlight shortly, we expect that business services will continue to drive a disproportionate amount of growth in 2013. So we'll continue to focus on and invest in B2B. That means additional expansion of our sales force and more buildings on net, as well as more new products.

Underlying our 2013 priorities are greater focus and better and faster decision making. To that end, we announced organizational changes last week to mark the final step in our evolution from decentralized geographic operating units to a more centralized structure that we're internally calling One Time Warner Cable.

We expect that over time, this more streamlined organization will deliver new products faster and better in addition to more reliable service. It will give our employees greater clarity on their roles and responsibilities. And of course, we believe these changes will help us to deliver the operational efficiency and profitable growth that our shareholders demand.

So in summary, we're gratified by our many successes in 2012, and we recognize the need to continually step up our game to meet the challenges of a world in which technology changes faster each year and competition continues to be intense.

We come to battle well prepared with a fabulous high-capacity network, more than 50,000 dedicated employees and an org structure that is tailored to address the opportunities and challenges we face. As I look forward, I am confident that we will succeed.

Thank you. And with that, I'll turn it over to Irene to discuss our financials.

Irene M. Esteves - Chief Financial Officer and Executive Vice President

Thanks, Rob. And good morning, everyone. I'll start with the fourth quarter highlights on Slide 4.

In the fourth quarter, we grew revenue about 10%, and we drove operating income and adjusted diluted EPS growth just under 14%. We increased the amount of capital returned to shareholders through dividends and share repurchases to $742 million.

In the following slides, I'll give you more insight into fourth quarter trends, point out some of the key drivers of our performance and provide some of our expectations for 2013.

So let's jump right into our financial results on the next slide. Revenue growth for the fourth quarter was driven primarily by acquisitions, business services and political advertising. Excluding acquisitions, revenue growth was 4.2%.

As you can see on the slide, we continue to drive revenue by increasing total ARPU per customer relationship, which increased 4% over last year and is approaching $120 per month.

We move on to Slide 6, fourth quarter business services revenue was up 26% or $106 million. Excluding $17 million from Insight during the quarter, business services revenue grew 22% year-over-year. That's our 11th consecutive quarter of at least 20% organic growth.

And looking at our organic growth, the $89 million increase was driven by a 21% growth in HSD from shared and dedicated Internet access, as well as Metro Ethernet. 46% growth in phone, 29% growth in managed and outsourced IT solutions and cloud services and 16% growth in wholesale transport revenue, mostly cell tower backhaul.

And we continue to invest in this growth opportunity and expect these investments to drive 2013 total business services revenue growth in the 20% to 25% range.

For residential services, let's start with revenue on Slide 7. We remain focused on driving both subscriber volume, as well as revenue and profit per household. Fourth quarter revenue grew 7%, and excluding the impact of acquisitions, revenue grew 1% driven by a robust 11% growth in HSD while video revenue was down 3% and voice revenue was down 1%.

Our total residential subscription ARPU per customer relationship increased to $103.79 in the fourth quarter, up 1.7% from last year's fourth quarter.

Residential HSD ARPU increased year-over-year for the 15th consecutive quarter, rising 6.3%, double the year-over-year growth rate from Q3 '12. The introduction of a modem fee accounted for about 3/4 of the ARPU growth. Improved subscriber mix also contributed to this ARPU growth, as we migrate subscribers to higher-priced tiers of service.

At quarter end, Turbo, Extreme and Ultimate subscribers comprised over 23% of our residential HSD customer base, up from 19% a year ago and just 11% 3 years ago. Video ARPU increased 0.7%, driven by price increases, a more favorable video subscriber mix and increased equipment rentals. These factors were partially offset by a decline in video-on-demand and premium channel revenue per sub. Voice ARPU declined 4.1%. Of course, all of these ARPU numbers are affected by the allocation of the bundle discounts.

On our next slide, in the fourth quarter, political ad revenue accounted for over 3/4 of our total advertising growth of 29%. Excluding political, fourth quarter advertising was up a strong 7%, driven by the acquisition of Insight and the additional ad inventory on the L.A. RSNs. In advertising, we achieved a new milestone by crossing the $1 billion mark in annual revenue.

So let's turn to Slide 9. Adjusted OIBDA increased 5.6% in the fourth quarter compared to last year. Fourth quarter total operating expense grew 12.5%, largely driven by acquisitions, L.A. RSN costs, including the Lakers rights fees and our hiring in business services. In Q4, the combined net costs from the Lakers and other new initiatives were about $60 million, putting our full year net cost at $110 million.

