

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)	
)	
Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers)	CC Docket No. 01-338
)	
Implementation of the Local Competition Provisions of the Telecommunications Act of 1996)	CC Docket No. 96-98
)	
Deployment of Wireline Services Offering Advanced Telecommunications Capability)	CC Docket No. 98-147
)	

**OPPOSITION OF VERIZON TO AT&T'S PETITION FOR
RECONSIDERATION**

Of Counsel:
Michael E. Glover

Edward Shakin
Julie Chen Clocker
VERIZON
1515 North Court House Road
Suite 500
Arlington, VA 22201-2909
(703) 351-3071

Counsel for the Verizon telephone companies

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OPPOSITION OF VERIZON¹ TO AT&T'S PETITION FOR RECONSIDERATION

The Commission should deny AT&T's petition for reconsideration² because there is simply no impairment with respect to providing broadband service to multiple dwelling units ("MDUs"). These buildings are being served already by competitive carriers and CLECs are not impaired in their ability to deploy broadband to MDUs. Moreover, even if competitive LECs faced some impairment in providing broadband to MDUs, which they do not, the Commission

¹ The Verizon telephone companies ("Verizon") are the local exchange carriers affiliated with Verizon Communications Inc. identified in the list attached as Attachment A hereto.

² AT&T Petition for Reconsideration, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket Nos. 01-338 et al., (filed Sept. 9, 2004) ("Petition") to the Order on Reconsideration, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 19 FCC Rcd 15856 (2004)("MDU Order").

was correct in its MDU Order to extend the *Triennial Review Order*'s³ fiber-to-the-premises (“FTTP”)⁴ rules to MDUs, and, if anything, was unnecessarily restrictive in extending those rules only to MDUs that are predominantly residential. As the D.C. Circuit has already affirmed, the Commission may properly find that the principles of section 706 of the Act outweigh whatever impairment findings may be present for fiber loops serving such customers. Finally, the Commission may eliminate any ambiguity in the rule by clarifying that there is no impairment for FTTP loops, regardless of the identity of the customer. By making this clarification, all customers, regardless of whether they are located in predominately residential MDUs, will benefit from the generalized deployment of next generation broadband.

1. Competitive carriers are not impaired in providing broadband service to MDUs.

Because competitive carriers are not impaired without unbundled access to next-generation broadband loops, the Commission’s decision to extend the unbundling relief granted FTTP loops to MDUs is eminently appropriate. As this Commission noted in the *TRO* proceeding and affirmed by the D.C. Circuit, “the Commission cannot ignore intermodal alternatives” when evaluating impairment. *USTA II*, 359 F.3d at 572-73. In this case, there is already significant competition from cable companies for broadband serving MDUs. Cable modem service is now available to more than 95.6 million homes (approximately 87 percent of

³ *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 18 FCC Rcd 16978 (2003) (“Triennial Review Order” or “TRO”), corrected by Errata, 18 FCC Rcd 19020 (2003) (“Triennial Review Order Errata”), vacated and remanded in part, aff’d in part, *United States Telecom Ass’n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004) (“USTA II”).

⁴ Under the current rules, FTTP loops include both fiber loops deployed to an end user’s customer premises and fiber loops deployed to the curb. See *Triennial Review Order Errata* ¶¶ 37-38; *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Order on Reconsideration, CC Docket Nos. 01-338 et al., FCC 04-248 (rel. Oct. 18, 2004) (“FTTC Reconsideration Order”).

all U.S. households), and is expected to reach 90 percent by the end of 2004.⁵ Four of the largest cable companies (Comcast, Time Warner, Cox, and Cablevision) now make cable modem service available to between 95 and 100 percent of their homes passed.⁶ Since approximately 30-35% of the population currently live in MDUs,⁷ cable modem service is necessarily serving these buildings.

The penetration of cable modem service to MDUs is further demonstrated in the Ninth Video Competition Report, where the Commission reported that “[a]ccording to one estimate, 20% to 23% of a cable operator’s income comes from MDU subscribers.”⁸ Indeed, industry statistics show that cable modem service leads DSL service among apartment dwellers that have internet access. According to a June 2004 In-Stat/MDR report, 22 percent of the apartment dwellers who have internet access subscribe to cable modem, whereas only 14 percent subscribe

⁵NCTA, *Industry Overview: Statistics & Resources*, <http://www.ncta.com/Docs/PageContent.cfm?pageID=86> (citing Morgan Stanley data as of December 2003); See also C. Moffett, et al., Bernstein Research Call, *Broadband Update: Narrower “Availability Gap” Points to RBOC/Cable Share Stabilization* at 6 (Aug. 25, 2004) (“Aug. 2004 Bernstein Broadband Update”) (cable broadband available to approximately 94 percent of total cable homes passed); UNE Fact Report 2004, Prepared for and Submitted by BellSouth, SBC, Qwest, and Verizon, *Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Appendix A (filed Oct. 4, 2004) (“UNE Fact Report 2004”)

⁶ Aug. 2004 Bernstein Broadband Update at 6 and Exhibit 5; UNE Fact Report 2004 at A-2.

⁷ See, e.g. Robert Currey, Vice Chairman, RCN Corporation, Prepared Statement Before the Senate Subcommittee on Antitrust, Business Rights, and Competition, Committee on the Judiciary, *Cable and Video: Competitive Choices*, 107th Cong., S. Hrg. 107-248, at 31 (Apr. 4, 2001) (“About 30-35% of the total population lives in multiple dwelling units (MDUs), such as apartments, cooperatives or condominiums.”); see also U.S. Dept. of Commerce, Economics and Statistics Administration, U.S. Census Bureau, *United States Summary: 2000; Summary Social, Economic, and Housing Characteristics; 2000 Census of Populations and Housing*, Table 9: Units in Structure 2000 (issued July 2003) (27% of the total housing units in the United States are in structures with two or more units).

⁸ *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Ninth Annual Report, 17 FCC Rcd 26901, ¶ 118 (2002) (citation omitted).

to DSL.⁹ In addition to cable and DSL, apartment dwellers are also being provided internet service by fixed wireless companies, with 10 percent of apartment dwellers with internet access choosing to obtain their service over fixed wireless. *Id.*

Service is not only being provided to residential customers in MDUs, cable companies are targeting business customers as well. Cable companies have moved rapidly to provide cable modem services to small-business customers. Five of the six largest cable system operators (which, collectively, represent approximately 90 percent of consumer cable modem subscribers) already offer broadband services specifically tailored to small businesses.¹⁰ These cable operators have acknowledged that they can readily reach most small-business customers with their existing infrastructure, and that it makes sense to serve them.¹¹ Indeed, these cable operators already have been very successful in attracting small-business subscribers.¹² For

⁹ Amy Cravens, In Stat/MDR, *Multi-Band: Markets for Shared Broadband Access, Part 2: Residential (MDU)*, at 36, Table 18 (June 2004).

¹⁰ See J. Shim, Credit Lyonnais Securities, *The U.S. Cable Industry – Act I* at 196-202 (Nov. 20, 2002); Time Warner, *Time Warner Cable*, http://www.aoltimewarner.com/companies/time_warner_cable_index.adp (copy attached).

¹¹ See, e.g., *A Snapshot of the Cox Business Strategy*, Interview with Coby Sillers, Vice President and General Manager for Cox Business Services, Xchange Mag. (June 1, 2003), <http://www.xchangemag.com/articles/361buzserv3.html> (Cox Business reaches “more than 90 percent of Cox’s overall footprint nationally, marketing basic data and video services aggressively to small- and medium-sized businesses the company can easily serve with current network connections.”) (copy attached); A. Figler, *Turning Businesses into Customers*, Cable World (Dec. 9, 2002) (Ken Fitzpatrick, senior vice president of commercial services for Time Warner Cable: “We’ve got an infrastructure there that is just ripe for commercial services. . . . We pass 1.2 million businesses”) (copy attached).

¹² See, e.g., J. Reif-Cohen, et al., Merrill Lynch, *Cox Communications: Chasing Profits and the 4 Million Non-Video Homes* at 6 (July 30, 2004) (Cox Business Services has “over 100,000 customers in over 18 markets” and “could continue to scale in 2004 as it expands its network to reach more than 25% of businesses within its franchise.”) (copy attached); J. Barthold, *Small Business, Big Money, No Guarantees*, Telephony Online (Aug. 12, 2002) (Kevin Curran, senior vice president of marketing and sales for Cablevision Lightpath: Cablevision “can’t keep up with demand” for Cablevision’s Business Class Optimum Online service for small businesses) (copy attached).

example, Time Warner Cable's senior vice president of Commercial Services recently stated that "[w]e're continuing to drive this business. . . . It's been a huge driver from the revenue standpoint."¹³

Several studies confirm that small businesses are increasingly turning to cable modem service for their broadband needs, with 26 percent of them using cable modem service as compared to only 4 percent using T-1 services.¹⁴ In-Stat/MDR likewise reports low penetration rates of T-1 service among the small-business customers it studied.¹⁵ In short, cable modem service continues to dominate the broadband mass market, controlling nearly two-thirds of all high-speed lines provided to residential and small business customers overall.¹⁶

Likewise, cable companies are also actively pursuing larger business customers. According to analysts, 41 percent of large businesses, 32 percent of mid-sized businesses, and 44 percent of small businesses were using cable modem service for at least some high-capacity

¹³ A. Breznick, *Cable Operators Show They Really Mean Business*, Cable Datacom News (Sept. 2004) ("Time Warner officials say they enjoyed a \$60 million gain in business sector revenue last year, boosting their overall commercial take by 70%. The MSO now boasts more than 140,000 commercial accounts for its Road Runner Business Class line of services.") (copy attached).

¹⁴S. Pociask, Telenomic Research, LLC, *A Survey of Small Business' Telecommunications Use and Spending* (Mar. 2004) at 44 (Fig. 30); *see also id.* at 47 (Fig. 32), 48 (Fig. 33), 50 (Fig. 35).

¹⁵ *See* K. Burney & C. Nelson, In-Stat/MDR, *The Business Hot Wire!: Data Access in the Commercial and Residential Environments of US Businesses; Part One: Cable Modem Services* at 20, Table 11 (Nov. 2003) (8.5% of SOHO businesses and 25.6% of small businesses use Full T-1 in their main office; 5.9% and 17.3%, respectively, use Fractional T-1; and 48.5% and 43.7%, respectively use cable modem).

¹⁶ Ind. Anal. & Tech. Div., Wireline Competition Bureau, FCC, *High-Speed Services for Internet Access: Status as of December 31, 2003* at Table 3 (June 2004) ("*June 2004 High-Speed Services Report*"); *Compare June 2004 High-Speed Services Report* at Table 3 (Cable provides 16,416,364 high-speed lines to residential and small-business customers) *with June 2004 High-Speed Services Report* at Table 1 (Cable provides a total of 16,446,322 high-speed lines); UNE Fact Report 2004 at A-1.

services.¹⁷ As a result of this competition, a Building Owners and Managers Association survey covering roughly 2100 commercial buildings reported that 80 percent of the respondents said they had more than one telecommunications service provider, and almost 60 percent offer their tenants a choice of three or more providers.¹⁸

In light of the existence of intermodal competition in broadband, the Commission properly concluded that broadband unbundling relief should be extended to MDUs. As the D.C. Circuit noted in the mass market context, “we agree with the Commission that robust intermodal competition from cable providers – the existence of which is supported by very strong record evidence, including cable’s maintenance of a broadband market share on the order of 60% – means that even if all CLECs were driven from the broadband market, mass market consumers will still have the benefits of competition between cable providers and ILECs.”¹⁹ The same is true with respect to customers occupying MDUs.

The Commission’s determination to provide unbundling relief for fiber deployed to MDUs is supported further by the fact that CLECs themselves are not impaired without unbundled access to FTTP loops. As the Commission found in the *TRO* proceedings, FTTP deployment is still very limited, and ILECs and CLECs face similar barriers to entry in deploying fiber loops.²⁰ Although the Commission in the *TRO* initially determined to treat mass market customers in MDUs as part of the enterprise market, its rationale was based on concerns about the ability of competitors to access the inside copper wiring owned by ILECs in such

¹⁷ See K. Burney, *et al.*, In-Stat/MDR, *Cash Cows Say “Bye-Bye”: The Future of Private Line Services in US Businesses* at 19, Tables 9 & 10 (Dec. 2003).

¹⁸ See Letter from Matthew C. Ames, Real Access Alliance to Magalie Roman Salas, Secretary, FCC, *Promotion of Competitive Networks in Local Telecommunications Markets, et al.*, WT Docket No. 99-217, CC Docket No. 96-98, Attachment at 3 (filed June 16, 2000).

¹⁹ *USTA II*, 359 F.3d at 582 (internal citations omitted).

²⁰ *TRO ¶¶* 240, 275 n.808, 276; *USTA II*, 359 F.3d at 584.

buildings.²¹ That concern is addressed, however, by the Commission rules that guarantee competitors access to such wiring. *See TRO ¶¶ 351-355*. Moreover, AT&T has no legitimate claim that it is disadvantaged with respect to “accessing rights of way,” and “obtaining and paying for building access.” Petition at 4. Rather, as shown above, most building providers do not limit access to a single provider. In fact, the Commission has already banned exclusive access arrangements in commercial buildings, and as long as the ILEC is in a building, a CLEC has the right to use the ILEC’s in-building risers and conduits to reach its customers.²² Thus, contrary to AT&T’s assertions, CLECs are not impaired in serving MDUs.

2. Even if there were some impairment, the Commission properly determined that the principles of section 706 of the Act outweigh whatever impairment may be present for fiber loops serving MDU customers.

In the Triennial Review Order, the Commission concluded that it had the flexibility under section 251(d)(2) to consider the statutory goals of section 706 of the Act in determining whether to require unbundling of network elements. *TRO ¶¶ 286-88*. Section 706 of the Act directs the Commission to pursue methods that remove barriers to infrastructure investment and to foster competition. In affirming the Commission’s conclusion, the D.C. Circuit not only agreed that the Commission had the flexibility to consider how unbundling might affect the Act’s other goals, it stated that the “Supreme Court in *AT&T* [mandated] exactly such consideration.” *USTA II*, 359 F.3d at 580. Accordingly, the Court found that the section 706 considerations – that removing unbundling obligations on FTTP loops will promote their deployment of the network infrastructure necessary to provide broadband services to the mass market – were sufficient to justify the Commission’s decision not to require unbundling of FTTP loops “even if

²¹ *TRO ¶¶ 197 n.624, 351-55*.

²² *See 47 C.F.R. § 64.2500; Promotion of Competitive Networks in Local Telecommunications Markets*, 15 FCC Rcd 22983 (2000).

the CLECs are to some extent ‘impaired’ in their ability to enter certain segments of the FTTH broadband market.” *Id.* 359 F.3d at 584.

