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U.S. Media / Cable & Satellite Broadcasting / Telecom

Broadband Update: Dial-Up Giveth, Broadband Taketh; Change in AOL Strategy Could Accelerate Transition

			8/24/2006		YTD	EPS			P/E			
Ticker	Rating	CUR	Closing Price	Target Price	Rel. Perf.	2005A	2006E	2007E	2005A	2006E	2007E	Yield
BLS	M	USD	39.80	40.00	43.0%	2.00	2.25	2.43	19.9	17.7	16.4	2.8%
T	M	USD	30.47	33.00	20.6%	1.72	2.25	2.59	17.7	13.5	11.8	4.4%
Q	M	USD	8.65	7.00	49.3%	-0.24	0.28	0.46	NM	30.9	18.8	NA
VZ	O	USD	34.65	40.00	11.2%	2.53	2.59	2.62	13.7	13.4	13.2	4.7%
CMCSA	O	USD	34.96	40.00	31.1%	0.42	0.85	1.52	83.2	41.1	23.0	NA
CVC	M	USD	22.87	25.00	33.5%	0.33	-0.81	-0.73	69.3	NM	NM	NA
TWX	M	USD	16.43	18.00	-9.6%	0.62	0.88	0.97	26.5	18.7	16.9	2.4%
SPX			1296			76.50	85.00	89.00	16.9	15.2	14.6	1.9%

O – Outperform, M – Market-Perform, U – Underperform

Highlights

- Earlier this month, AOL announced an end of their aggressive marketing of Internet access. We believe this will have profound effects on AOL. It could also have a significant impact on the broadband market overall.
- Over the past 2 years, broadband growth has been powered by a steady stream of dial-up defections. The four largest dial-up ISPs have lost a collective 11 million subscribers, while U.S. broadband providers added 13.5 million customers.
- Not surprisingly, AOL's dial-up business has been the biggest net loser, with almost 8.5 million lost subs since the start of 2004. Over the past six quarters, AOL's dial-up losses have accounted for 46% of all broadband net additions.
- We now estimate dramatically higher AOL dial-up losses over the balance of 2006 and 2007. These declines do not come from increased churn, but rather from the end of AOL's addition of subscribers to replace the losses. If these gross additions to find their way to broadband, broadband additions could surprise in the coming 18 months. Many of these customers, however, are likely to take their business to the two other functioning ISPs – United Online or Earthlink – making the impact on broadband uncertain.
- Best case, assuming that the historical relationship of AOL losses to broadband net adds hold at 46%, we could see potential *incremental* broadband adds of 2.4 million in 2H 2006E and 1.95 million in 2007E. The biggest beneficiaries of this surprise would be the Big Four broadband providers (*i.e.,* Comcast, AT&T, Verizon, and Time Warner Cable).
- AOL's reduced marketing could accelerate the RBOCs' subscriber share gains. The "non-tenured" subscribers likely to be "released" to broadband are likely the markets' most price/promotion sensitive. To the extent that these subscribers opt for broadband rather than alternative dial-up services, we would therefore anticipate that they would to be disproportionately likely to choose DSL over cable modem offerings. For the cable MSOs, the availability of low-priced VoIP in the bundle could help mitigate this impact.

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Investment Conclusion

For the cable MSOs, faster erosion of dial-up service could further accelerate near term growth rates, triggering another round of upward revisions during the second half of 2006 and 2007. The longer-term impact can be expected to be relatively minor, however, since we believe any near term gains would likely represent little more than a "pull-forward" of longer term growth. We continue to view Comcast (CMCSA, outperform, target price $40) as the most compelling investment opportunity within the multichannel group.

Though we believe the largest TelCos will lose significant voice market share to the Cable MSOs and, to a lesser degree, independent VoIP providers, they are expected to maintain their overall stake in the broader communications (distribution) services industry subsectors through ongoing strong growth in wireless services, an improving share position in broadband services and modest share gains in the multichannel video market. Within the TelCo group, we prefer Verizon (rated outperform, with a target price of $40). We rate BellSouth, AT&T, and Qwest all market-perform.

Time Warner is rated market-perform with a price target of $18, 10% above the current price.