But before we move on to operating income, let me pause for a second to tell you what neighborhood we think we'll be in for the 2013 revenue and adjusted OIBDA. We expect organic revenue growth to be around 3% to 4%, comparable to the 3.5% growth rate in 2012. In addition to organic growth, we will have 12 months of Insight revenue in 2013 compared to 10 months in 2012. So we expect total reported revenue growth to be in the 4% to 5% range.

However, we expect adjusted OIBDA margin contraction of 50 to 100 basis points, driven primarily by programming cost growth per sub of around 10% related to adding new programming services and rate increases, the absence of high-margin political advertising revenue and approximately 20% higher pension expense.

In order to offset some of this impact, we continue to pursue operational efficiencies throughout the company, and Rob touched on some of those initiatives. But as you know, our efforts to in-source the back-office of our phone service will yield only modest benefits in 2013, the more significant savings come in 2014.

As you build your 2013 quarterly models, recall that first quarter margins typically step down from Q4 levels due to a variety of factors, including the timing of employee-related expenses like payroll taxes and merit increases. In addition, first quarter 2013 margins will be negatively impacted by the absence of high-margin political advertising revenue booked in Q4, as well as the timing of the Lakers rights fees.

Moving on to Slide 10, operating income increased 13.6% to $1.2 billion in the fourth quarter of '12, reflecting a higher adjusted OIBDA in the fourth quarter 2011 wireless asset impairments, partially offset by increases in depreciation and amortization.

Higher D&A from Insight was partially offset by lower depreciation related to the roll-off of Adelphia and Comcast assets. We incurred $17 million of merger-related and restructuring costs in the quarter compared to $34 million in the fourth quarter of 2011.

So turning to Slide 11, our fourth quarter diluted EPS was $1.68. Adjusted diluted EPS, which excludes a number of items affecting comparability, increased 14% to $1.57. And these items affecting comparability for both periods are detailed in Note 1 to our press release. We expect that in 2013, we'll deliver 10% to 15% adjusted diluted EPS growth.

Turning to capital spending on Slide 12. Capital spending finished the year as planned, including about $100 million of Insight-related CapEx. We invested $3.1 billion in total CapEx in 2012 or 14.5% of revenue, a 40-basis-point decrease from 2011. Business services' capital intensity was 31.9%, and residential, advertising and other capital spending was at 12.8% of revenue.

Fourth quarter CapEx was down 4% from a year ago to $904 million, and was 16.5% of revenue, which was a 240-basis-point reduction from the fourth quarter of 2011. Overall, we expect capital intensity will continue to decline modestly, with full year capital spending around $3.2 billion in 2013.

And moving on to free cash flow, excluding bonus depreciation, free cash flow for the year was up 25%, primarily due to higher adjusted OIBDA, lower pension contributions and lower income tax payments due to Insight NOLs and other onetime deductions. This was partially offset by higher interest payments and CapEx.

Before I share with you our free cash flow expectations for 2013, let's flip to our favorite Slide 14 to give you a quick update on the impact of stimulus programs over the next several years. As you know, the federal government extended 50% bonus depreciation for 2013 as part of the American Taxpayer Relief Act of 2012. This act effectively delays the large step-down of bonus depreciation and tax deferrals for another year.

Assuming around $3.2 billion in 2013 CapEx, we expect that the impact of bonus depreciation deductions and reversals of prior-year benefits on cash taxes in 2013 will be around the same as in 2012. The chart on this slide highlights the net expected cash tax impact from bonus depreciation as adjusted for the new act for 2017.

But we still expect to pay higher overall taxes this year than we did last year, given the non-stimulus-related tax benefits we received in 2012. As a result, we expect 2013 total free cash flow, including stimulus impacts, to decline to around $2.3 billion.

Let's move on to our capital return slide. We ended the year with net debt and preferred equity totaling $23.5 billion, a $2 billion increase from year-end 2011, and our reported leverage ratio was 3.01x our last 12 months adjusted OIBDA.

Including the normal adjustments, which include items like the underfunded pension obligations and facility leases, and adjusted for a full year of Insight results, the leverage ratio is closer to our target. And despite higher net debt year-over-year, our success at raising capital at lower rates and managing our average costs through interest rate swaps resulted in a decline in our net interest cost in the fourth quarter.