Despite the clear authority, indeed mandate, for the Commission to balance the costs of unbundling with the Act’s other goals, AT&T rehashes many of the same arguments that were rejected by this Commission in the *TRO* and by the DC Circuit in *USTA II*. First, AT&T argues that because the Commission had found *some* impairment with respect to mass market customers in MDUs, the Commission was precluded from declining to impose unbundling obligations for FTTP loops to MDUs. Petition at 4. Of course, this was the exact argument presented to and soundly rejected by the DC Circuit. As discussed above, even where impairment is found, the Commission retains flexibility to balance that impairment against the statutory goals under section 706 that require the Commission to encourage the deployment of advanced telecommunications capability to all Americans. In this case, like in the *TRO* proceeding, the Commission determined that unbundling requirements would create disincentives for bringing broadband to predominantly residential MDUs as it could cause incumbent LECs to shift deployment away from those buildings to markets with fewer investment disincentives. *MDU Order* ¶ 7. Accordingly, the Commission properly determined that the goals of section 706 outweighed any impairment that the CLECs may face.

AT&T next argues, as it did in the *TRO* proceeding, that the Commission could not “rationally determine that it is uneconomic for competitors to deploy all-fiber high-capacity loops to serve enterprise customers, and yet turn around and conclude that competitors could economically deploy FTTH to mass market customers – including those in MDUs.” Petition at 5. AT&T claims that the D.C. Circuit found this argument to be “convincing.” *Id.* However, AT&T fails to mention that although the D.C. Circuit stated that the “objections are convincing

in many respects, *they are ultimately unavailing*” because “the § 706 considerations that we upheld as legitimate in the hybrid loop case are enough to justify the Commission’s decision not to unbundle FTTH.” *USTA II*, 359 F.3d at 583 (emphasis added). In this respect, the Commission has also recognized that it is more economical for competitors to deploy fiber to customers in MDUs – where customers are highly concentrated – than to deploy fiber to customers that are more dispersed. The Commission noted that competitive carriers “usually” target MDUs precisely because such premises have an aggregated base of customers that provide “sufficient demand . . . to generate a revenue stream that could recover the sunk construction costs of the underlying loop transmission facility.” *TRO* ¶ 303. Indeed, many of the competitors that have deployed broadband facilities to the mass market have specifically targeted MDUs. For example, RCN has noted that the “ability to serve this sector of the market is crucial because it is generally more profitable due to the large number of subscribers in each MDU.”²³ Similarly, Z-Tel has stated that as it moves to VoIP from UNE-P, it will “initially focus on the small-to-medium business market and multiple dwelling units (MDUs) such as condominiums, apartment buildings and hotels in Georgia and Florida.”²⁴

AT&T’s argument that the Commission did not have evidence in the record that unbundling would promote the deployment of fiber to MDUs is equally unavailing. AT&T asserts that the Commission relied on a CSMG study that examined the investment disincentives of only single family homes and that the Commission had conceded that fiber is already being

²³ Robert Currey, Vice Chairman, RCN Corporation, Prepared Testimony before the Senate Subcommittee on Antitrust, Business Rights, and Competition, Committee on the Judiciary, Cable and Video: Competitive Choices, Federal News Service (Apr. 4, 2001).

²⁴ See Z-Tel News Release, *Z-Tel to Launch Voice Over IP Services Delivering Enhanced Voice and Data Bundles to Small and Medium Businesses and Multiple Housing Units* (Feb. 9, 2004) at http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=ztel&script=410&layout=-6&item_id=494243.

deployed to MDUs. Petition at 6-7. However, the Commission had ample evidence in the record that disincentives faced by carriers seeking to deploy broadband capabilities to individual customer locations, including single family homes, also apply in the context of MDUs. *See MDU Order* ¶ 7 n.24. As Verizon has informed the Commission, any rules that make it less attractive to deploy fiber to a significant segment of the mass market would reduce the overall revenues that ILECs could expect to earn from deploying fiber. This, in turn, reduces the incentives to deploy fiber to all other customers as well.²⁵ Other commenters agreed. The High Tech Broadband Coalition stated that extending broadband unbundling to customers in multi-unit premises “unreasonably deters deployment of fiber to buildings housing a substantial portion of mass-market customers.” HTBC Comment at 3. Catena likewise noted that by treating fiber to MDUs with greater unbundling obligations, “the Commission preserves the disincentives to ILEC investment in new fiber-based technologies to these subscribers.” Catena Comment at 12. And, numerous associations representing a broad range of households that live in MDUs agree that by removing unbundling requirements for broadband to MDUs, the Commission will provide incentives for LECs to rapidly deploy broadband to communities that could benefit from it most – communities such as the disabled, seniors, minorities and low-income citizens. *See* TRAC comments at 6-7.

Moreover, the fact that fiber may be already being deployed to MDUs in some cases does not undercut the Commission’s finding that unbundling relief is necessary to encourage the deployment of broadband to all Americans, especially those occupying MDUs. By ensuring that economic and regulatory barriers to deployment are kept at a minimum, the Commission

²⁵ Consolidated Reply of Verizon to Oppositions to Petitions for Reconsideration or Clarification, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket Nos. 01-338 et al., at 18 (filed Nov. 17, 2003).

encourages such deployment to proceed and to proceed as efficiently and at the lowest cost possible – all to the benefit ultimately of consumers. Indeed, the D.C. Circuit rejected this argument too in *USTA II* in the context of hybrid loops. There, the Court held that even if unbundling would have no impact on ILEC investment in fiber feeder portion of hybrid loops, which is not the case for FTTP deployed to MDUs, the other investment incentives the Commission identified were sufficient to justify the decision not to require unbundling. *USTA II*, 359 F.3d at 581-82. These included incentives to deploy greater electronic equipment, the deployment of more feeder fiber as a first step toward FTTP and incentives for CLECs to invest and deploy in their own facilities, possibly using different technology. *Id.* 359 F.3d at 581. Additional incentives apply equally to FTTP deployed to MDUs. Because the deployment of FTTP is still in its infancy, the lack of regulatory and economic barriers to deployment will spur additional deployment of this next generation network to MDUs, at a greater pace and at lower cost to consumers. As the Commission recognized, “disincentives are attributable to not only the prospect that regulated unbundling will diminish the compensation BOCs receive from users of their broadband facilities, but also the costs of constructing BOC broadband facilities in a fashion that will allow the BOC to satisfy whatever access requirements might foreseeably be imposed under section 271, as well as the significant costs that can be associated with regulatory proceedings themselves.”²⁶ More significantly, however, by declining to require unbundling of fiber to MDUs, the Commission will provide additional incentives to CLECs to deploy their own facilities, whether using fiber or some other technology.

²⁶ *Petition for Forbearance of the Verizon Telephone Companies Pursuant to 47 U.S.C. § 160(c)*, Memorandum Opinion and Order, WC Docket Nos. 01-338 et al., FCC 04-254, ¶ 25 (rel. Oct. 27, 2004).

3. The Commission can address any ambiguity that may exist in the *MDU Order* by eliminating unbundling obligations with respect to new broadband facilities, regardless of the customers served.

In its petition for reconsideration, AT&T argues that the Commission's *MDU Order* is "arbitrary and unjustified" because it sweeps in enterprise customers that operate in predominantly residential MDUs, when the Commission has determined that CLECs cannot serve these customers without access to unbundled loops. Therefore, AT&T argues, enterprise customers in predominantly residential MDUs will not have the benefit of broadband provided by competitive carriers, whereas enterprise customers elsewhere would. Petition at 8. AT&T's argument, however, is simply not supported by the facts because, as shown above, competitive carriers are not impaired in providing broadband service to either residential or commercial MDUs. Moreover, the Commission can obviate AT&T's claims of ambiguity and arbitrariness, and address its complaint about the lack of a "bright line" test, by eliminating any unbundling requirements for new broadband facilities, regardless of the customer served.

In the *TRO*, the Commission stated that it was adopting a bright line distinction between incumbents' existing legacy networks and their new broadband facilities. The Commission explained that, by providing certainty as to what the rules would be for these new broadband facilities, its rules would "provide the right incentives for all carriers, including incumbent LECs, to invest in broadband facilities." *TRO* ¶ 213. To that end, the Commission made clear not only that FTTP networks are not subject to unbundling, but also that any transmission path over a fiber facility that is used to transmit packetized information is not subject to unbundling, without regard to the identity of the customer being served. *See id* ¶ 288; ¶ 210 ("our unbundling obligations and limitations for such loops do not vary based on the customer to be served"). These rules thus make clear that the new FTTP deployments, such as those Verizon is rolling

out, are not subject to an unbundling requirement, regardless of the speed of service offered and regardless of the customer served.

The *TRO*, however, created an ambiguity with respect to enterprise customers, by imposing a requirement to provide access to dark fiber without explaining how that rule is reconciled with the rules excluding new broadband facilities from unbundling requirements. *See TRO ¶¶ 311-314*. Although the Commission's rules are therefore clear that FTTP facilities used to serve the mass market are not subject to a dark fiber unbundling requirement, they do not squarely address what the rule may be for customers classified as part of the enterprise market. This ambiguity will similarly affect FTTP deployed to "predominantly residential" MDUs, which are governed by the mass-market rules. To eliminate any remaining uncertainty in this regard and to ensure that the investment incentives the Commission properly sought to foster are not undermined, the Commission should make clear that facilities deployed as part of a generalized roll out of a next-generation, integrated FTTP network are not subject to an unbundling requirement, regardless of the customer served.

Such clarification is important for two reasons. First, small and medium businesses are entitled to the benefits that these new, advanced networks can provide. These businesses, moreover, are an important engine for economic growth. As a result, the availability of new, next-generation networks will benefit not only these customers, but also the broader economy. Accordingly, it is important for the Commission's rules to preserve incentives for carriers to serve these customers as part of a generalized roll out of next-generation FTTP networks.

Second, from a network perspective, imposing an unbundling obligation for some customers necessarily affects how incumbents, like Verizon, plan and build their networks. In order to serve the affected customer segment, the significant inefficiencies and extra costs

associated with any unbundling obligation would still have to be incurred, and Verizon still would be forced to undertake costly redesigns of the network and development of systems and procedures to address such customer-specific unbundling requirements. This is in addition to the reduced incentive to invest, as a result of the increased risks of deployment, that comes with the imposition of unbundling obligations. Incumbents will therefore be left with the choice of bypassing the customer segments subject to unbundling, or passing the additional costs and risks on to all customers. For both reasons, the Commission should confirm that FTTP facilities that are part of a generalized roll out are not subject to any form of unbundling obligation regardless of the specific customer served.

At a minimum, the Commission should make clear that, to the extent it continues any unbundling obligation for dark fiber, which it should not, any such requirement only applies where customers are purchasing a separate, customized network solution, rather than obtaining service through a generalized roll out of a next-generation FTTP network in a particular geographic area. This approach is consistent with the Commission's own analysis of the difference between enterprise and mass market customers, where the Commission has stated that in "the enterprise market, companies are able to target individual buildings and customers and determine which technology is the optimal means of reaching each customers," while, "in the mass market where revenues are small, customers are typically served in large groups, using uniform technologies and mass-marketing and provisioning techniques to minimize the cost of serving each customer." *TRO* ¶ 309. This approach would also fully address AT&T's argument that enterprise customers might be subject to inconsistent treatment by making clear that the only customers in MDUs who qualify as "enterprise" customers are those who purchase a customized solution rather than those served as part of a generalized roll out.

CONCLUSION

For the reasons stated above, the Commission should deny AT&T's petition for reconsideration and eliminate unbundling obligations with respect to new broadband facilities, regardless of the customer served.

Respectfully submitted,

Of Counsel:
Michael E. Glover



Edward Shakin
Julie Chen Clocker
VERIZON
1515 North Court House Road
Suite 500
Arlington, VA 22201-2909
(703) 351-3071

Counsel for the Verizon telephone companies

November 12, 2004

THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States
GTE Southwest Incorporated d/b/a Verizon Southwest
The Micronesian Telecommunications Corporation
Verizon California Inc.
Verizon Delaware Inc.
Verizon Florida Inc.
Verizon Hawaii Inc.
Verizon Maryland Inc.
Verizon New England Inc.
Verizon New Jersey Inc.
Verizon New York Inc.
Verizon North Inc.
Verizon Northwest Inc.
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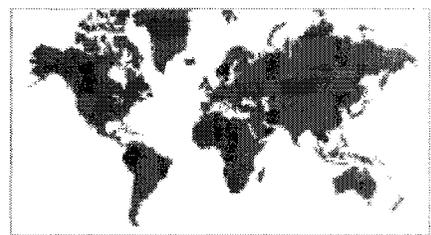
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TIME WARNER CABLE



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Bringing Digital Home
 A pioneer in the cable industry, Time Warner Cable manages either directly or through joint ventures the most advanced, best-clustered cable television operation in the country, with 75% of its customers concentrated in clusters of 300,000 or more.

OPERATING OFFICERS

Glenn A. Britt, Chairman and CEO
 Complete list of operating officers

CORE STATISTICS

10.9 million	Time Warner Cable managed basic service customers as of June 30, 2004
4.6 million	Digital video customers managed as of June 30, 2004
3.5 million	High-speed broadband services subscribers managed as of June 30, 2004
27	States in which Time Warner Cable operates as of December 31, 2003

COMPANY WEBSITES

www.timewarnercable.com

HIGHLIGHTS

Time Warner Cable leads the industry in deploying video on demand and subscription-based VOD services.

New products include High Definition Television (HDTV), Digital Video recording (DVR) functionality and home networking to interconnect multiple computers in the household with a single broadband connection.

In May 2003, the company launched its new phone service, branded Time Warner Cable Digital Phone, in its Portland, Maine, division. Digital Phone will be available in essentially all of Time Warner Cable divisions by the end of 2004. The new all-inclusive voice service enables Time Warner Cable to provide consumers with an attractive retail rate and a single point of contact to meet their video, high-speed data and voice needs.

Time Warner Cable's Road Runner high-speed Internet service was named the 2004 Site of the Year by Favourite Website Awards for its innovative design. Road Runner recently increased its maximum download speed to 3 mbps from 2mbps. Time Warner Cable offers its customers a choice of ISPs in addition to Road Runner. As of June 2004 Time Warner Cable provides broadband service to more than 3.5 million subscribers, or 19% of the eligible homes it serves.

SYSTEMS

Clusters of more than 100,000 subscribers

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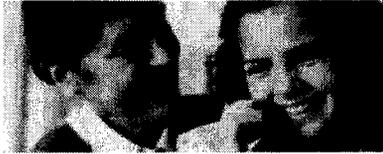
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Quote of the Month:

"Our forefathers made a new constitution, one fitting the revolution. We too need a new constitution for the regulation of voice-over-IP services."
-- FCC Chairman Michael Powell

Business Services

A Snapshot of the Cox Business Strategy

Cox Communications Inc. probably has been the most aggressive cable company in targeting the business market. Cox Business Services serves more than 65,000 business customers. The company's business efforts have grown in the past three years from less than 1 percent of Cox's overall revenue to just more than 5 percent of Cox's consolidated revenue. "That is remarkable," says Coby Sillers, vice president and acting general manager for Cox Business Services. "We are no longer a dot on the radar screen, the company is focused on it." Those numbers don't include video-only business customers. XCHANGE Editor in Chief Paula Bernier recently spoke with Sillers about the company's business effort. Below is an excerpt of that interview.



-- Cox's Coby Sillers

X: How does Cox Business Services fit in with the overall strategy at Cox?