Details

Over the past two years, the growth in broadband Internet access has been fueled by a steady stream of dial-up subscriber defections. Over that period, the four largest dial-up ISPs have lost a collective 11 million customers while U.S. broadband providers added 13.5 million customers. Clearly, dial-up's loss is broadband's gain. Over this period, AOL's dial-up ISP business was the main contributor to the dial-up exodus with a decline of over 8 million subscribers.

Thus, it came as little surprise that AOL, earlier this month, announced a significant change in their subscriber acquisition strategy by essentially retreating from the Internet access business. AOL, in an effort to drive its online advertising revenue, now offers AOL's integrated software and e-mail for free to all broadband users. AOL's free offer reverses their recent strategy of selling bundled AOL broadband software (at a monthly cost of $10.95 per month) and 3rd party broadband access. As importantly, AOL also announced that they will no longer aggressively market their "flagship" dial-up access service.

While we believe the change in strategy will clearly alter the economics of AOL's P&L (which we have studied in previous reports – see our August 3rd report entitled *TWX: 2nd Qtr Earnings and AOL Strategy Update – No Surprises to Us*), it could also have significant implications for the broader internet access market.

At the end of 2Q:06, AOL's branded Internet service had 17.7 million total subscribers, with 11.5 million dial-up customers (reported by AOL as "$15 and over") and 6.2 million broadband customers (reported by AOL as "Under $15"). Only 31% of AOL's dial-up subscribers are estimated to lack a broadband access *option.* The rest would appear to be obvious candidates for a faster transition to broadband (see **Exhibit 1**).

From an Internet access market perspective, AOL's strategy change will, logically, have the most meaningful impact on the 11.5 million subscribers who are currently paying AOL for dial-up service. The 6.2 million broadband subscribers already have broadband access through a 3rd party provider (e.g., Comcast, Time Warner Cable, Verizon, or AT&T).

At the end of 2Q:06, AOL's dial-up service was the single largest internet access provider – dial-up or broadband – with 19% share of the market (of publicly-listed participants) and almost 60% of the dial-up market (see **Exhibit 2**).

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Exhibit 1
AOL Subscribers Composition as of 2Q:06 (in 000)

AOL Subs by Price Plan:	
$15 and Over	11,458
Under $15	6,206
Total	**17,664**
No. of Subs w/o BB Access	3,533
% of Dial-up Subs w/o BB Access	30.8%

Source: Company Reports, Bernstein Estimates

Exhibit 2
Largest U.S. Internet Providers – 2Q:06 (in 000)

Largest Internet Access Providers As Of Q2 2006

	Mkt Share	**Total Subs**
AOL Dial-Up	19.3%	11,458
Comcast	15.8%	9,344
AT&T*	11.1%	6,570
Verizon*	9.3%	5,505
Time Warner Cable	9.1%	5,398
Earthlink (Dial-Up & BB)	8.8%	5,221
Bell South*	4.4%	2,604
United Online Dial-Up	4.3%	2,556
Charter	4.0%	2,375
MSN (Dial-Up)	3.5%	2,070
Cablevision	3.2%	1,891
Adelphia	3.0%	1,808
Qwest*	2.4%	1,438
Insight	0.9%	535
Mediacom	0.9%	516
TOTAL	**100%**	**59,290**

* Broadband subs only. Excludes an estimated 2.5m collective dial-up subs for Bells.

Source: Company Reports, Bernstein Research

AOL's Loss is Broadband's Gain

AOL's top-ranked position is even more remarkable given the magnitude of its recent dial-up subscriber losses. Over the past two and a half years, AOL has lost over 8.4 million dial-up customers, or 42% of its subscriber base.

AOL's losses have been broadband's gain, with almost half of all broadband net additions coming from net AOL losses. Moreover, the correlation between AOL's losses and broadband's gains has been rising; suggesting that AOL's contribution to broadband growth is also on the rise; AOL dial-up losses sourced 20% of net broadband adds in 1Q:04, 34% of net broadband adds in 1Q:05, and 39% of net broadband adds in 1Q:06.