Our average cost of debt has dropped from 6.5% to 6.0% over the last 2 years. That's a 50-basis-point drop on $26.7 billion of total debt or roughly $130 million of annual interest savings. In the fourth quarter, we returned over 125% of free cash flow or $742 million in total to shareholders, $171 million in dividends and $571 million in share repurchases. This was an increase of 14% in share repurchases compared to Q3 and 56% over a year ago.

And given our strong and sustainable cash flow generation, we announced another 16% increase in our quarterly dividend to $0.65 a share or $2.60 on an annualized basis. And let me remind you that our share repurchases are really an outcome of our balance sheet philosophy. We're a large borrower, and we're committed to maintaining our solid investment-grade rating. To do that, we manage to 3.25 leverage ratio with the normal adjustments over time.

So in summary, with these fourth quarter results, we have delivered another year of steady financial performance and we continued to return excess financial capacity to our shareholders, a total of $2.6 billion in dividends and share repurchases in 2012. We extended our track record today by raising our quarterly dividend for the third consecutive year.

Thank you. And with that, I'll turn it over to Tom for the Q&A portion of the call.

Tom Robey

Thanks, Irene. Candy, we're ready to begin the Q&A portion of the call. [Operator Instructions] First question please, Candy?

Question-and-Answer Session

Operator

First question is Doug Mitchelson, Deutsche Bank.

Douglas D. Mitchelson - Deutsche Bank AG, Research Division

I guess a question for Rob. How meaningfully and how quickly can the initiatives you outlined impact customer churn?

Robert D. Marcus - President and Chief Operating Officer

Doug, it's a great question, and my expectation is that certain of these initiatives that are very execution oriented could have an impact right away. Others will take some time to actually manifest themselves. Things that relate to customer satisfaction, reducing churn volume or churn calls in the first instance will unquestionably take a longer time to have an impact. Execution-related changes, I think, can have a more immediate impact. But the goal is to work it on both fronts, and my hope is that we see a better outcome throughout 2013.

Douglas D. Mitchelson - Deutsche Bank AG, Research Division

Yes, I mean, the follow-up would be -- I mean, I know you don't like talking about potential future video subscriber levels. But given the comment that you've had improvements each of the last 3 quarters, you've got the initiatives you have underway, I mean I think people are going to leave this call with the expectation that video sub losses are going to start to improve in 2013. Is that fair or is it really too early to gauge that?

Robert D. Marcus - President and Chief Operating Officer

It's what we're striving for, but it's early to gauge any full year results.

Operator

The next question is Jessica Reif Cohen of Bank of America Merrill Lynch.

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

I was hoping you could give us some color on your newest RSN. What can you say about the economics of the Dodgers RSN? And how different is it from the Lakers economics, which you actually own?

Irene M. Esteves - Chief Financial Officer and Executive Vice President

Hi, Jessica, it's Irene. The Dodgers deal is similar in economics to the Lakers deal in that we're guaranteed access to important sports programming over a long period of time. And our objective here, as it was with the Lakers, is to ensure that access to programming at a certain cost. And we think over the long-term, this will be a lower cost alternative than if we had not guaranteed those rights for the 25-year period.

Glenn A. Britt - Chairman and Chief Executive Officer

Jessica, this Glenn. I just want to emphasize one thing that Irene just said. We do not pretend that these deals are inexpensive or cheap. And our sense is that if we're going to carry these games, they're going to be expensive when we get them. So what we think we've done with these deals is to minimize and stabilize the cost over a long time period. But we're not trying to pretend the first year is really, really cheap or anything.

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

But is this why margins are coming down in 2013?

Irene M. Esteves - Chief Financial Officer and Executive Vice President

It really doesn't impact us, Jessica, until 2014.

Jessica Reif Cohen - BofA Merrill Lynch, Research Division

All right. Okay. So can you say anything about the first year impact?

Irene M. Esteves - Chief Financial Officer and Executive Vice President

It should be minimal. We might have a little bit of startup cost, but it's really a '14 impact.

Operator

Next question is Phil Cusick, JPMorgan.

Philip Cusick - JP Morgan Chase & Co, Research Division

I guess, just following up on Jessica's question, can you help us think about the -- are the Lakers and Dodgers RSN deals sort of more dilutive up front and so dragging margins even more than might have been in a normal or sort of a -- you buying from the previous contract? But then we

expect margins to improve over time. So are we seeing more pressure from these given the structure, but again, you think it's better this way to do it?