Sillers: There was an integration of CBS into Cox at the end of 2003. That means more resources for the business unit. In Phoenix, for example, we have the entire Phoenix residential group now focused on business in addition to residential. It's like now the corporation has really embraced commercial in addition to residential service.

X: How does Cox differentiate its business services in the marketplace?

Sillers: Within Cox we have a saying 'it's the bundle, baby.' And we do it on both the business side and the residential side. The one thing we can provide that no one else can provide is video added to our bundle. Especially since the events of Sept. 11, there's been increased interest -- and that's only accelerated with the war -- in watching TV to keep up on compelling events. One of the strategies we have is lobby sessions with buildings with a large display screen TV and we offer a discounted

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approach to the bundle. The business manager understands how to buy voice, understands how to buy data, but doesn't really understand how to buy video. So one of our strategies is to offer video for free. Cox also is a leader in customer care in the industry.

X: Does Cox do anything special to appeal to small and medium businesses?

Sillers: We have quarterly campaigns and other promotions throughout the year. Somebody that has our data service is more than likely to try our voice service. So, we do mailings to try to upsell those customers. Other campaigns might include an offer that if you take the bundle maybe there's one month free of a certain service.

X: Who are the company's biggest business customers?

Sillers: Broadcom, Motorola, Norfolk International Airport, every school in Santa Barbara. There are many more.

X: What's next for Cox Business Services?

Sillers: The integration of Cox Business Services directly into Cox Communications, I think, will mean greater success in our integration strategy and will create increased growth, driving deeper penetration in servable areas. We'll also do select network expansion through buildouts. We will expand our existing product portfolio with DOCSIS 1.1, which supports QoS and bandwidth shaping and rating. It means being able to guarantee businesses the bandwidth they will ask for. That will put us in direct competition with the telcos. We're also looking to accelerate deployment of voice across Cox markets through VoIP.

"There was an integration of CBS into Cox at the end of 2003.... It's like now the corporation has really embraced commercial in addition to residential service."

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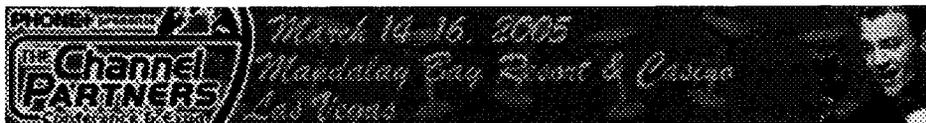
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Turning Businesses Into Customers

Byline: ANDREA FIGLER

A 33-year-old woman rolls out of bed, walks to her desk, turns on a computer with a high-speed Internet connection, then starts to brew the morning coffee. Before the water boils, she's checked her e-mail and any news she might need to start the workday.

Who is this woman? She's your average 21st century telecommuter, that's who.

Of what consequence is she to the cable business? That depends on whether a cable operator wants to build a commercial subscriber base.

The woman, it turns out, is part of a group that's expected to be 50.3 million telecommuters strong by 2006. That's a 26.4% increase in ranks over 2001, according to In-Stat/MDR.

Cable operators believe that targeting this group paves the way for an easier, more successful entree into the businesses where they work. And if done right, nabbing this market opens doors to new revenue streams from small businesses all the way to large corporations. Were cable to get 60% of just the small business market, it would mean \$54 billion in the bag, according to the consulting group AMI Partners and researcher Dun & Bradstreet.

But it has to be done right. Remember ABIZ, Adelphia Communication's business arm that sank into bankruptcy only months before Adelphia itself fell victim to the same fate. The key to avoid an Adelphia-like pitfall is leveraging existing hybrid fiber coaxial networks rather than solely expanding fiber into new markets, which is an expensive proposition.

Most MSOs dipping their toes into the commercial market tend to focus on at-home workers and small- to medium-sized businesses sprinkled close to their existing coax lines. "We've got an infrastructure there that is just ripe for commercial services," says Ken Fitzpatrick, SVP of commercial services for Time

Warner Cable, also referred to as Road Runner Business Class. "We pass 1.2 million businesses, and we're in 17 million homes. When you look at the growing population of teleworkers, the numbers are out there for the taking."

Hired in March to lead a national effort to land more commercial business, Fitzpatrick says telecommuters typically need more services attached to their high-speed Internet connection, such as managed security and virtual private networks, than the average Road Runner subscriber. And that means more revenue for the cable operator.

While Fitzpatrick would not disclose the price for a business-class connection, Mike Paxton, an In-Stat/MDR senior analyst, says that for nearly 60% of cable operators the price for a business cable modem connection falls between \$50 and \$99 a month. Paxton also found that 21.2% of the MSOs he surveyed charge between \$100 and \$149.

And, Paxton adds, since installing cable modems for business services doesn't cost much more than residential installations, operators can earn up to three times the revenue on telecommuter accounts as they do for an average residential cable modem subscriber. He figures the average residential customer pays about \$44 a month. "The margins," he says, "are very good for business."

To get these margins, TWC's Fitzpatrick has a few sales reps in every division devoting 100% of their time to winning business clients. Though he won't disclose actual numbers, Fitzpatrick claims that TWC's business arm has doubled both its revenue and customer base this year.

Aside from the data connection, Road Runner Business Class provides Web hosting, e-mail solutions, managed security and private data lines. If the company decides to provide voice services to businesses, it will likely be voice over Internet protocol. It has two VoIP tests running, in Rochester, N.Y., and Portland, Maine.

For Cox Communications, VoIP is definitely a better fit for commercial services than it is for residential, says EVP of operations Pat Esser, who also oversees Cox Business Services. After doing a test in Oklahoma last year, Cox found that residents need a lifeline phone connection that VoIP doesn't provide. Also, the test found no clear answers as to VoIP's apparent cost savings for residents. But, on the commercial side, the new telecom technology could serve businesses such as hotels very well, Esser says. For now, Cox will stick to the business services it knows well - from local and long-distance phone service

to high-speed cable modems to private line networks.

This year, Cox Business Services expects revenue to total roughly \$225 million, about 53% more than last year. As of the third quarter, CBC revenue totaled \$164 million, a 57.7% increase.

The number of fiber transport lines, also known as carrier lines that are used by companies to provide their own data transport, grew to 1.5 million in the third quarter, compared with 1.4 million last year.

Traditional switch phone lines also grew to 135,900 lines compared with 88,000. Commercial high-speed cable modem subscribers totaled 30,000.

"It looks like data is where a lot of the growth is," Esser says. "The carrier side isn't growing that fast."

Comcast Corp. has scaled back efforts to land more clients for its Comcast Business Communications unit. "The reason we did that was the general state of the industry and the general state of the economy," says Ron Tonge, SVP of sales and marketing for CBC. A few years ago, CBC started rolling out both voice and data services commercially system by system. Last year, Comcast began a national approach to consolidate efforts and leverage its existing coaxial network to lay more fiber in key strategic areas.

Similar to other MSOs, Comcast targeted small businesses. The system has several thousand customers including health care outlets and government agencies. CBC brings in a wide range of revenue from an average \$90 a month for a business cable modem subscriber to up to \$10,000 a month for a private data network line, Tonge says.

While Comcast had a direct sales force working commercial accounts in the beginning of this year, it stopped hiring in the second quarter.

Exactly how Comcast will integrate AT&T Broadband's business units, which total about eight markets, remains unclear. "It's probably too early to tell," Tonge says. "We're still doing assessments."

Comcast's cautious stance is to be expected, says Yankee Group analyst Mike Lauricella. The weak economy makes most companies want to steer clear of new territory and protect their existing assets. For cable, that means focusing on residential subscribers.

"Apparently, we are hitting a kind of a bump in the road," Lauricella says. "They are clearly not abandoning the business market, but I think their focus [on it] is waning."

Charter Communications has a lot on its plate right now, including a Securities and Exchange Commission investigation and an internal reorganization. But spokesman David Andersen said the operator is focused on offering high-speed Internet services to small- and medium-sized businesses through Charter Business Networks. "With over 600,000 small- and medium-sized businesses located within reach of our networks, this opportunity is just too good to pass up," he said in a statement. "CBN generated over \$9.65 million in revenue during the third quarter of this year, and we expect that to increase in the fourth quarter. In the second quarter of 2002, CBN generated \$7.74 million of revenue. We're continuing to roll out a consistent national marketing strategy and expect to be fully operational in all regions by the end of the year."

As for total business cable modem subscribers, Charter's third-quarter earnings report showed about 85,500 commercial customers included in its overall cable modem subscriber count of 1 million. That compares to 38,000 commercial customers out of 507,000 total cable modem subscribers for the same period last year.

In early 2001, Cable One started offering commercial high-speed services just six months after it launched residential cable modems, says Stephen A. Fox, VP of digital services and technology. The operator has over 2,000 small office or home office (also known as SOHO) subscribers to its cable modem service, he says. At \$99.95 a pop, this market is bringing in more revenue without a lot of additional costs since the operator uses similar self-installation modem services for small businesses as it does for residential customers. About 70% of these SOHO subscribers also take video services, Fox says.

The other top MSOs, specifically Cox and TWC, say telecommuters are their prime consumers of bundled video and high-speed data services. Neither operator provided exact take rates or pricing for bundled services, though.

As for Cable One's commercial revenue stream, Fox says it is "very profitable." While he would not reveal exact details, he says it's so profitable that Cable One has been evaluating putting a commercial sales force in select markets to go out and chase business. Fox also would like to offer other commercial services such as Voice Over IP but says he wants to wait until others test the waters.

"We're waiting on the sidelines for the large MSOs to venture down that road and see whether it's a market worth chasing," he says.

Cable One will be watching the larger MSOs as they test new technologies and rejigger residential vendor services for business clients. For example, four undisclosed cable operators started testing Narad Networks, a broadband access solution, this past spring, says Chuck Kaplan, Narad's VP of marketing. The private company, with investors such as Polaris Ventures, won't release MSO names because it is under non-disclosure agreements, Kaplan explains. The tests, however, are an effort to help operators leverage their existing plant without clogging up the shared network, a problem that keeps companies wary of cable, he says.

Based in Westford, Mass., Narad provides a mixture of hardware and software at the last mile that leverages the unused frequencies above the 860 MHz of cable plant. It offers switched Ethernet services via a cable operator's existing HFC plant, providing 100-megabits-per-second drops on the coax cable in the last mile so a cable operator doesn't need to construct new fiber.

"What the Narad technology provides is the ability to run T1 lines over the cable," Kaplan says. T1 lines are one of the strongest and highest-speed data connections. "Really, you could put 30 to 40 T1s over coaxial cable. And with \$800 to \$1,000 a month for a T1, that's a lot of extra money."

The average installation for Narad generally costs between \$6,000 to \$7,000 for small- to medium-sized businesses, he says. A cable operator installs Narad between the node and the actual business served. This investment is worth it, Kaplan says, especially since Narad helps an MSO provide business-class quality of service. Corporations, especially larger ones, oftentimes want a service level agreement that guarantees a specific quality of service before they will sign up for a high-speed data connection.

Cable modems, which offer their connections via an operator's shared network line, can't necessarily offer those guarantees at this point, says Yasin Altaf, product manager for commercial data access aggregator MegaPath Networks. "The only drawback we see in cable is a shared technology," Altaf says. "This is where it lags behind DSL."

Cable's growing high-speed data subscribers in residential areas (i.e., the telecommuter population), however, make cable key for MegaPath. It cut a deal with TWC to resell its Road Runner Business Class service in August. And last month, MegaPath reached an agreement with Cox to resell its high-speed business connections.

"The telecommuter program is a very good fit for a cable commercial product," Altaf says. "Most of the

customers we have signed up with cable today do have telecommuters."

In fact, many businesses have started to request cable high-speed access rather than a digital subscriber line offered by a telco because cable is less expensive. "In the end, cable pricing might be better than any other," Altaf says, adding that a few hundred of his business clients are up and running on Road Runner, and 150 business customers use Cox.

MegaPath went after these two MSOs primarily because they centralized their back-office, support and billing services for commercial accounts. This made it feasible for MegaPath to reach an agreement with the operators. Before, Altaf had to negotiate deals system by system.

One of cable's traditional residential billing and support vendors, Convergys has been working closely with cable operators to help them revamp back-office services, says Kurt Champion, senior director of product and industry marketing.

"I think demand is growing," Champion says. "We have seen a steady increase in the number of business accounts and the complex services being requested."

While Cablevision Systems would not discuss its vendors, it has probably the longest history of providing business services among its peers. Lightpath, the MSO's business arm, began providing local and long-distance phone services 12 years ago, says Joseph Lhota, EVP of corporate administration. As the business grew, it added high-speed data services and private line services, growing at a double-digit pace each year, he says.

As of the third quarter, Lightpath reported a 20% increase in net revenue to \$39.7 million. The company attributes this to a 25% jump in the number of buildings connected to Lightpath's network; a 25% increase of access, or carrier, lines; and a reduction in workforce.

Lhota attributed Lightpath's success to the operator's mantra of sticking close to home or, as Cox's Esser affectionately coined it, playing in their own sandbox. "We run Lightpath through the backbone of the cable area," Lhota says. "We don't leave that space."

Lightpath also puts every potential client through a business test to see if it will be profitable before it wires the system. Hospitals are the major portion of Lightpath's business. About 90% of all the hospitals on Long Island use Lightpath, Lhota says. Wall Street firms are now calling on Lightpath to set up back-

office and support systems outside New York City after Sept. 11 tragically brought their business to a halt, he says.

Lightpath has been so successful that it is targeting the telecommuter from the inside out, or rather from a business's headquarters reaching into residential homes.

A few years ago, Lightpath won a \$25 million deal to wire government buildings throughout Westchester County. While this wired network is separate from Cablevision's residential HFC system throughout the county, the two networks are compatible, making it easy for the county government to begin offering a telecommuter program. Five months ago, the county began testing a telecommuting program with about 50 probation officers, says Norm Jacknis, the county's chief information officer.

"It saves them the trouble of spending an hour or so on the road to enter some data that they need for a case," Jacknis says. "Beyond that, they can get access to data they need at home before they go on the road."

This telecommuting aspect has worked so well that the county plans to extend the program to its fire department, specifically the information technology division.

Who ever heard of a telecommuting fireman? Well, with technology advancing faster than you can yell "smoke," even the government needs to be on top of its game.

And cable, if it's smart, will take advantage, says Yankee Group's Lauricella. "It's a huge opportunity," he says. "It's just a question of their focus. I do worry that if the cable companies sit back and hedge, that they are going to miss the boat shortly."

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30 July 2004

 Jessica Reif Cohen
(1) 212 449-3334

 Keith Fawcett
(1) 212 449-3106

 Hyun-Ju Kwak
(1) 212 449-9127

Cox Communications Inc.