Notably, there appears to be a great deal of seasonality in the relationship; the correlation tends to be highest during Q2 (when the market itself expands the most slowly due to contraction in the college market), and lowest in Q4 and Q1, when overall Internet access market expands the most briskly). Over the past six quarters, the ratio of AOL losses to broadband (market) gains has averaged 46% (**Exhibit 3**).

Exhibit 3
Net Impact of AOL's Dial-Up Losses on Leading Broadband Providers – 1Q:04 to 2Q:06 (in mil.)

Broadband Adds	**1Q:04**	**2Q:04**	**3Q:04**	**4Q:04**	**1Q:05**	**2Q:05**	**3Q:05**	**4Q:05**	**1Q:06**	**2Q:06**	**Total**
Top 7 Cable	961	698	1,058	901	969	734	1,025	920	1,145	833	9,245
Top 4 RBOCS	911	728	853	654	1,039	705	1,045	1,272	1,226	916	9,348
Total Broadband Adds	1,872	1,426	1,911	1,556	2,008	1,439	2,070	2,192	2,371	1,749	18,593
AOL Dial Up Losses	(369)	(748)	(749)	(562)	(682)	(1,207)	(934)	(949)	(924)	(1,343)	(8,467)
AOL Losses / BB Adds	**-20%**	**-52%**	**-39%**	**-36%**	**-34%**	**-84%**	**-45%**	**-43%**	**-39%**	**-77%**	**-46%**
Incremental Change (in bps)					(1,424)	(3,144)	(591)	(717)	(501)	711	

Source: Company Reports, Bernstein Research

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Turning off AOL's Marketing Machine

The end of AOL's aggressive dial-up campaign will reduce AOL's subscriber base, as new gross ISP additions will no longer be added to replenish the shrinking subscriber base.

In recent months, AOL management has become more transparent about churn dynamics of the subscriber base. As we have previously written, AOL's subscriber base can be broken into two distinct pieces – tenured subscribers (66% of the total base) who have had AOL for more than two years and non-tenured customers who are less than two years old. Churn among tenured customer is 24% per annum – in-line with broadband churn – and speaks to either the stickiness of AOL's products (especially e-mail) or the simple lack of an Internet access alternative. (As noted previously, as much a 31% of AOL's dial-up customer base is not served by a broadband provider). The non-tenured base – one-third of AOL's total sub base – churns like rabbits, at a rate of 96% per year. In other words, the average non-tenured subscriber barely sticks around for one year.

AOL's strategy shift is aimed at ending this non-tenured subscriber tread-mill, and at eliminating the bundled broadband access re-selling.

As a result, we recently (in the August 3rd report) lowered our AOL subscriber estimates for the next five years. Ironically, we *increased* the out-year dial-up forecast from 0 subscribers in 2010E to 2.9 million, as we now have better data that shows a core base of customers that have no broadband alternatives (**Exhibit 4**).

In the short term, however, the lack of new subscriber marketing reduces our AOL dial-up estimate by -1.1 million in 2006E and -900K in 2007E. The bigger revision was to our AOL broadband estimate, which show massive downward revision (i.e., -2.7 million in 2006E to -10.7 million in 2010E) in out-year estimates as AOL drops this business line.

Exhibit 4

Recent Revisions to AOL Subscriber Estimates 2006E to 2010E (in mil.)

	2006E	2007E	2008E	2009E	2010E
New AOL Dial-Up Est.	8.8	5.7	4.5	3.6	2.9
Old AOL Dial-Up Est.	9.9	6.6	3.9	1.5	-
Dial-up Revision	**(1.1)**	**(0.9)**	**0.6**	**2.1**	**2.9**
New AOL Broadband Est.	4.5	2.0	1.3	0.9	0.6
Old AOL Broadband Est.	7.2	8.5	9.6	10.5	11.3
Broadband Revision	**(2.7)**	**(6.5)**	**(8.3)**	**(9.6)**	**(10.7)**
Total Revision	**(3.8)**	**(7.4)**	**(7.7)**	**(7.5)**	**(7.8)**

Source: Bernstein Estimates

Impact on the Broader Market

At this point, investors should be asking themselves what will AOL's new strategy mean for the broader internet access market. For starters, we believe the likely very steep decline in AOL broadband net-adds will not impact the overall market as AOL is only eliminating the tariff that it charges for broadband, which in itself is not a driver of new broadband additions; it is only a tax on those AOL subscribers who were willing to pay for e-mail (like Michael's wife!).