Glenn A. Britt - Chairman and Chief Executive Officer

Phil, the answer is no. Again, we think we're stabilizing and minimizing costs over a long time period. These -- in both cases, these rights were up for auction in a sense and they were going to be expensive no matter what happened. We think we've done the best of the alternatives.

Irene M. Esteves - Chief Financial Officer and Executive Vice President

And with the experience we've had with the Lakers, we'd say that given the net cost of that deal compared to where sports rights programming is going, that we're confident that we made the right decision with the Lakers and we're hopeful we made -- we'll find the same with the Dodgers.

Robert D. Marcus - President and Chief Operating Officer

Even in the short term.

Philip Cusick - JP Morgan Chase & Co, Research Division

Can you give us any early indication on what this should do to '14 margins as well?

Irene M. Esteves - Chief Financial Officer and Executive Vice President

It's too early to say.

Operator

Next question, Laura Martin, Needham & Company.

Laura A. Martin - Needham & Company, LLC, Research Division

Let's leave sports and talk about the Google overbuild in Kansas City. Can you guys give us any update as to what's happening to your subscribers and cost down there? And then I thought the most interesting thing to come out of CES was the Roku app, and I'd be interested in you guys sizing what that might mean to your capital spending. Could that take that down? And Glenn, strategically, should we expect to see to roll that out over other platforms other than the Roku platform?

Glenn A. Britt - Chairman and Chief Executive Officer

Let me answer the last part, Laura, and then, Rob will do the first part. I think I've said this before, but I'll repeat it, our goal is to have our video services on every device that is capable of displaying them and carrying them. So there's all sizes and shapes and varieties of devices, but

you should assume we're actively talking to everybody and that's our objective. So over time, you will see a series of announcements such as Roku. Bob?

Robert D. Marcus - President and Chief Operating Officer

Yes, and just to amplify what Glenn said, Roku is just one example of many. Whether the actual experience will be attractive to a broad number of customers, I think, remains to be seen. So I wouldn't anticipate meaningful impact on our set-top box cost in the near term. I think this is more about the philosophy and direction we're headed. So going to Google, just at the risk of repeating what we've said before to put the Google overbuild in context, they have talked about what will ultimately be a 600,000 home build, I think 300,000 of those homes are in our footprint. And if you get to the subscriber level, it's something like 100,000 video customers and 100,000 HSD customers. So a very small percentage of our total subscriber base. And the reality is most of the action is going to happen towards the back half of this year. So they really haven't built out very much, and the customer impact we've seen, so far, is essentially de minimis. That said, we're hard at work ensuring that our customer relationships are strong, that our product set is good. We recently increased the tiers of service on HSD that we have available in the Google footprint. And we're now offering 100 megabits a second service, which is the fastest we're making available anywhere. So like with any overbuilder, we're ready for the competition.

Glenn A. Britt - Chairman and Chief Executive Officer

And Laura, if I could just add one more thing. I think that there's a lot of PR and a lot of hype about this whole thing. The reality is, today, there are not really applications that require 1 gigabit per second. So our philosophy has been to keep our speeds in line with what the market demands and what it needs. There's no doubt in my mind that the speeds will, over time, get faster and faster as they have since we started this in 1996. So I expect some time in the future, we'll have 1 gig, maybe 2 gigs. But other than PR and hype, this is not a real need for anybody right now.

Operator

Next question is Jason Bazinet, Citi.

Jason B. Bazinet - Citigroup Inc, Research Division

Just had a question either for Mr. Marcus or Mr. Britt. I guess, the entire cable industry is now at a point where they've gone all digital and most of the executives seem to extol the virtues of that decision and claim that it's helped their fundamental results fairly significantly. Do you still believe that not going all digital is the right move? And if so, do you mind just elaborating on what it is that you think makes your footprint or operational strategy fundamentally different from the rest of the industry?

Glenn A. Britt - Chairman and Chief Executive Officer

Sure. I think if you cut through it all, going all digital is something that cable operators did to increase the usable capacity in their plan by getting rid of analog. So in that sense, it was something done for the benefit of the cable operator, not particularly for the consumer. And it's somewhat disruptive to consumers. What we've done is to initially create more capacity by using switch video, and that's stood us in very good stead. We most certainly, over time, will be going more and more towards all digital, but we're doing it on an evolutionary basis. I actually think the ultimate all digital is going to be IP digital, not MPEG-2, which is what everybody's stuck with. So I think that as we evolve to that, we'll be doing all things IP and not sort of in this intermediate phase. So we actually feel very good about what we've been doing and I think the future it's going to pay big dividends.