**Chasing Profits and the
4 Million Non-Video Homes**
BUY
Reason for Report: 2Q04 Earnings Announcement

**Volatility Risk:
HIGH**
Price: **\$28.08**

12-Month Price Objective: \$48.00

Date Established: 05-May-2003

Estimates (Dec)	2003A	2004E	2005E
EPS:	d\$0.22	\$0.42	\$0.67
P/E:	NM	NM	41.9x
GAAP EPS:	d\$0.22	\$0.42	\$0.67
GAAP P/E:	NM	NM	41.9x
EPS Change (YoY):		NM	59.0%
Consensus EPS:		\$0.46	\$0.75
(First Call: 26-Jul-2004)			
Cash Flow/Share:	\$3.34	\$3.85	\$4.26
Total EV/EBITDA:		8.9x	7.5x
Cable EV/EBITDA:		8.6x	7.1x
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

 Investment Opinion: C-1-9
 Mkt. Value / Shares Outstanding (mn): \$17,879 / 637

Stock Data

 52-Week Range: \$36.95-\$27.17
 Symbol / Exchange: COX / New York Stock
 Exchange
 Institutional Ownership-Vickers: 36.6%
 Brokers Covering (First Call): 34

Highlights:

- Cox reported strong 2Q financial results with EBITDA growth of 16% to \$616 mil. and revenue growth of 12% to \$1.595 bil., and mixed subscriber results.
- Cox's success with the student segment in 3Q03 was a major factor in the 54,000 pro forma basic sub loss reported in 2Q04, due to the disconnect activity at the end of the academic year.
- We believe Cox will more aggressively target the 4 million non-Cox video households in its footprint, as part of its strategy to grow via volume gains rather than rate increases. We anticipate tightly restricted, limited time offers exclusive to the non-video homes, designed to motivate call traffic and create upsell opportunities.
- In Roanoke, Cox's first VoIP market, data sell-in is now growing at double the pace of the company average, a positive trend favoring accelerated deployments of VoIP service.
- We maintain our CY04 estimates of 12% revenue growth to \$6.43 bil. and 15% EBITDA growth to \$2.435 bil.; the impact of lower projected data and phone ARPUs offset by higher subs.
- We expect data and phone ARPUs to drift lower in 2H04, reflecting declining installation and modem related data revenue and FCC mandated access charge reductions phased in 3Q.
- Raising CY04 pro forma HSD subscriber net adds from 510k to 525k as Cox pursues tiering and maintains 70% share of broadband homes in its markets. Raising CY04 phone net adds from 280k to 300k, as Cox also launches 3-4 new VoIP markets.
- Maintain our Buy rating on Cox. Our \$48 price objective is based on 14x CY04E cable EBITDA. Risks are mainly related to DBS & DSL competition.

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Refer to important disclosures on page 14. Analyst Certification on page 7.

In the Pursuit of Profits

Table 1: 2Q Strong Financials, Mixed Sub Metrics

Financial:	2Q04A	2Q04ML	Var	Y/Y
Video	961	958	3	6%
Data	271	272	(1)	28%
Telephony	144	143	1	24%
Other	26	24	3	30%
Residential Rev	1,402	1,396	6	12%
Advertising	107	106	1	9%
Commercial	86	88	(1)	22%
Tot Revenue	1,595	1,590	5	12%
Tot PF EBITDA	616	604	12	16%
EBITDA Margin	38.6%	38.0%	+60 bp	
Cable Salients:				
Ad Rev/ Mo/ Sub	\$ 5.65	\$ 5.59	\$ 0.06	9%
Res Cable / Mo/ Sub	\$ 79.64	\$ 79.20	\$ 0.44	11%
Total Rev/ Mo/ Sub	\$ 84.19	\$ 83.82	\$ 0.38	12%
EBITDA/ Mo/ Sub	\$ 32.51	\$ 31.85	\$ 0.66	15%
Video ARPU	\$ 50.71	\$ 50.49	\$ 0.23	6%
HSD ARPU	\$ 41.04	\$ 41.23	\$ (0.19)	-5%
Tele ARPU	\$ 43.65	\$ 43.54	\$ 0.11	-9%
Cable Capex	323	305	18	-4%
Cable Capex / Sub	51	48		-4%
PF Subs Basic	6,263	6,274		0.6%
PF Subs Digital	2,279	2,279		18%
PF Subs Data	2,246	2,249		34%
Subs Phone	1,134	1,122		35%
Basic Net Adds	(54)	(41)	(13)	nm
Digital Net Adds	60	60	0	-13%
Data Net Adds	98	100	(3)	-13%
Phone Net Adds	66	55	12	18%
Digital Wkly Adds	4.6	4.6		
Data Wkly Adds	7.5	7.7		
Phone Wkly Adds	5.1	4.2		
Basic % of HP	60.0%	59.6%		
Digital % of Basic	36%	36%		
HSD % HSD-R	22%	22%		
HSD % Basic	36%	36%		
Phone % P-Ready	21%	20%		

Source: ML. Actual financial results; subscriber results pro forma for the 53,000 system sale.

Cox reported strong 2Q financial results marked by 16% EBITDA growth, yet mixed subscriber results headlined by the 54,000 pro forma basic sub loss and steady but not blow-out 98,000 data net adds. The company's laser focus on operating efficiencies is clearly paying off, as cash flow margin expanded 120 basis points Y/Y and 180 basis points sequentially to 38.6%, the sixth consecutive quarter of margin expansion as efficiency measures take effect.

The key highlights from Cox's 2Q earnings announcement are:

- 1) **Maintaining Rational Pricing:** *Cox is committed to competing on products and features and not solely on price, countering investor concerns of widespread deep promotional activity. Cox's reiteration of a judicious pricing approach echoes Comcast's comments confirming typical "Back to School" promotional activity in 2H04.*
- 2) **4 Million HH Opportunity:** *We believe Cox will more aggressively target the 4 million non-Cox video households in its service areas, as part of its strategy to grow via volume gains rather than rate increases. We anticipate tightly restricted, limited time offers exclusive to the non-video homes, designed to motivate call traffic and create upsell opportunities. We believe Cox has been extremely successful in upgrading the first-time callers to higher level of services beyond the promotional plan.*
- 3) **Share Buyback/Dividend Plan, Not Yet:** *Investors seeking clarity on Cox's plans for its building free cash flow will have to wait a few more quarters yet, according to the company management, as it crafts the most optimal cash usage plan. YE04 debt leverage is projected to be 2.6x EBITDA, well within the approximate 2.75x internal comfort range to maintain its investment grade credit ratings. By our estimates, Cox will generate \$965 million in free cash flow in CY05, highlighting the possibility of a share buyback or a dividend plan, barring any acquisitions.*
- 4) **Reiterated CY04 forecasts:** *No changes to its full-year guidance, including 11.5% to 12.5% revenue growth, 14% to 15% cash flow growth and basic sub growth of under 1%. We maintain our CY04 estimates of 12% revenue growth to \$6.43 billion, 15% EBITDA growth to \$2.435 billion and 0.8% basic sub growth.*

The company disclosed that **DR Partners recently put its 25% interest in some systems serving 260,000 subscribers** to Cox. The upgraded systems are concentrated in Tyler, Texas. We assume a theoretical \$2,500/sub valuation for the 65,000 attributable subs given the rural profile of the systems, and derive a potential \$165 million settlement value modestly above the \$140 million book value. We anticipate the transaction to be settled this year and have proactively adjusted our CY04 minority interest and debt projections accordingly.

■ 2Q04 Highlights

We note that the 2Q results reflect the sale of 53,000 basic subscribers in rural areas to Allegiance Communications. The divested assets were non-upgraded systems serving Oklahoma, Kansas, Texas and Arkansas. The non-strategic systems did not offer telephony and only sparsely offered digital TV and broadband services. The transaction closed in mid-April for \$53.1 million in cash for an

implied purchase price per sub of \$1,000. The pre-tax loss of \$5 million on the sale is reflected as an operating income adjustment. Per GAAP rules, no pro forma financial results are available, although the subscriber figures are adjusted pro forma for the Allegiance transaction to ensure year-over-year comparability.

- **2Q revenue of \$1.595 billion (+12%), in line with video revenue +6%, data +28% and telephony +24%. 2Q EBITDA of \$616 million (+16%), ahead of our \$604 million estimate; we believe the reduction in EBITDA from the system sale was minimal given the systems' rural character. 2Q margins of 38.6%, up nearly 180 basis points from 1Q04 and up 120 basis points Y/Y; six consecutive quarters of sequential margin expansion as continued efficiency measures take effect.**
- **Pro forma basic sub net loss of 54,000 versus our 41,000 loss estimate (+0.6%, Y/Y) due to seasonality; we believe Cox maintains low satellite penetration of roughly 11% in its markets.**
- **Pro forma high-speed data net adds of 98,000, in line with our 100,000 estimate or 7,500 a week, compared to weekly sub additions of 12,400 in 1Q04A and 8,700 in the prior-year period. The sequential drop in net adds is due to seasonality, driven by the substantial student population (one of the biggest customer segments for broadband adoption) in Cox's markets. The company continues to maintain 70% share of broadband homes in its markets.**
- In comparison, SBC, Verizon and BellSouth combined added 715,000 DSL net subscribers in 2Q04, significantly below ML expectation of 900,000 DSL net adds for the three RBOCs. Investor concerns coming to the fore of saturation in the broadband marketplace, in light of sluggish DSL results and weak residential HSD net adds at Time Warner Cable (127,000 net adds, a sharp drop from 193,000 net adds in 1Q04 and 170,000 in 2Q03).
- **Pro forma digital net adds of 60,000, in line or 4,600 a week, versus 5,900 a week in 1Q04A and 5,300 in the prior-year period as the company focuses on digital sell-in rather than aggressive promotions; digital penetration increased to 36% versus 31% in the same period last year, buoyed by VOD/SVOD expansion and growing consumer adoption of HDTV.**
- **Pro forma phone net adds of 66,000, ahead of our 55,000 estimate or 5,100 a week, compared to 6,100 weekly add rate in 1Q04A and 4,300 in the prior year period. Cox activated its last circuit-switched telephone market, Northern Virginia, on June 1st, bringing Cox's telephone markets to 13 total.**
- 2Q capex of \$323 million versus our \$305 million estimate, down 4% Y/Y. 2Q FCF before working capital (net of cash interest and cash taxes) of \$168 million versus our \$193 million estimate,

reflecting higher than projected capex and interest expense. Cox reiterated guidance of positive free cash flow for full year 2004; we maintain our CY04 \$625 million free cash flow estimate (before working capital).

■ CY04 Outlook

For 2004, we are leaving our revenue and EBITDA estimates unchanged. We are raising our data and telephone subscriber estimates, reflecting 1H04 positive trends. We had previously adjusted our estimates for the Allegiance transaction.

Upside exists if Cox pursues a widespread launch of cable telephone service this year, a prospect boosted by Cox's updated white paper confirming the readiness of VoIP technology for scale launches. More importantly, *positive trends in Roanoke, its first VoIP market, indicate that data sell-in is growing at double the pace of the company average since the introduction of telephone.* In effect, Cox's VoIP service is boosting data penetration in that market, a positive trend favoring accelerated deployments of VoIP service.

- **Maintain CY04E EBITDA estimate of \$2.435 billion, up 15%,** reflecting continued efficiency improvements. Benefits of Cox's new ESPN contract baked in already, which we believe will moderate the historical 20% per sub rate increase toward 13% this year and to 2% to 3% in the latter-end of the nine-year contract. Management guidance for EBITDA is 14% to 15% growth.
- **Maintain CY04E total revenue of \$6.43 billion, up 12%. Video +6%, data +27%, telephone +23% and advertising +9%. Projecting lower data and phone ARPU's in 2H04, chiefly reflecting declining installation and modem related data revenue and FCC mandated access charge reductions for phone ARPU's. The impact of lower projected ARPU's is offset by higher data and phone sub estimates. Management revenue guidance is 11.5% to 12.5% growth.**
- **Maintain CY04 pro forma basic sub net adds of 50,000, basic subs +0.8% Y/Y; we expect advanced services rollouts coupled with innovative, niche marketing campaigns to increase connect activity. Management's estimate is just under 1% growth consistent with CY03 expectations.**
- **Project CY04 pro forma digital subscriber net add estimate of 310,000.** Digital net add rate projected to be 6,000 per week to 39% penetration at YE04; lift from accelerating pace of advanced services such as HDTV, VOD/SVOD and PVR. Motorola's dual-tuner capable HD PVR box launched in select markets, supporting a rapid expansion of PVR service to 95% of Cox's footprint by YE04.

- **Raising CY04 pro forma HSD subscriber net adds from 510,000 to 525,000** or 10,100 per week versus 11,200 in CY03; as the company pursues tiering and given the company's ability to maintain 70% share of broadband homes in its markets; HSD penetration is projected to reach 24% of HSD-ready homes. We project 40% HSD penetration of basic subscribers surpassing the projected digital video penetration; incremental HSD penetration gain of 17 percentage points in just two years as Cox continues to capture the majority of the narrowband migration.
- **Raising CY04 phone net adds from 280,000 to 300,000** or 5,800 per week, above CY03 rate of 5,200 a week, as the telephony footprint expands from 12 markets at YE03 to 17 markets at YE04. We believe one of the 3-4 new VoIP markets in 2H04 could be Las Vegas, a strategic cluster with 340,000 basic subscribers.
- Raising total pro forma new service RGUs from 1.15 million to 1.18, versus management's forecast of 1.0 to 1.1 million.
- Maintain CY04E FCF before working capital (net of cash interest and cash taxes) of \$625 million or \$0.99/share. Maintain CY04 estimated capex of \$1.4 billion, at the upper end of management guidance of \$1.35 to \$1.4 billion.
- Raising CY04 EPS estimate from \$0.39 to \$0.42; as we project lower depreciation expense and 2Q EPS was \$0.01 higher than our estimate.

We note that Cox management has been very vocal in quashing merger speculation around the Adelphia auction process, publicly stating no interest in acquiring Adelphia assets in its entirety. However, the Adelphia bondholders may be contemplating piecemeal asset divestitures, pairing the most coveted systems with the most impaired systems to maximize the proceeds. If the Adelphia auction should evolve to allow for piecemeal sales, it could invite Cox's participation depending on the parceling of assets. We believe Cox would be financially disciplined as an acquirer, and seek to preserve its investment grade profile in any scenario.

2Q Highlights

Cox report strong 2Q EBITDA growth of 16% to \$616 million, on revenue growth of 12% to \$1.595 billion. Cox's 2Q results – stellar financial performance yet mixed subscriber results – resembled Comcast's 2Q results, including high-speed data net adds that were within the range of our estimates but below consensus. Addressing investor concerns about price competition, Cox management forcefully reiterated its commitment to preserving pricing integrity and profitability.

Video ARPU was up 6% from \$48.06 in 2Q03 to \$50.71 in 2Q04 and up 2% from \$49.87 in 1Q04. HSD ARPU of \$41.04, was below 1Q04 HSD ARPU of \$41.51 and 5%

lower than 2Q03 ARPU of \$43.39, primarily due to higher self-install and declining modem lease revenue (only 16% of HSD customer base lease modems today). For Cox, we project HSD ARPU could drift lower throughout CY04 as the trends in customers buying modems and self-installation continue and the company experiments with different promotions (e.g. weekend speed previews). Overall, HSD revenue jumped 28% to \$271 million, reflecting a 34% increase in subs.

As demonstrated by 16% cash flow growth in the 2Q, operating leverage via higher self-installation and sell-in of advanced services are helping to drive profitability. Cox is achieving 30% digital self-installation and 52% data self-installation rates, and 49% digital sell-in and 36% data sell-in, record highs for the company. In addition, network costs are declining at a rate similar to Comcast's 30% Y/Y decline. Cox is uniquely advantaged in reining in operational costs as the company manages its own national network backbone.