In contrast to the "broadband effect" (or lack thereof), the change in dial-up marketing should have an impact on the market as AOL retreats from new subscriber marketing. As noted above, these new clients are of lower quality given their proclivity to churn and continued interest in dial-up internet service.

Our recent estimate revision calls for a dramatic acceleration in AOL dial-up losses in the near term (i.e., the balance of 2006 and 2007), and more stability in the 2008 to 2010 period. Again, the decline in subscribers does not come from increased churn, however, but rather from the end of AOL's gross addition of lower quality subscribers. Clearly, it is possible for these lower quality gross additions to find their way to broadband, and if so broadband adds could surprise in the coming 18 months. On the other hand, these customers could take their business to the two other functioning ISPs – United Online or Earthlink.

Best case, assuming that the historical relationship of AOL dial-up losses to broadband net adds hold at 46% (per Exhibit 3), we could see potential incremental new broadband adds of 2.4 million in 2006E and 1.95 million in 2007E. Logically, we believe the biggest beneficiaries of this surprise would be the Big Four broadband providers (i.e., Comcast, AT&T, Verizon, and Time Warner Cable).

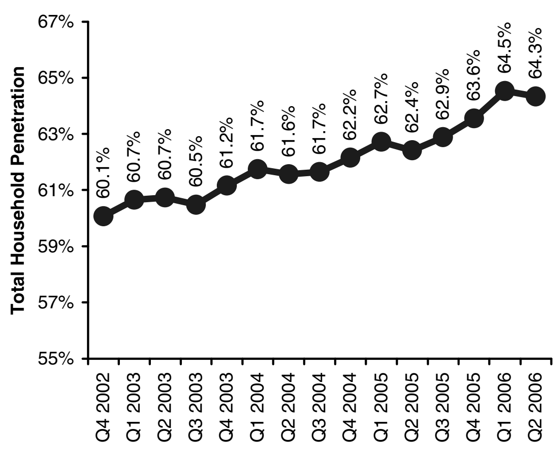
Interestingly, the dial-up migration looks likely to end by 2008, as the core AOL dial-up user by then will likely consist of those customers that are unable to receive broadband. After that, the days of easy broadband growth – mainly at the expense of AOL – will likely come to an end. We believe any benefit to broadband growth from AOL's new strategy would therefore likely represent simply a pull-forward of future growth, rather than a change to overall market size.

Market Gains Continue

During the second quarter of 2006, total Internet penetration was 64.3%, a sequential decline from 64.5% in the first quarter, and consistent with the pattern of sequential contraction seen in the two prior second quarters due to seasonal disconnects of both dial-up and broadband (see **Exhibit 5**).

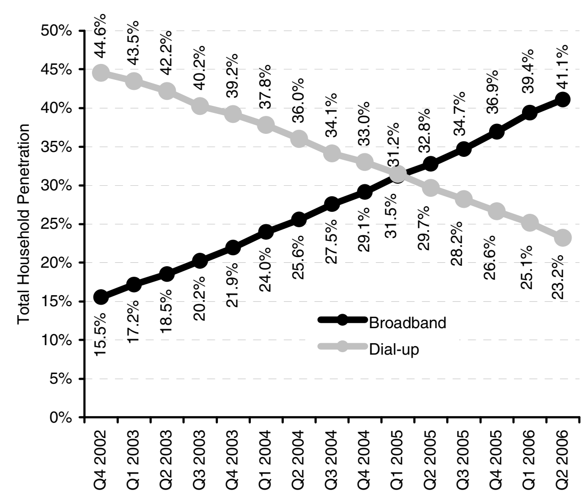
Dial-up penetration slipped by 190 bps to 23.2% of total U.S. households, while broadband penetration continued to grow, increasing by 170 bps sequentially to 41.1% (see **Exhibit 6**).