Robert D. Marcus - President and Chief Operating Officer

Let me just clarify one thing that I mentioned in my prepared remarks. We are, in fact, in the process of reclaiming bandwidth that's previously been dedicated to analog video. And the way we're going about doing that is, as Glenn mentioned, rather than doing a flash cut and ceasing to deliver all of the networks in analog, we're starting really with the most -- the least viewed networks and kind of chipping away at the lineup and ceasing to deliver those networks in analog when a customer, who likes to watch those networks but doesn't have a set-top box, raises their hand, then we provide them with the D-to-A converter. So we can increase the usable bandwidth, to use Glenn's term, without some of the related disruption that generally is associated with these transitions. So we think we've struck the right balance, and it's working quite well.

Glenn A. Britt - Chairman and Chief Executive Officer

I think just to be clear also, we have gone all digital in some markets where we needed the capacity. So New York City is one of them and parts of L.A. and then maybe some other places.

Operator

Next question, Marci Ryvicker, Wells Fargo.

Marci Ryvicker - Wells Fargo Securities, LLC, Research Division

I just had a quick question for Irene. Can you share with us your thoughts on share repurchase activity for 2013? I know last year, you had told us that it should be more than free cash flow. Should we expect the same thing again?

Irene M. Esteves - Chief Financial Officer and Executive Vice President

Hi, Marci. On free cash flow, what we've said is we're guided by our 3.25 leverage ratio, and we've been very consistent talking about that, and we will continue to use that as a guiding principle. I'm not giving specific guidance on the pace, but as you look back on our history, you can see that we've consistently increased the pace, and that we are fully committed to 3.25 leverage ratio over time.

Marci Ryvicker - Wells Fargo Securities, LLC, Research Division

And can you just clarify for free cash flow guidance there. I've seen a couple of different calculations between $2.3 billion and $2.5 billion. Is there a definitive number for 2013?

Irene M. Esteves - Chief Financial Officer and Executive Vice President

We said it will be around $2.3 billion.

Operator

Next question is a Jason Armstrong, Goldman Sachs.

Jason Armstrong - Goldman Sachs Group Inc., Research Division

Rob, you mentioned, I think, in your upfront remarks that Southern California is the bright spot operationally. I realize we've obviously talked about the Dodgers deal a decent amount. You were early in that market with WiFi initiatives, early obviously with RSN ownership relative to the rest of the footprint. Are those the key drivers that are impacting performance there? And to what extent, do you think, that can service sort of a broader blueprint?

Robert D. Marcus - President and Chief Operating Officer

Yes. So I think that the programming benefits we got out of the TWC SportsNet and maybe as significantly, Pac-12 Networks, did definitely help subscriber performance in SoCal in Q4. WiFi, I think it's still early days. We've got a nice network of WiFi Hotspots in L.A., and the evidence we have so far certainly suggest the correlation between churn reduction and WiFi utilization. But candidly, the usage is still at a level that I can't point to it having a meaningful impact on overall subscriber performance. We believe in the benefits of WiFi to our customers, but I think it's a little early to say that, that's a big driver of the subscriber performance. I think more than anything else, what I would attribute it to is superior execution. We've spent a lot of energy and it's been a long road since the acquisition of the Adelphia and Comcast properties to hardening the network, ensuring that the products that we delivered were reliable and state-of-the-art, and ensuring that our marketing and sales machine and our service organization were firing on all cylinders. And I think we're getting to that point, and that's manifesting itself in better subscriber performance.

Operator

Next, Ben Swinburne, Morgan Stanley.

Benjamin Swinburne - Morgan Stanley, Research Division

I have, I guess, 2 questions for Rob. Rob, as you look at the subscriber metrics over the last few years, one of the areas that did get worse in '12 was Double Play, which I'm presuming the vast majority is probably data and phone. But would love any color on that line since it seems like an

area where you're operating from a position of strength and it was pretty solid in '10 and '11. And then just on the margins in '13, the programming cost number isn't too surprising, and it feels like there's other stuff going on around maybe marketing, I know there's been some press around some new marketing initiatives you guys have. And I don't know if you'd be willing to talk about the startup losses, which were, I think, 110 for '12. Is there a number in '13 that we should be thinking about? Because it seems that a lot of the things you've done around CDN and data centers, the consolidation and reorg, would be margin enhancers but doesn't seem like that's kicking in, in '13. So any color would be helpful.