■ Basic Subs

The historic seasonality trends were replicated again this year, leading to basic sequential subscriber losses of 54,000 versus our 41,000 estimate, total subs +0.6% Y/Y. Cox is a victim of its own success, in many ways, as the more successful Cox becomes in converting the substantial student population in its footprint, the more Cox becomes subject to the disconnect activity at the end of each academic year. In particular, Cox's 2Q04 basic sub decline was heavily impacted by the 3Q03 success with the student demographic. We anticipate highly targeted marketing tactics will increase connect activity in 2H04, including improved Latino programming.

■ High-Speed Data

In 2Q04, Cox added 98,000 HSD subscribers at a weekly rate of 7,500 subscribers. We note that notwithstanding DSL promotional activity, Cox continues to serve roughly 7 out of 10 broadband homes in the Cox markets and we believe that Cox should maintain a healthy lead as Cox pursues tiering. Cox aims to capture a significant portion of the 5 million narrowband users in its footprint and the lower-priced, lower speed service could accelerate narrowband migration. Cox is using the tiers to migrate the bandwidth hogs to the higher price point of \$70 - \$80/month (promoted as \$60-\$65/month for 6 months in some markets) and reserving the lower price point of \$25 mostly for customer retention efforts.

Notably, Cox's narrowband alternative offers 128 kbps symmetrical speeds and appeals to subscribers who do not want to tie up telephone lines. The value service is available in all its markets, chiefly as a save tool. However, *in July, three markets began offering the value service as an entry-level tier to compete head-on with dial-up service; promising results could motivate more widespread marketing of the lower-priced data product.*

Table 3: Cox HSD Tiers

	Prices*	Speed
Premium	\$59.95 - \$79.95	4 Mbps down /384 kbps upstream
Preferred	\$39.95	3 Mbps down/256 kbps upstream
Value	\$24.95	128 kbps down/ 128 kbps upstream

Source: Company website; ML. *Prices with \$10 discount applied for Cox customers who have at least one other Cox service.

We note the light broadband results to date for the second quarter have provoked concerns about a potential saturation in the broadband marketplace. The big three telcos, SBC, Verizon, and BellSouth reported a material slowdown in net adds, *the first time DSL net adds declined since widespread availability of DSL service.*

Table 4: 2Q HSD Net Add Results To Date

	2Q04A	2Q04ML	Var
Comcast	327	302	25
Time Warner	127	151	(24)
Cox	98	100	(2)
Subtotal Cable Net Adds	552	553	(1)
Verizon	280	330	(50)
BellSouth	120	145	(25)
SBC	315	425	(110)
Subtotal DSL Net Adds	715	900	(185)

Source: ML

SBC, Verizon and BellSouth combined added 715,000 DSL net subscribers in 2Q04, 185,000 subs below ML expectation of 900,000 DSL net adds for the three RBOCs. For the first time, the telcos cited seasonality pressures, which the cable operators have noticed earlier given higher data penetration levels. In addition, SBC attributed the slowdown to strike preparations negatively impacting its marketing abilities. The three telcos indicated a measured pricing approach to maintain DSL momentum, including introducing higher-speed/higher-priced tiers at SBC. *The telcos' public stance combined with Cox's and Comcast's pricing strategy suggests to us that a price war is not looming in the immediate horizon for the broadband service providers.*

■ Digital

Cox added 60,000 digital subscribers in 2Q04 at 4,600 a week. Cox has centered its digital marketing efforts using sell-in at the time of the initial sign-up for basic video subscription. The company has made strong progress in adopting this sell-in strategy with digital sell-in at a record 49% at 2Q04.

VOD. Cox launched VOD service in 2 new markets in 2Q04, and VOD/SVOD coverage will grow to eight markets by YE04 covering 40% of homes passed and 49% of digital customers. Combined with other digital service rollouts such as DVR and HDTV, digital penetration is projected to increase to 39% at YE04 versus 34% at YE03.

DVR. Cox's DVR service footprint expanded from 42% in 1Q04 to 49% of homes passed in 2Q04 or to 13 markets. The company plans to more than double the DVR footprint to 95% of markets by YE04, including high-potential, major clusters like Orange County and New England, as the Motorola dual-tuner PVR boxes becomes available in bulk. Pricing for the Cox DVR service is flexible running on average \$10/month with no additional box charge; these offers are competitive with EchoStar's \$10/month service fee for America's Top-50 customers and versus \$5/month fee for DirecTV Total Choice subscribers. User response to surveys in Cox's two earliest DVR markets, Gainesville, Florida and Northern Virginia, have been extremely positive. The DVR service in the two markets garnered 89% satisfaction scores and 93% of users indicated that they would recommend the service to a friend, resembling the early enthusiastic customer feedback for the high-speed internet service.

HDTV. HDTV service is currently available to 92% of homes passed. We believe the initial data points on consumer adoption of HDTV suggest that HD could emerge as a prominent winback tool. Cox earlier estimated that approximately 17% of HD subscribers are first-time subscribers to the company's cable services. In the initial phases of the HD rollout, Cox estimated 22% of HD subs were new subscribers, and we believe the pick-up from first-time Cox subscribers could decline as the company upgrades more of its existing base (so a mix shift) and as DirecTV increases its HD local into local footprint.

Generally, cable operators can deliver local broadcasts in HD versus the satellite operators that face capacity constraints to do so. To exploit its advantage, Cox offers ten channels including local network broadcasts in HDTV at no incremental charge above the equipment leasing charge to digital subscribers. The free package includes popular channels such as ESPN HD and Discovery HD.

■ Residential Telephony

Cox added 66,000 net telephone subscribers in the 2Q at a weekly rate of 5,100, compared to 6,100 weekly add rate in 1Q04A and matching the prior year period rate of 4,300. Cox has been the most successful cable operator in deploying phone service, demonstrating an ability to deliver high penetration with good margins while lowering video churn. The company's deep experience in deploying conventional circuit-switched service on its fiber-coax network positions it well to deploy the cable telephony service using VoIP technology. The circuit-switched telephone business is EBITDA positive with fully loaded margins exceeding 40%.

Cox launched phone service in Orange County in 1997 and now has 13 telephone markets with the launch of its latest, and last circuit-switched market, Northern Virginia on June 1st. Cox serves more than 250,000 basic subscribers in Northern Virginia, one of Cox's large strategic markets and a prime area to introduce cable telephone service.

Cox upgraded its VoIP trial in Roanoke, Virginia to full commercial status in December 2003. Cox markets its VoIP service the same way as its circuit-switched service, with a 10% discount on the first line and 30% on the second line versus the local telephone incumbent. There is no surcharge for standalone Cox telephone service (unlike the \$10 premium for data-only Cox service). A record 79% of local phone subscribers also take Cox long-distance service. The triple-play bundle is proving to be a powerful churn buster: churn in three-product households is 44% lower.

This year, Cox became the first cable operator to win the coveted 2004 JD Power award for highest customer satisfaction for bundled long distance and local residential telephone service. Cox also received the top prize in the JD Power survey for local residential telephone service in the Western Region covering 16 states, repeating last year's achievement. We believe Cox's emphasis on superior customer service is rewarded in improved upgrade and sell-in abilities.

Cox's VoIP Opportunity

For 2004, Cox noted that VoIP service will be deployed to 3-4 new markets in 2H04. *We believe the company could accelerate deployments, as trends in Roanoke VoIP market indicate healthy positive contribution to data net adds and the economics of VoIP improve.* Compared to last year's premise-powered VoIP costs, VoIP capex requirements have dropped 34% Y/Y from \$404 per telephone subscriber to \$267 per subscriber, assuming 1.3 lines per customer and 20% penetration. **VoIP capex is 49% lower than circuit-switched deployments for savings of \$260 per subscriber.** Primarily due to lower media terminal adapter (MTA) vs NIU and lower battery backup power vs network power costs, the differential between capex for circuit-switched telephony and VoIP has widened Y/Y, from \$206 per subscriber to \$260 per subscriber. In the current Cox cost models, Cox assumes four hours of standby power at the plant for both technologies, with in-home battery back-up for the VoIP MTA and network-supplied power for the circuit-switched NIU. This implies that the MTA will be inside the home and not a network-powered side-of-home NIU/MTA.

Assuming telephone ARPU of \$40 and EBITDA margin of 45%, the payback period for the VoIP telephone service is estimated to be 14 months.

■ Advertising

Advertising increased 9% to \$107 million in 2Q04, reflecting the loss of certain third-party MSO contracts at Cox Media, a cable rep firm for national spot cable advertising. These MSOs, including Mediacom, have elected to take this function in-house in some markets, and are developing their own in-house advertising salesforce. We note that the loss of roughly 700,000 rep homes was muted on Cox's cash flow as those contracts offered thin margins. We believe the impact of the lost rep homes will cycle through by the end of the year. Thus far, Cox has not seen a material boost from Olympic and political ad

spending, although management is optimistic about the opportunity in the 3Q.

We expect cable advertising to be a big beneficiary of Nielsen Media Research's introduction of local people meters in major U.S. markets. Nielsen Media findings using LPM data from the Boston rollout indicates that cable's audience delivery jumps substantially, while broadcast networks decline versus the old methodology of passive meters and diaries. For example, in the A18-34 demographic, Cable viewing rose 66% while broadcast declined 24%. Likewise in the key A18-49 category, Cable rose 51% while broadcast declined 16%. The double-digit gains for cable and double-digit declines for broadcast viewing was also evidenced in the viewing patterns of African-American and Hispanic homes, using LPM trial data in New York. In effect, Nielsen's analysis showed a sizable shift in viewing from the big broadcast networks to cable, regardless of race and with the same amount of television viewing.

Marking a significant milestone, Nielsen began deploying local people meters (LPM) in New York in May and Los Angeles in July. **New additions to the Nielsen LPM roster will be Chicago as of August 5th and San Francisco as of September 30th.**

We regard the LPM rollouts in the top 10 DMAs to be major structural changes supporting the cable operators' efforts to narrow the gap between share of viewing and share of spot advertising. This gap represents a \$4 to \$5 billion opportunity in spot TV advertising revenue for the cable operators, and we anticipate major market operators like Cox to be the prime beneficiaries.

■ Commercial Services

Commercial business revenue grew 22% to \$86 million in 2Q04. Cox Business Services (CBS), formally launched in 2000, targets the small businesses and corporations located within 100 feet of Cox's HFC network with a total telecom spend of roughly \$3.3 billion annually. The division has over 100,000 customers in over 18 markets, and the CBS accounts are accretive to Cox as it leverages the existing HFC network.

We believe the business services segment has EBITDA margins of roughly 40% and payback on commercial capex and investment within three years. Cox's business unit leverages all its existing infrastructure by using the same switches, NOC (network operating center), billing system, brand and technicians/truck that the core cable business uses. We project that CBS could continue to scale in 2004 as it expands its network to reach more than 25% of businesses within its franchise and launches voice capabilities to additional voice markets at YE04.

Investment Conclusion

We maintain our Buy rating on Cox. Our \$48 price objective is based on 14x CY04E cable EBITDA, or upside potential of 70% from current trading levels. Cox is trading at 8.6x CY04E our cable EBITDA estimates and 7.1x CY05E.

In our view, Cox as the pioneer of the triple-play bundle and tight attention to customer service has many advantages in a more crowded, competitive marketplace. We believe Cox's fundamentals remain very healthy, with HSD and cable telephony as growth products. Cox's penetration rates for high-speed data and phone are merely 22% of the upgraded digital-broadband footprint, implying significant upside potential.

Risks are mainly related to DBS and DSL competition, including pricing pressures and telco fiber to the premises (FTTP) plans. However, we note that the capital commitment (e.g., \$4-\$5 billion for SBC), timeframe (3-5 years) of the FTTP plans are challenging, and ultimately may make it uneconomical for the telcos to gain a meaningful toe-hold in a crowded marketplace.

Analyst Certification

I, Jessica Reif Cohen, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Table 5: ML Cable Valuation

	Comcast	Cox	Cablevision
Ticker	CMCSA	COX	CVC
Rating	B-1-9	C-1-9	C-1-9
Price Target	\$46	\$48	\$32
Sh Price	\$ 27.54	\$ 28.08	\$ 17.38
Shares	2.256	0.637	0.288
Equity	61.1	17.9	5.0
Debt	20.3	6.4	8.8
Other	(18.3)	(4.5)	(5.4)
04 Core Cable EV	63.1	19.8	8.4
2004E			
EV/EBITDA	8.6x	8.6x	7.8x
EV/Sub	\$2,932	\$3,120	\$2,847
P/FCF	31.1x	28.6x	NM
EBITDA	7.315	2.285	1.075
EBITDA/sh	\$3.24	\$3.59	\$3.73
FCF/sh	\$ 0.89	\$ 0.98	\$ (0.03)
Debt/EBITDA	2.7x	2.6x	6.9x
2005E			
EV/EBITDA	6.9x	7.1x	6.7x
EV/Sub	\$2,657	\$2,789	\$2,775
P/FCF	17.3x	18.4x	36.0x
EBITDA	8.320	2.524	1.219
EBITDA/sh	\$3.69	\$3.96	\$4.23
FCF/sh	\$ 1.60	\$ 1.52	\$ 0.48
Debt/EBITDA	1.9x	2.0x	6.0x

Source: ML

Cox Communications: Summary

Revenue & Cash Flow:	1Q03A	2Q03A	3Q03A	4Q03A	1Q04A	2Q04A	3Q04E	4Q04E	CY02A	CY03A	CY04E	Y/Y% Change				CY03A	CY04E
												1Q04	2Q04	3Q04	4Q04		
Video	899	908	919	933	951	961	970	984	3,440	3,659	3,866	6%	6%	6%	5%	6%	6%
Data	194	211	227	239	258	271	283	296	575	871	1,107	33%	28%	25%	24%	51%	27%
Telephony	107	116	120	127	134	144	147	153	343	470	578	26%	24%	23%	20%	37%	23%
Other	19	20	21	26	27	26	27	27	72	87	107	37%	30%	26%	3%	20%	23%
Residential Rev	1,219	1,255	1,287	1,325	1,369	1,402	1,427	1,460	4,430	5,086	5,657	12%	12%	11%	10%	15%	11%
Advertising	81	98	100	107	88	107	109	117	378	385	421	10%	9%	9%	9%	2%	9%
Commercial	67	70	74	77	83	86	90	93	230	288	352	25%	22%	21%	21%	25%	22%
Tot Revenue	1,366	1,424	1,460	1,508	1,540	1,595	1,625	1,669	5,039	5,759	6,430	13%	12%	11%	11%	14%	12%
PF Cable Exp	(887)	(892)	(917)	(947)	(973)	(979)	(1,005)	(1,038)	(3,250)	(3,642)	(3,995)	10%	10%	10%	10%	12%	10%
Tot PF EBITDA	479	532	543	562	567	616	620	632	1,789	2,117	2,435	18%	16%	14%	12%	18%	15%
EBITDA Margin	35.1%	37.4%	37.2%	37.2%	36.8%	38.6%	38.2%	37.8%	35.5%	36.8%	37.9%						
Cable Salients:																	
Ad Rev/ Mo/ Sub	\$ 4.26	\$ 5.20	\$ 5.27	\$ 5.61	\$ 4.64	\$ 5.65	\$ 5.76	\$ 6.15	\$ 5.03	\$ 5.09	\$ 5.55	9%	9%	9%	10%	1%	9%
Res Cable / Mo/ Sub	\$ 68.79	\$ 71.64	\$ 73.43	\$ 75.46	\$ 76.45	\$ 79.64	\$ 81.44	\$ 83.16	\$ 64.01	\$ 72.33	\$ 80.16	11%	11%	11%	10%	13%	11%
Total Rev/ Mo/ Sub	\$ 72.31	\$ 75.37	\$ 77.34	\$ 79.52	\$ 80.81	\$ 84.19	\$ 86.19	\$ 88.06	\$ 67.07	\$ 76.14	\$ 84.81	12%	12%	11%	11%	14%	11%
Cable EBITDA/ Mo/ Sub	\$ 25.37	\$ 28.17	\$ 28.78	\$ 29.62	\$ 29.76	\$ 32.51	\$ 32.89	\$ 33.32	\$ 23.82	\$ 27.99	\$ 32.12	17%	15%	14%	13%	18%	15%
Video ARPU	\$ 47.58	\$ 48.06	\$ 48.66	\$ 49.20	\$ 49.87	\$ 50.71	\$ 51.44	\$ 51.93	\$ 45.79	\$ 48.37	\$ 50.99	5%	6%	6%	6%	6%	5%
HSD ARPU	\$ 43.59	\$ 43.39	\$ 43.00	\$ 41.53	\$ 41.51	\$ 41.03	\$ 40.73	\$ 40.26	\$ 42.29	\$ 42.81	\$ 40.85	-5%	-5%	-5%	-3%	1%	-5%
Tele ARPU	\$ 47.41	\$ 47.84	\$ 45.64	\$ 44.56	\$ 43.44	\$ 43.65	\$ 41.83	\$ 40.83	\$ 49.07	\$ 46.26	\$ 42.36	-8%	-9%	-8%	-8%	-6%	-8%
Cable Capex	326	337	383	516	295	323	345	437	1,932	1,561	1,400	-10%	-4%	-10%	-15%	-19%	-10%
Cable Capex / Sub	52	54	61	82	46	51	55	69	\$ 309	\$ 248	\$ 222	-10%	-4%	-10%	-15%	-20%	-10%
PF Subs Basic	6,261	6,223	6,255	6,285	6,316	6,263	6,303	6,335	6,227	6,285	6,335	0.9%	0.6%	0.8%	0.8%	0.9%	0.8%
PF Subs Digital	1,868	1,937	2,058	2,141	2,218	2,279	2,374	2,452	1,791	2,141	2,452	19%	18%	15%	14%	20%	14%
PF Subs Data	1,561	1,674	1,843	1,987	2,149	2,246	2,386	2,512	1,406	1,987	2,512	38%	34%	29%	26%	41%	26%
PF Subs Phone	783	839	912	988	1,067	1,134	1,209	1,288	718	988	1,288	36%	35%	33%	30%	38%	30%
Basic Net Adds	34	(38)	32	31	31	(54)	40	32	6	58	50	-9%	42%	28%	5%	941%	-15%
Digital Net Adds	77	69	122	83	77	60	95	78	407	351	310	0%	-13%	-22%	-6%	-14%	-12%
Data Net Adds	155	112	169	145	161	98	140	126	523	581	525	4%	-13%	-17%	-13%	11%	-10%
Phone Net Adds	64	56	73	77	79	66	75	79	265	270	300	23%	18%	3%	3%	2%	11%
Digital Wkly Adds	5.9	5.3	9.4	6.4	5.9	4.6	7.3	6.0	7.8	6.7	6.0	0%	-13%	-22%	-6%	-14%	-12%
Data Wkly Adds	11.9	8.6	13.0	11.1	12.4	7.5	10.8	9.7	10.1	11.2	10.1	4%	-13%	-17%	-13%	11%	-10%
Phone Wkly Adds	4.9	4.3	5.6	5.9	6.1	5.1	5.8	6.1	5.1	5.2	5.8	23%	18%	3%	3%	2%	11%
Basic % of HP	61.6%	61.0%	61.0%	60.9%	60.9%	60.0%	59.6%	59.6%	61.6%	60.9%	59.6%						
Digital % of Basic	30%	31%	33%	34%	35%	36%	38%	39%	29%	34%	39%						
HSD % HSD-Ready	16%	17%	18%	20%	21%	22%	23%	24%	14%	20%	24%						
HSD % Basic	25%	27%	29%	32%	34%	36%	38%	40%	23%	32%	40%						
Phone % P-Ready	18%	18%	19%	20%	20%	21%	17%	16%	18%	20%	16%						

Source: ML

Cox Communications: Quarterly Estimates

	First Quarter				Second Quarter				Third Quarter				Fourth Quarter				Calendar Yr								
	2002A	2003A	%	2004A	%	2002A	2003A	%	2004A	%	2002A	2003A	%	2004E	%	2002A	2003A	%	2004E	%					
REVENUES:																									
ARPU	\$ 44.48	\$ 47.58	6.9%	\$ 49.87	4.8%	\$ 45.62	\$ 48.06	5.3%	\$ 50.71	5.5%	\$ 46.11	\$ 48.66	5.5%	\$ 51.44	5.7%	\$ 46.94	\$ 49.20	4.8%	\$ 51.93	5.6%	\$ 45.79	\$ 48.37	5.6%	\$ 50.99	5.4%
Basic Subs	6,248	6,298	0.8%	6,354	1%	6,293	6,297	0.6%	6,316	0%	6,257	6,294	0.6%	6,283	0%	6,272	6,324	0.8%	6,319	0%	6,260	6,303	0.7%	6,318	0%
Video Subscription	834	899	8%	951	6%	857	908	6%	961	6%	865	919	6%	970	6%	883	933	6%	984	5%	3,440	3,659	6.4%	3,866	5.6%
Residential Oth	18	19	7%	27	37%	18	20	15%	26	30%	16	21	33%	27	26%	21	26	26%	27	3%	72	87	20%	107	23%
Total Video	852	918	8%	977	6%	875	928	6%	987	6%	882	940	7%	997	6%	904	959	6%	1,011	5%	3,512	3,746	6.7%	3,972	6.0%
HSD ARPU	\$ 43.00	\$ 43.59	1%	\$ 41.51	-5%	\$ 42.48	\$ 43.39	2%	\$ 41.03	-5%	\$ 41.48	\$ 43.00	4%	\$ 40.73	-5%	\$ 42.35	\$ 41.53	-2%	\$ 40.26	-3%	\$ 42.29	\$ 42.81	1.2%	\$ 40.85	-4.6%
HSD Subs	942	1,485	58%	2,069	39%	1,058	1,619	53%	2,198	36%	1,194	1,759	47%	2,316	32%	1,340	1,916	43%	2,449	28%	1,134	1,695	50%	2,258	33%
Hi-Speed Data	122	194	60%	258	33%	135	211	56%	271	28%	149	227	53%	283	25%	170	239	40%	296	24%	575	871	51%	1,107	27%
Res-Tel ARPU	\$ 49.87	\$ 47.41	-4.9%	\$ 43.44	-8%	\$ 50.06	\$ 47.84	-4%	\$ 43.65	-9%	\$ 48.10	\$ 45.64	-5%	\$ 41.83	-8%	\$ 48.56	\$ 44.56	-8%	\$ 40.83	-8%	\$ 49.07	\$ 46.26	-6%	\$ 42.36	-8%
Res-Tel Subs	485	750	55%	1,028	37%	547	811	48%	1,101	36%	615	875	42%	1,171	34%	685	950	39%	1,249	31%	583	847	45%	1,137	34%
Telephony	73	107	47%	134	26%	82	116	42%	144	24%	89	120	35%	147	23%	100	127	27%	153	20%	343	470	37%	578	23%
Residential	1,046	1,219	17%	1,369	12%	1,092	1,255	15%	1,402	12%	1,119	1,287	15%	1,427	11%	1,174	1,325	13%	1,460	10%	4,430	5,086	15%	5,657	11%
Advertising	80	81	1%	88	10%	98	98	0%	107	9%	97	100	3%	109	9%	103	107	3%	117	9%	378	385	2%	421	9%
Commercial	52	67	27%	83	25%	55	70	29%	86	22%	59	74	24%	90	21%	64	77	21%	93	21%	230	288	25%	352	22%
Total Revenue	1,178	1,366	16%	1,540	13%	1,245	1,424	14%	1,595	12.0%	1,275	1,460	15%	1,625	11%	1,341	1,508	12%	1,669	11%	5,039	5,759	14%	6,430	12%
EXPENSES:																									
Programming	(255)	(291)	14%	(318)	9%	(256)	(287)	10%	(321)	12%	(251)	(293)	14%	(323)	10%	(274)	(288)	9%	(314)	9%	(1,037)	(1,159)	12%	(1,275)	10%
Oth Cost of Sales	(243)	(289)	19%	(318)	10%	(268)	(303)	17%	(324)	7%	(289)	(324)	16%	(353)	9%	(276)	(316)	9%	(351)	11%	(1,076)	(1,233)	15%	(1,345)	9%
SG&A	(279)	(307)	10%	(337)	10%	(279)	(302)	8%	(335)	11%	(281)	(299)	7%	(329)	10%	(299)	(343)	15%	(373)	9%	(1,137)	(1,251)	10%	(1,375)	10%
PF Expenses	(776)	(887)	14%	(973)	10%	(803)	(892)	11%	(979)	10%	(822)	(917)	12%	(1,005)	10%	(849)	(947)	11%	(1,038)	10%	(3,250)	(3,642)	12%	(3,995)	10%
Other	(10)	-	-	-	-	-	0	-	-	-	-	-	-	-	-	-	(0)	-	-	-	(10)	-	-	-	-
Total Expenses	(786)	(887)		(973)		(803)	(892)		(979)		(822)	(917)		(1,005)		(849)	(947)		(1,038)		(3,259)	(3,642)		(3,995)	
EBITDA:																									
PF EBITDA:	402	479	19%	567	18%	442	532	20%	616	16%	453	543	20%	620	14%	492	562	14%	632	12%	1,789	2,117	18%	2,435	15.0%
Margin	34.1%	35.1%		36.8%		35.5%	37.4%		38.6%		35.6%	37.2%		38.2%		36.7%	37.2%		37.8%		35.5%	36.8%		37.9%	
Reported EBITDA	392	479		567		442	532		616		453	543		620		492	562		632		1,779	2,117		2,435	
Margin	33.3%	35.1%		36.8%		35.5%	37.4%		38.6%		35.6%	37.2%		38.2%		36.7%	37.2%		37.8%		35.3%	36.8%		37.9%	
SUMMARY:																									
Res Rev/ Mo/ Sub	55.80	64.53	16%	71.81	11%	58.11	66.44	14%	73.99	11%	59.81	68.16	14%	75.68	11%	62.38	69.85	12%	77.01	10%	58.98	67.25	14%	74.82	11%
Ad Rev/ Mo/ Sub	4.24	4.26	0%	4.64	9%	5.22	5.20	0%	5.65	9%	5.17	5.27	2%	5.76	9%	5.50	5.61	2%	6.15	10%	5.03	5.09	1%	5.55	9%
Non-Comm Rev/Mo	60.05	68.79	15%	76.45	11%	63.33	71.64	13%	79.64	11%	64.77	73.43	13%	81.44	11%	67.88	75.46	11%	83.16	10%	64.01	72.33	13%	80.16	11%
Total Rev/ Mo/ Sub	62.85	72.31	15%	80.81	12%	66.25	75.37	14%	84.19	12%	67.93	77.34	14%	86.19	11%	71.26	79.52	12%	88.06	11%	67.07	76.14	14%	84.81	11%
PF EBITDA/ Mo/ S	21.44	25.37	18%	29.76	17%	23.52	28.17	20%	32.51	15%	24.16	28.78	19%	32.89	14%	26.14	29.62	13%	33.32	13%	23.82	27.99	18%	32.12	15%

Source: ML

Cox Communications: PF Subscriber Model

	2003					2004				
	1QPF	2QPF	3QPF	4QPF	CY	1QPF	2QPF	3QPF	4QPF	CY
Cable Homes Passed	10,163	10,206	10,258	10,321		10,376	10,442	10,570	10,625	
Net Additions	58	43	52	63	216	55	65	128	55	304
% Chg YOY	1.4%	1.3%	1.1%	2.1%	2.1%	2.1%	2.3%	3.0%	2.9%	2.9%
PF Basic Cable Subs	6,261	6,223	6,255	6,285		6,316	6,263	6,303	6,335	
Average Basic Subs	6,244	6,242	6,239	6,270	6,249	6,301	6,290	6,283	6,319	6,298
Net Additions	34	(38)	32	31	58	31	(54)	40	32	50
% Chg YOY	-0.2%	-0.4%	-0.1%	0.9%	0.9%	0.9%	0.6%	0.8%	0.8%	0.8%
Basic Penetration	61.6%	61.0%	61.0%	60.9%		60.9%	60.0%	59.6%	59.6%	
PF Digital Cable Subs	1,868	1,937	2,058	2,141		2,218	2,279	2,374	2,452	
Average Digital Subs	1,829	1,902	1,998	2,100	1,957	2,180	2,248	2,326	2,413	2,292
Net Additions	77	69	122	83	351	77	60	95	78	310
Weekly Add Rate	5.9	5.3	9.4	6.4	6.7	5.9	4.6	7.3	6.0	6.0
% Chg YOY	21.3%	18%	20%	20%	20%	18.8%	18%	15%	14%	14%
Penetration Basic Subs	29.8%	31.1%	32.9%	34.1%		35.1%	36.4%	37.7%	38.7%	
Digital-ready Homes	9,866	9,983	10,092	10,170		10,239	10,381	10,410	10,466	
% Digital HP/ Total HP	97.1%	97.8%	98.4%	98.5%		98.7%	99.4%	98.5%	98.5%	
PF Hi-Speed Data Subs	1,561	1,674	1,843	1,987		2,149	2,246	2,386	2,512	
Average HSD Subs	1,484	1,618	1,758	1,915	1,694	2,068	2,197	2,316	2,449	2,258
Net Additions	155	112	169	145	581	161	98	140	126	525
Weekly Add Rate	11.9	8.6	13.0	11.1	11.2	12.4	7.5	10.8	9.7	10.1
% Chg YOY	55.9%	50%	45%	41%	41%	37.6%	34%	29%	26%	26%
Penetrate HSD-ready HP	15.8%	16.8%	18.3%	19.5%		21.0%	21.7%	23.1%	24.2%	
Penetrate Basic Subs	24.9%	26.9%	29.5%	31.6%		34.0%	35.9%	37.9%	39.7%	
HSD-ready HP	9,866	9,962	10,085	10,175		10,242	10,343	10,337	10,391	
HSD-ready HP / Total HP	97.1%	97.6%	98.3%	98.6%		98.7%	99.1%	97.8%	97.8%	
Telephony Subs	783	839	912	988		1,067	1,134	1,209	1,288	
Average Phone Subs	750	811	875	950	847	1,028	1,101	1,171	1,249	1,137
Net Additions	64	56	73	77	270	79	66	75	79	300
Weekly Add Rate	4.9	4.3	5.6	5.9	5.2	6.1	5.1	5.8	6.1	5.8
% Chg YOY	51.6%	45%	40%	38%	38%	36.4%	35%	33%	30%	30%
Penetrate T-ready Subs	18.5%	18.4%	19.3%	19.6%		20.3%	20.8%	17.3%	16.1%	
Penetrate Basic Subs	12.5%	13.5%	14.6%	15.7%		16.9%	18.1%	19.2%	20.3%	
Tele-ready HP	4,230	4,569	4,712	5,031		5,267	5,462	7,000	8,000	
Tele-ready HP / Total HP	41.6%	44.8%	45.9%	48.7%		50.8%	52.3%	66.2%	75.3%	
Rev-Generating Units	10,472	10,672	11,068	11,402		11,750	11,921	12,272	12,587	
Average RGUs	10,308	10,572	10,870	11,235	10,746	11,576	11,836	12,096	12,429	11,984
Net Additions	330	200	395	335	1,260	348	170	351	315	1,184
% Chg YOY	12%	11%	12%	12%	12%	12%	12%	11%	10%	10%
RGUs per Home Passed	1.03	1.05	1.08	1.10		1.13	1.14	1.16	1.18	
RGUs per Basic Sub	1.67	1.71	1.77	1.81		1.86	1.90	1.95	1.99	
New Service RGUs	4,212	4,449	4,813	5,117	4,648	5,434	5,658	5,969	6,252	5,828
Net Additions	296	238	364	304	1,201	317	224	310	283	1,134
Bundled Subs (2+)	1,802	1,917	2,092	2,252		2,406	2,473	2,600	2,765	
Sequential additions	152	115	175	160	602	153	68	127	165	513
% Chg YOY	48%	43%	39%	36%	36%	33%	29%	24%	23%	23%
Penetration basic subs	28.8%	30.8%	33.5%	35.8%		38.1%	39.5%	41.3%	43.6%	

Source: Merrill Lynch estimates.