Robert D. Marcus - President and Chief Operating Officer

Yes, so let me start with the question on doubles. I'll make a brief comment on marketing then, I'll flip it over to Irene to handle the rest of the margins. So Double Play -- first of all, you mentioned -- you made reference to data and phone. In fact, the vast majority of our Double Plays are video, data doubles, and that's where we saw the most softness in 2012. This is an area I think I highlighted on our Q3 call and it's an area that we're going to focus on going into this year. I think we can do a better job competing with U-verse in particular on the Double Play front. They've been very aggressive in their Double Play promotions, most notably in Texas and to some extent, in the Midwest. The focus has been on customers who reside in MDUs and generally don't take landline phone at all from anyone. They tend to be wireless-only customers. It's a younger, typically unmarried base, and we just need to re-craft some of our offerings to be more responsive to their needs. We haven't yet talked much about our Verizon Wireless relationship, but I feel that, that's a place where our Verizon Wireless relationship can actually position us well. So more to come on that front, but it's an area of focus. I guess, one mechanical thing that goes without saying, and it doesn't take away at all from the fact that we're focused on doubles, one of the reasons that doubles have been weaker is our emphasis has been on triples. And we probably sold in some triples to customers that otherwise in the past would have taken doubles. So some of this is just trading among bundled subs. But nonetheless, it's an area of focus for us in '13.

Irene M. Esteves - Chief Financial Officer and Executive Vice President

And then on the margins, if you think about programming, which was $4.6 billion, if that's growing at 10% a sub, that's a huge impact on our margins. We also mentioned 2 other piece, the pension expense which is with historically low interest rates, that expense line goes up. And we're -- it's a nonpolitical year in '13, so we're missing that very high-margin political revenue. In prior years, we also had offsets to some of the programming expenses with large Go It Alone savings in our phone business, which we're not expecting as much of this year. And you asked about the new initiatives and what we spent in 2012. We will continue to invest behind those businesses, but because it's a multi-year investment, we don't think it makes sense to break them out anymore. But suffice it to say, we are continuing to invest behind things like IntelligentHome rollout and our business services expansion, and Rob mentioned, the WiFi. So we'll continue to invest behind those businesses because we think it's right for the long-term profitability of the company. So those are the main drivers of that margin decline that we're expecting.

Robert D. Marcus - President and Chief Operating Officer

And just specifically to address your question on marketing, it's true that marketing was up in Q4 year-over-year, but I don't anticipate that being a meaningful driver of margin contraction in '13. In fact, due to the -- some of organizational changes we've made and actually a trend that started probably last year, we're getting more efficient with our marketing dollars. I think we're getting more bang for the buck in everything we spend. We're dedicating more of our dollars to working dollars, in other words, buying media as opposed to some of the administrative and production costs. And I think we're actually doing a better job spending marketing dollars more wisely. So I don't anticipate that being a factor.

Glenn A. Britt - Chairman and Chief Executive Officer

Yes, one thing I'd remind you about margins is that it's a good conversation about costs, and it's a good measure of whether we're managing costs. But at the end of the day, it's a mixture of a whole bunch of stuff and different products with different characteristics. And we actually don't run the business for margin, we run it for the bottom line. So if we can sell more of a lower margin product but add to the bottom line, we'll do that. So I just -- I know everybody needs it for modeling, that we pay attention to it, but it's not our primary focus. We're focused on the bottom line.

Operator

Next, Richard Greenfield, BTIG.

Richard Greenfield - BTIG, LLC, Research Division

You talked about reducing programming costs, but you've been out of contract, I believe, with Starz Encore for a number of years. Just wondering if that's an opportunity for you to make a dent in the programming cost line that you mentioned several times during the call? And then on broadband, it's becoming an increasingly profitable business, I mean the modem fee is going to have a, say, a notable impact on 2013's growth. Do you worry or how do you think about the risk to broadband sub fees emerging like what you pay in ESPN 3 today? Could that proliferate over time and chew into any of that revenue that you're generating?