Cox Communications: Quarterly Income Statement

	First Quarter				Second Quarter				Third Quarter				Fourth Quarter				Calendar Yr								
	2002A	2003A	%	2004A	%	2002A	2003A	%	2004A	%	2002A	2003A	%	2004E	%	2002A	2003A	%	2004E	%	2002R	2003A	%	2004E	%
REVENUES:																									
Video	834	899	8%	951	6%	857	908	6%	961	6%	865	919	6%	970	6%	883	933	6%	984	5%	3,440	3,659	6%	3,866	6%
Data	122	194	60%	258	33%	135	211	56%	271	28%	149	227	53%	283	25%	170	239	40%	296	24%	575	871	51%	1,107	27%
Telephony	73	107	47%	134	26%	82	116	42%	144	24%	89	120	35%	147	23%	100	127	27%	153	20%	343	470	37%	578	23%
Other	18	19	7%	27	37%	18	20	15%	26	30%	16	21	33%	27	26%	21	26	26%	27	3%	72	87	20%	107	23%
Residential Rev	1,046	1,219	17%	1,369	12%	1,092	1,255	15%	1,402	12%	1,119	1,287	15%	1,427	11%	1,174	1,325	13%	1,460	10%	4,430	5,086	15%	5,657	11%
Advertising	80	81	1%	88	10%	98	98	0%	107	9%	97	100	3%	109	9%	103	107	3%	117	9%	378	385	2%	421	9%
Commercial	52	67	27%	83	25%	55	70	29%	86	22%	59	74	24%	90	21%	64	77	21%	93	21%	230	288	25%	352	22%
Total	1,178	1,366	16%	1,540	13%	1,245	1,424	14%	1,595	12%	1,275	1,460	15%	1,625	11%	1,341	1,508	12%	1,669	11%	5,039	5,759	14%	6,430	12%
OPER INCOME:																									
PF Expenses	(776)	(887)	14%	(973)	10%	(803)	(892)	11%	(979)	10%	(822)	(917)	12%	(1,005)	10%	(849)	(947)	11%	(1,038)	10%	(3,250)	(3,642)	12%	(3,995)	10%
PF EBITDA	402	479	19%	567	18%	442	532	20%	616	16%	453	543	20%	620	14%	492	562	14%	632	12%	1,789	2,117	18%	2,435	15%
Other Expenses	(10)	-	-	-	-	-	0	-	-	-	-	-	-	-	-	-	(0)	-	-	-	(10)	-	-	-	-
Depr & Amort	(326)	(384)	18%	(392)	2%	(338)	(364)	8%	(397)	9%	(343)	(382)	11%	(405)	6%	(351)	(400)	14%	(411)	3%	(1,358)	(1,530)	13%	(1,605)	5%
OPER INCOME	66	95	44%	175	84%	104	168	61%	219	30%	110	161	46%	215	33%	141	162	15%	221	37%	421	586	39%	830	42%
Interest Exp	(128)	(130)		(97)		(128)	(130)		(96)		(142)	(117)		(93)		(153)	(91)		(90)		(551)	(468)		(375)	
G / (L) on Derivatives	720	(3)		(0)		48	(24)		(0)		103	4		-		255	(0)		-		1,126	(23)		(0)	
G / (L) on investments	(412)	(4)		26		(814)	120		1		(158)	41		-		34	9		-		(1,349)	165		29	
G / (L) on Asset Sales	-	-		-		(4)	0.5		(12)		-	-		-		-	-		-		(4)	0.5		(12)	
Other	1	(0.3)		(2)		0	(1)		(0)		(0)	(444)		-		(6)	(22)		-		(5)	(467)		(2)	
Pre-Tax Income	248	(41)		105		(794)	133		112		(87)	(354)		122		271	57.72		131		(362)	(205)		470	
Income (Taxes)/Benefit	(100)	14		(46)		289	(13)		(50)		26	140		(52)		(90)	(68)		(56)		125	73		(204)	
o Tax rate	40%	35%		44%		36%	10%		44%		30%	40%		43%		33%	1.18		43%		35%	36%		44%	
Minority Interest	(12)	(2)		(1)		(12)	(2)		0		(13)	(1)		-		(1)	(1)		0		(37)	(6)		(1)	
NI - Continuing	136	(29)		58		(516)	118		63		(73)	(215)		70		180	(11.47)		75		(274)	(138)		265	
Extra Items/Discon Ops	-	-		-		-	-		-		-	-		-		-	-		-		-	-		-	
NET INCOME	136	(29)		58		(516)	118		63		(73)	(215)		70		180	(11)		75		(274)	(138)		265	
Per sh amts:																									
EBITDA	\$ 0.64	\$ 0.76		\$ 0.90		\$ 0.70	\$ 0.84		\$ 0.99		\$ 0.72	\$ 0.86		\$ 0.97		\$ 0.78	\$ 0.89		\$ 0.99		\$ 2.84	\$ 3.34		\$ 3.85	
Basic EPS	0.23	(0.05)		0.09		(0.86)	0.19		0.10		(0.12)	(0.35)		0.11		0.29	(0.02)		0.12		(0.45)	(0.22)		0.42	
Diluted EPS	0.22	(0.05)		0.09		(0.86)	0.19		0.10		(0.12)	(0.35)		0.11		0.28	(0.02)		0.12		(0.45)	(0.22)		0.42	
FCF - Cash Tax	\$ (0.24)	\$ 0.09		\$ 0.21		\$ (0.23)	\$ 0.15		\$ 0.24		\$ (0.09)	\$ 0.24		\$ 0.20		\$ (0.03)	\$ (0.09)		\$ 0.08		\$ (0.59)	\$ 0.40		\$ 0.99	
Basic avg shs	601	620		621		602	620		622		621	620		632		621	620		632		611	620		627	
Diluted avg shs	626	633		633		630	633		623		633	635		637		633	634		637		631	634		632	

Source: ML

Cox Communications: Quarterly Free Cash Flow & Capitalization Model

	First Quarter			Second Quarter			Third Quarter			Fourth Quarter			Calendar Yr			
	2002A	2003A	2004A	2002A	2003A	2004A	2002A	2003A	2004E	2002A	2003A	2004E	2002R	2003A	2004E	
Net Cash Flow:																
Reported EBITDA	392	479	22% 567	18% 442	532	20% 616	16% 453	543	20% 620	14% 492	562	14% 632	12% 1,779	19% 2,117	2,435	15%
Interest Exp, Accrued	(128)	(130)	(97)	(128)	(130)	(96)	(142)	(117)	(93)	(153)	(91)	(90)	(551)	(468)	(375)	
Taxes, Accrued	(100)	14	(46)	289	(13)	(50)	26	140	(52)	(90)	(68)	(56)	125	73	(204)	
CapEx	(515)	(326)	-37% (295)	-10% (498)	(337)	-32% (323)	-4% (418)	(383)	-8% (345)	-10% (501)	(516)	3% (437)	-15% (1,932)	(1,561)	(1,400)	-10%
FCF - Book tax	(351)	38	nm 130	238% 104	51	-51% 147	189% (80)	185	nm 130	-30% (252)	(113)	nm 49	nm (579)	nm 161	nm 456	183%
FCF/sh - Book Tax	\$ (0.58)	\$ 0.06	\$ 0.21	\$ 0.17	0	\$ 0.24	\$ (0.13)	\$ 0.29	\$ 0.20	\$ (0.41)	\$ (0.18)	\$ 0.08	\$ (0.95)	\$ 0.25	\$ 0.72	
Deferred Taxes	197	(17)	26	(288)	15	45	2	(70)	52	165	69	66	76	(3)	189	
Non-Cash Int Exp	8	36	28	42	31	(24)	24	37	(15)	67	(10)	(9)	141	94	(20)	
FCF - Cash tax	(146)	58	nm 183	218% (141)	97	nm 168	74% (55)	152	nm 167	10% (20)	(55)	nm 106	nm (362)	nm 251	nm 625	149%
FCF/sh - Cash Tax	\$ (0.24)	\$ 0.09	\$ 0.29	\$ (0.23)	\$ 0.15	\$ 0.27	\$ (0.09)	\$ 0.24	\$ 0.26	\$ (0.03)	\$ (0.09)	\$ 0.17	\$ (0.59)	\$ 0.40	\$ 0.99	
Chg Working Capital	52	(28)	(99)	(28)	29	(13)	73	16	15	105	38	47	239	55	(50)	
Free Cash Flow	(95)	30	nm 84	179% (169)	126	nm 156	24% 18	168	818% 182	9% 86	(17)	nm 153	nm (122)	nm 307	nm 575	88%
Other (Acq/Disp, etc)	59	82		38	20		(225)	-		(19)	(165)		(147)	(63)		
Net FCF	89	166		163	176		(58)	182		(36)	(12)		159	512		
Chg in Debt	(197)	(169)		(136)	(182)		(21)	(182)		50	12		(304)	(520)		
Chg in Cash	108	3		(28)	6		78	-		(14)	-		145	8		
Chg Financing	(89)	(166)		(163)	(176)		58	(182)		36	12		(159)	(512)		
Capitalization:																
Revolver/Commercial Paper	98	148		109	37		-	234	(145)	-	302	(133)	-	302	(133)	
Med-term Notes	391	436		391	438		470	391	438	391	364	438	391	364	438	
Notes/Debentures	5,050	6,077		5,664	6,023		5,757	6,171	6,023	5,352	6,079	6,023	5,352	6,079	6,023	
Exchg Sub Debentures	1,309	27		527	19		1,573	40	19	1,296	26	19	1,296	26	19	
Zero Coup Debt	47	-		78	-		(4)	0	-	41	0	-	41	0	-	
Cap Leases/Other	223	156		213	145		171	126	145	235	240	145	235	240	145	
Total Debt	6931	7,119	6,843	6,984	6,983	6,662	7,967	6,962	6,480	7,316	7,012	6,492	7,316	7,012	6,492	
Cash	135	121	81	194	148	75	607	70	75	229	84	75	229	84	75	
Net Debt	6,796	6,998	6,762	6,790	6,834	6,586	7,360	6,892	6,404	7,087	6,928	6,416	7,087	6,928	6,416	
Net Debt / Rep EBITDA	4.3x	3.6x	3.0x	4.1x	3.4x	2.8x	4.3x	3.3x	2.7x	4.0x	3.3x	2.6x	4.0x	3.3x	2.6x	

Source: ML

Cox Communications: Valuation

29-Jul-04

	EBITDA			Mult (x)	Asset Value			Asset Value per Share		
	2004E	2005E	2006E		2004E	2005E	2006E	2004E	2005E	2006E
Core Cable	2,403	2,645	2,875	14.0 x	33,520	36,903	40,110	52.65	57.96	63.00
Commercial - Cox FiberNet	150	191	230	13.5 x	2,020	2,573	3,101	3.17	4.04	4.87
Corporate & Other	(118)	(121)	(125)	6.0 x	(710)	(731)	(756)	(1.12)	(1.15)	(1.19)
OPERATING ASSETS	2,435	2,715	2,980	14.3 x	34,830	38,745	42,456	\$ 54.70	\$ 60.85	\$ 66.68
Equity Investments										
Discovery US Networks	185	205	242	13.8 x	2,540	2,819	3,329	3.99	4.43	5.23
Discovery Int Networks	26	35	45	12.0 x	311	418	538	0.49	0.66	0.84
Discovery Dev Nets	(46)	(31)	(26)	Various	180	225	265	0.28	0.35	0.42
Discovery Retail/Other	(10)	(10)	(10)		45	45	45	0.07	0.07	0.07
Discovery Debt					(588)	(588)	(588)	(0.92)	(0.92)	(0.92)
Attributable (25%)	155	199	251		2,487	2,918	3,588	3.91	4.58	5.64
Public Investments										
Sprint shares	\$ 19.02	-	-		-	-	-	-	-	-
Other					25	25	25	0.04	0.04	0.04
INVESTMENT ASSETS					2,512	2,943	3,613	\$ 3.95	\$ 4.62	\$ 5.67
TOTAL ASSET VALUE					37,342	41,688	46,069	\$ 58.65	\$ 65.47	\$ 72.35
Less: Net Debt					6,416	5,451	4,178	10.08	8.56	6.56
Less: Minority Interests					-	-	-	-	-	-
TARGET EQUITY VALUE					30,926	36,237	41,891	\$ 48.57	\$ 56.91	\$ 65.79
VALUE PER SHARE					\$ 49.00	\$ 57.00	\$ 66.00			
Appreciation					75%	103%	135%			

TRADING MULTIPLES

	Price	Shares	Equity	Asset Value			Asset Value per Share		
				2004E	2005E	2006E	2004E	2005E	2006E
COX Class A	\$ 28.08	605	16,980						
COX Class C (unlisted)	\$ 28.08	28	775						
Convertible Preferred	\$ 28.08	-	0						
Options (T-accting)	\$ 28.08	4	124						
Equity Value	\$ 28.08	637	17,879	17,879	17,879	17,879	28.08	28.08	28.08
Plus: Net Debt				6,416	5,451	4,178	10.08	8.56	6.56
Less: Other Assets				2,512	2,943	3,613	3.95	4.62	5.67
Plus: Minority Interests				-	-	-	-	-	-
Total Enterprise Value				21,783	20,387	18,444	34.21	32.02	28.97
Commercial - Cox FiberNet				2,020	2,573	3,101	3.17	4.04	4.87
Cable Enterprise Value				19,763	17,814	15,343	31.04	27.98	24.10
Cable EBITDA				2,435	2,715	2,980	\$ 3.82	\$ 4.26	\$ 4.68
Total EV: Total EBITDA				8.9 x	7.5 x	6.2 x			
Cable ex Comm. EBITDA				2,285	2,524	2,750	\$ 3.59	\$ 3.96	\$ 4.32
Cable EV: Cable EBITDA				8.6 x	7.1 x	5.6 x			
Basic Cable Subs				6,335	6,386	6,441			
Core Cable EV: Basic Sub				\$ 3,120	\$ 2,789	\$ 2,382			
Free Cash Flow/Share				\$ 0.99	\$ 1.52	\$ 2.00			
Price/FCF				28.4 x	18.5 x	14.0 x			

Source: Merrill Lynch estimates.