Glenn A. Britt - Chairman and Chief Executive Officer

Rich, I'll take a shot at both those. First of all, individual programming deals, I don't -- I'd be remiss making any comments at this point. But suffice it to say, we're going to look at everything hard. On the broadband subject, I think you raised an interesting issue because in a world where there's net neutrality and a push for net neutrality, which is essentially applications and content people saying they don't want anybody to be favored, there's the potential for reverse network neutrality. And I think perhaps an illustration of the government trying to put rules in place too early without really thinking through everything that happened. The essence of Internet is that you provide access to the web and people will go wherever they want and do whatever they want and what we sell is the access. So I think we need to be very careful about turning that into a business where some application or content providers seek favor or demand favor. It's not kind of what this is all about.

Operator

Next, John Hodulik, UBS.

John C. Hodulik - UBS Investment Bank, Research Division

First, maybe a quick clarification on the programming cost. You're seeing some real acceleration per sub in terms of growth. Maybe Glenn, are the initiatives to drive some of these channels -- I mean, should we keep that number at about 10% going forward or do you think the initiative to drive some of these channels can put some pressure on that as we move beyond 2013? And then maybe from Rob, can we just get some more detail or could you elaborate on a couple of the initiatives you talked about? First, the rollout of the cloud-based IP guide and you talked about developing more video apps and extending those beyond the home. When -- what -- can you give us a little bit more detail there and when we can see those?

Glenn A. Britt - Chairman and Chief Executive Officer

On the first one, I think it's -- beyond what we said, I don't want to say much, numerically. But the actions we're taking are not going to dramatically change the trajectory of programming cost. I do hope that we can, over time, improve the perceived price value relationship though and then, clearly, consumers, particularly people who are under economic duress, are looking at these big packages and they're saying, it costs more than I can afford, number one. And number two, there's too many networks I never watch and I don't care about. And that's kind of what we're trying to address. Obviously, sports and other really popular programming keep getting more and more expensive, and that's where most of the money is. But these networks that hang on, I think they have a birthrate of carriage even though hardly anybody watches them. Those are the ones we're going to be taking a look at.

Robert D. Marcus - President and Chief Operating Officer

And John, with respect to the cloud-based guide, I mean I guess the first thing that's worth mentioning, and we've mentioned it before, is that we already have a cloud-based guide that's in front of a couple of hundred thousand customers in a couple of markets and we've had it out there for a while, and we've learned from it. The cloud-based guide I was referring to, is what we call our hosted navigation product. It will be available back half of this year. It will work on our new IP set-top boxes. It will work on what is essentially a souped-up DVR. Some people have referred to it as a Gateway device, which has 1 terabyte of storage, 6 tuners and has the ability to transcode video into IP, so it can be consumed not only by the IP set-top boxes but by other devices in the home. So we're looking forward to that. I think the experience will be markedly better than the set-top box-based guide experience. There will be easier navigation, more box art, better search, all of the things that viewers have come to expect based on their interaction with video on the web. So I think that's going to be a really exciting change. Refresh, what was your question on the video apps?

John C. Hodulik - UBS Investment Bank, Research Division

Yes, first, is that new guide? And that media guide, will it going to be available in all your markets in the second half? And then you said, extending the apps not just so that they're useful inside the home but potentially I guess, with maybe the...

Robert D. Marcus - President and Chief Operating Officer

So on the guide, look, it will not -- the guide will initially only function on these new pieces of hardware that I'm referring to. So on one level, the proliferation of the guide will be dependent upon the rollout of the hardware. Whether or not it's available in every single market, I think it's still too early to say what the exact rollout schedule is. So we'll give you more as the year progresses. On video apps, we already have a pretty healthy portfolio of rights to deliver video product outside the home. But so far, customers access to those -- the video product, has been dependent on their visiting the programmers' website. What I expect later this year, and in fact late first quarter, early second quarter, is that those video products will find their way into our apps even when you're outside the home. So the experience will be better in the sense that the programming will be aggregated and easier to navigate. So I think we've listed these before but obviously, we have the ESPN suite of services, we have rights with respect to Viacom's products, Big Ten Network, we have some professional sports product from the leagues. It's a pretty decent list, and I think the experience will be a lot better once we incorporate them in our apps.

I see that it's half past the hour, so that's probably all we have time for this morning. Thanks, everyone, for joining us. And to give a little bit of advanced notice, our next quarterly conference call will be held on Thursday, April 25 at 8:30 a.m. Eastern Time. Thanks for joining us, and have a great day.

Operator

Thank you. That does conclude today's conference. You may disconnect at this time.