Small business, big money, no guarantees

by Jim Barthold

Telephony, Aug 12, 2002

Hindsight is a powerful facility. It makes it easy to see that CLECs were doomed from the beginning, despite demand for reasonably priced high-speed data connectivity in the small- and medium-sized business (SMB) market. Also clear with 20/20 precision is that the Bell companies, content at having squashed the CLECs and glutted on large business customers, haven't been rushing to service that market.

Looking forward, though, things get blurry. Who will step in and serve the still-eager market? Suitors are plentiful on paper, but those with concrete business plans backed by money can be counted on one hand.

Cable operators have all the tools to move aggressively into the SMB space. Most have separate units to connect existing cable infrastructure to commercial customers. The cable industry, however, has always been more focused on wringing the last nickel from its ESPN addicts than in driving a viable commercial business plan. Many cable operators that privately boast of their commercial strengths to analysts and vendors are loath to talk about them publicly, lending even more suspicion to the strength of the industry and its dedication to the commercial market.

Comcast Business Solutions, the company's commercial unit, boasted about its prospects in this magazine 18 months ago. More recently, however, a company spokeswoman said things haven't changed but that no one wanted to discuss the current state of business — or where it might be going.

“Comcast has not been the most successful of the operators,” said an industry source. “They began this business anew last year [with a new management structure] and took an approach that was different than other operators' approaches. That's been a little bit problematic for them.”

Likewise, a spokesman for Charter Communications, which vendors say is moving into the commercial business space, said it was “too early” to talk about how things are progressing. And AT&T Broadband, mired in the details of being acquired by Comcast, never returned calls requesting interview for this story.

Are these big players representative of cable's on-again, off-again fascination with the SMB market, or are they throwing up a smoke screen built from natural reluctance to talk about business and a general lack of media savvy?

There is an argument to be made that, in spite of the market opportunity, cable might snatch defeat from the jaws of victory because cable has not traditionally addressed this commercial market,” said William Markey, a general partner with RelevantC, a company that provides market development services.

Markey's skepticism is understandable — cable has historically stutter-stepped into anything that deviated from video. Commercial data services, despite a lucrative opportunity, could be another tango that eventually leaves customers stranded on the dance floor.

But that won't happen, said Kevin Curran, senior vice president of marketing and sales for Cablevision Systems' long-running Lightpath commercial venture. Curran dismissed the notion that cable can't — or won't — succeed in a business that has less to do with moving pictures and more to do with moving data.

“There's a tremendous story here,” Curran said. “We can't keep up with demand.”

Dependability, said Markey, is the key. People still need high-speed data service; the previous generation of providers is going or gone, and the ILECs are blasé about offering it. But many SMBs, burned by the previous generation of suppliers, are wary.

“Cable should not take the market for granted,” Markey said. “They have to focus very closely on stimulating the demand side of the equation, but we certainly do feel positive that they have the supply part figured out.”

The supply part is fueling business for successful operations like Cox Business Services. Cox takes a four-pronged market approach, said Constantine Dantoulis, product marketing director for Cox Business Services. It serves small businesses off its HFC plant, the medium-sized business space with fiber or coax, and large customers with Sonet or ATM over large fiber rings. The fourth is the carrier market, to which it offers either switched or dedicated access.

Cablevision is moving in that direction, Curran said, with a planned third quarter release of “static IP” that will guarantee bit rates and quality of service. “We’re dramatically enriching the product,” he said, noting that the SMB market is a new target for Cablevision, which is building upon its residential service.

The operator’s Business Class Optimum Online, or BCOOL, costs \$69.95 per month for customers that take video and \$99.95 for those without a video connection. However, the inexpensive service and its video link don’t mean that BCOOL is an extended residential offering — not when the target audience is based in Cablevision’s New York metropolitan area service base of New York City, North/Central New Jersey, Long Island, Westchester County and Connecticut.

Rather than just concentrating on customers that are easy to connect to the existing network, the business sector opportunity has “actually helped us build the network into the business areas and business parks,” Curran said.

Even though the CLECs may be gasping for air, cornering the business market is still “not necessarily a walk in the park,” said Cox’s Dantoulis.

“There is competition,” he said. “[The CLECs] are dying, but we shouldn’t forget bankruptcy doesn’t mean that they’re out of business.” Besides, he said, a little competition keeps the regulators happy, and the opportunity is so large that it’s worth the effort.

Ken Fitzpatrick, senior vice president of Time Warner Cable’s Commercial Services, said his company views the SMB market as a high-growth opportunity. “DSL standalone companies like Rhythms and NorthPoint went by the wayside, and the ILECs haven’t been deploying their DSL to the magnitude that at one time analysts thought,” he said.

Throw in a “very secure, very viable option in high-speed data via cable” and “you have a great opportunity to drive the penetration,” Fitzpatrick said.

One new idea is the use of wireless technology — perhaps Wi-Fi — to fill gaps in the HFC plant (see sidebar). Doug McKinnon, president and CEO of USURF America, is partnering with companies — including DSL providers — that need help filling gaps in their networks. USURF starts with Wi-Fi but can use licensed fixed wireless spectrum, McKinnon said.

“We go out and look for customers first before we build the network, then we design a network to fit the needs,” he said.

Wi-Fi intrigued Proxim enough that it acquired the ORiNOCO Wi-Fi product line from Agere, said David King, Proxim’s president and chief operating officer. “The market for Wi-Fi is expanding beyond the enterprise LAN,” he said.

Cable has the perfect infrastructure for deploying Wi-Fi, King said. “They have this beautiful backbone that covers the residential environment. License-free radio is the cheapest way to provide high-bandwidth connectivity access to existing hybrid fiber/coax plant.”

But the technology isn’t always used as a long-term solution.

“We have deployed some 802.11b short-range wireless solutions,” said Rich Mazurek, senior data product manager for Cox Business Services. “We used this when we were doing fiber builds and had an excessively long construction period.”

A wireless connection, he said, can go up in a matter of days, feed the last-mile needs, then be brought down and taken elsewhere when the construction is completed. Long-term, though, wireless isn’t up to snuff with fiber or coax.

At least in part, however, there’s no rush to wireless because wireline business is booming.

“Is the cable business in the commercial space real? The answer is absolutely,” said Mike Smith, managing director at Stratecast. “If you're a cable MSO and have plants passing many of those customers, clearly that's a legitimate opportunity.”

Wi-Fi HAS ITS LIMITS

For the time being, Wi-Fi is boxed in, limited by a number of factors that keep it from spreading outside buildings into a last-mile or last-100-meters space. Some vendors are touting Wi-Fi's potential to move beyond buildings or campus environments because it is cheap, easy to install and easy to use. The drawbacks, though, easily outweigh those positives.

“The biggest issues, as they relate to last-mile, are security and traffic management,” said Joe Ladiri, BellSouth's data product management director.

Those are big considerations that don't even touch the biggest drawback of all: bandwidth. Ladiri cautions that Wi-Fi is not an access cure-all because it generates only 5 to 6 Mb/s of bandwidth. “There's probably not a whole lot of rationale for us to use it to eliminate last-mile physical facilities,” Ladiri said.

Still, that's where vendors see the technology going, although not necessarily with the incumbents. “There are a lot of ISPs trying to reform themselves to find a way to bypass the phone company,” said David King, president and COO of vendor Proxim.

For BellSouth, the last-mile is in the distant future — if it's in the picture at all — although there are instances where it can come into play today.

“We have a customer in Memphis that has a facility across the Mississippi River and is actually using [802.11b] wireless to connect,” Ladiri said. “In a situation like that, it probably makes a lot of sense to do inter-building communications that way.”

Tony Pierson, marketing vice president for optical technology vendor Jedai Broadband Networks, said that his company was tempted by Wi-Fi's possibilities.

“It's so inexpensive [and] the receivers are so cheap, [but] I'm afraid it's such a small capacity,” he said, adding that Wi-Fi doesn't have security.

Security was top of mind for BellSouth when it set up a wireless LAN for St. Vincent's Hospital in Birmingham, Ala. This, Ladiri said, was a “natural application because doctors move around, patients move around. The workstation becomes the patient's bed and, for lack of a better term, that end user changes on a regular basis.”

That kind of application is indicative of where Wi-Fi will come into play, Ladiri said.

“When I'm ready to upgrade my cabling or I'm ready to replace it, then it makes a lot of sense to go wireless,” he said. “You'll continue to see wireless catch on, but the curve won't be quite as steep as what was first forecast.”— Jim Barthold

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SEPTEMBER 2004

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Cable Operators Show They Really Mean Business

MSOs Step Up Pursuit of Commercial Sector with Data, Voice and Video Products

SEPTEMBER 01, 2004

By Alan Breznick, Editor, *Cable Datacom News*

Seeing the potential for a big score, large cable operators are beefing up their efforts to land more business customers of all shapes and sizes. Several major MSOs are increasing the size of their commercial sales units, sharpening their technological tools and pumping up their promotional efforts to capture more of the huge commercial market for telecommunications services, estimated to be more than \$120 billion in size.

In particular, Time Warner Cable, Cox Communications, Charter Communications, Cablevision Systems and Adelphia Communications are looking to make their mark in the business space. With high-speed data, digital video and now voice-over-Internet-Protocol (VoIP) service in their product portfolio, they're hankering to steal market share away from the phone companies as well as expand the overall commercial market.

"We're continuing to drive this business," said Ken Fitzpatrick, senior vice president of Time Warner Cable Commercial Services. "It's been a huge driver from the revenue standpoint."

Indeed, Time Warner officials say they enjoyed a \$60 million gain in business sector revenue last year, boosting their overall commercial take by 70%. The MSO now boasts more than 140,000 commercial accounts for its Road Runner Business Class line of services.

Overall, industry officials estimate that cable's fledgling commercial sector efforts may quietly bring in more than \$1 billion this year for the first time.

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Cox alone aims to boost commercial revenue by more than 20% this year, a jump of more than \$50 million. One of the two cable leaders in business services along with Time Warner, Cox generated \$287 million in commercial sales last year, a healthy 25% increase over 2002's total.

"Everybody has focus on this," said Kristine Faulkner, vice president of product development and management for Cox Business Services. "Some are choosing to walk and others are choosing to run. Cox is running."

Cox has good reason to run. MSO officials estimate that the commercial sector in their territories represents an \$8 billion to \$10 billion opportunity. Narrowing it down to firms within 100 feet of Cox's cable plant, they see a \$3 billion market.

Of course, cable operators face steep hurdles in expanding their commercial business. For one thing, companies tend to be far more demanding and discriminating than consumers. While paying much more for business-class broadband services, they expect much more too.

For another, the Bells are definitely fighting back. BellSouth, SBC Communications and Verizon Communications have all crafted their own business-oriented bundles of local, long-distance and DSL services to draw and retain small and medium-sized firms.

Nevertheless, sensing the possibilities beyond their traditional residential market, cable operators are rolling out new offerings for small, medium-sized and even large companies. In the latest example late last month, Cox's business services division turned up the speed for all of its broadband data packages geared towards commercial clients.

Cox Business Services, which offers six levels of high-speed data service to commercial subscribers, generally raised its top speeds as high as 6 Megabits per second (Mbps) downstream and 1.5 Mbps upstream without raising prices. The MSO's business unit also launched a fresh marketing campaign to attract new customers and entice existing customers to rev up their speeds.

"For the most part, the intent was to deliver more speed for our current customers," Faulkner said. "Generally they get more speed for what they were paying."

In another recent example, Time Warner introduced two broadband networking solutions for businesses in May. Designed specifically for large commercial customers with 1,000 employees or more, the two new offerings -- dedicated access and teleworker/branch office connectivity -- offer fiber and broadband communications tools for linking remote workers and branch offices "seamlessly" to their main facilities.

"We're seeing a lot of success in the enterprise space with dedicated access and telecommuting bundling," Fitzpatrick said. "It's been received very well and we're aggressively marketing it."

Thanks to such efforts, Time Warner now has about 500 large enterprise firms among its 140,000 commercial customers. Even though cable operators have generally focused more on smaller firms that can be served with cable modem connections, executives at Time Warner, Cox and other big MSOs say they are actively recruiting more large companies with fiber-based services.

"We've got quite a bit of opportunity in the enterprise space," Fitzpatrick said. "There are thousands of opportunities."

In most cases, cable operators are focusing on the industries that are strong in their regions. For instance, Time Warner is devoting plenty of attention to the financial sector in New York City. The MSO is also concentrating on the medical and retail industries and began courting the hospitality business last fall.

In addition, Time Warner is pursuing the education sector. In both the Raleigh, N.C. and Kansas City metro areas, for example, it has linked grade schools with all-fiber connections, generating more than \$4 million in revenue in Kansas City alone.

"We're well positioned" to serve schools, Fitzpatrick said. "School systems tend to be in residential areas."

Similarly, in Las Vegas, Cox is placing its bets on the casino and hotel industries. At the CTAM Commercial Services Seminar in May, Cox executives outlined their successful efforts to wire more than 120 casino hotels for data, cable TV and video-on-demand (VOD) services.

"We have a very strong presence in the Vegas market," Faulkner said. "That's a great market for us."

Besides the hospitality business, Cox is focusing on the education, government and health care sectors. "Those typically are regional businesses, rather than businesses spread across many cities around the nation," Faulkner noted.

Time Warner, Cox and the other MSOs have largely succeeded in the commercial sector by catering to firms' high-speed data needs, often by beating the phone companies to the punch. But now cable operators are seeking to grab more commercial business by expanding into other product lines, such as VoIP service.

At Time Warner, for example, officials are itching to offer VoIP service to commercial customers. The MSO, which is ambitiously deploying residential VoIP service in all of its markets this year, sees commercial IP telephony as a huge growth opportunity.

"We're putting together our business plans for offering commercial voice," Fitzpatrick said. Time Warner's tentative plans call for staging a trial in one market this fall and then rolling out the service nationwide next year.

Cable operators also see wireless service as a promising commercial product. At Cox, for example, executives are now studying how they can use wireless links to reach businesses without costly plant extensions.

"There's a lot of focus on the wireless space," Faulkner said. She sees particular potential in companies with multiple locations in one market, including facilities not reached by the MSO's cable plant.

NEXT STORY