Exhibit 5
U.S. Internet Penetration (% of Total U.S. HHLDs)



Source: Bernstein estimates and analysis

Exhibit 6
Penetration of U.S. Households – Dial-up vs. Broadband



Source: Bernstein estimates and analysis

Booming Broadband Market Share Growth

The ongoing transition from dial-up to broadband has proceeded at a remarkably steady pace. As of the end of the second quarter, over 61% of Internet connections are now broadband (see **Exhibit 7**). This

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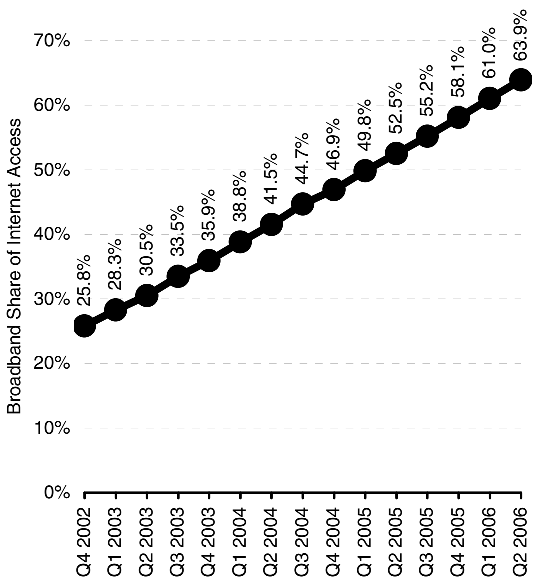
represents an over 850 bp increase since the second quarter of 2005, and 290 bps sequentially from first quarter 2006. While quarterly subscriber rates of change are seasonal and, therefore, less telling than annual rates of change, the 290 bp increase is in-line with the sequential increase witnessed in previous second quarters.

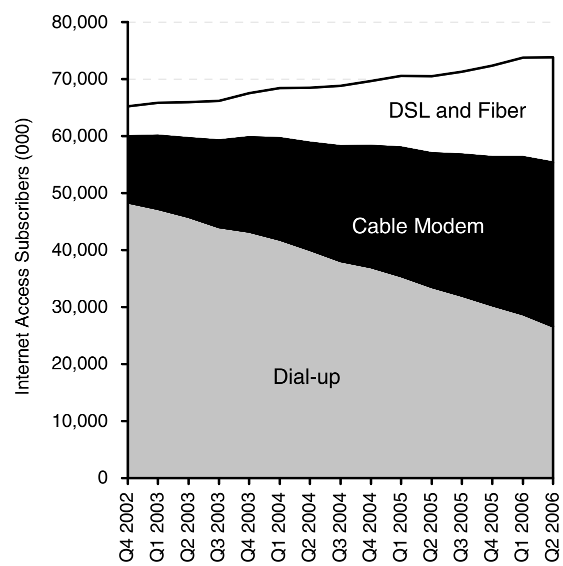
The continued growth in broadband market share, with three-fifths of Internet users now on broadband connections, also reinforces the trend of dial-up subscriber losses to broadband gains (see **Exhibit 8**).

Exhibit 7
Broadband Share of Total Internet Accesses



Source: Bernstein estimates and analysis

Exhibit 8
Composition of Internet Access Market



Source: Bernstein estimates and analysis

As we have noted in prior editions of the *Bernstein Quarterly Broadband Update*, one would normally anticipate a deceleration at the point at which penetration reaches 50% of *its* eventual limit. Though broadband penetration has now reached 61% of total Internet subscribers, we have not yet seen any signs of decelerating broadband penetration, suggesting that the marginal utility of broadband continues to increase, even to late adopters, as overall penetration rises.

RBOCs and MSOs Engaged in High Speed Battle

While broadband has continued to gain subscriber market share within the Internet access market, the quarterly net additions for the two major player segments – the Bells and the cable MSOs – have witnessed a continued reversion toward 50/50. As shown in **Exhibit 9**, since roughly fourth quarter 2004, DSL and cable have swapped position as the leader in net add share. While the cable MSOs accounted for over 60% of broadband net additions, and of the broadband market overall, during all of 2002 and 2003, the quarterly gap in net additions has now disappeared, and the gap in overall subscriber share is therefore narrowing. (*Note that our net subscriber estimates are adjusted to reflect DSL's higher share of business broadband customers, and therefore differ from more commonly cited unadjusted subscriber additions).*

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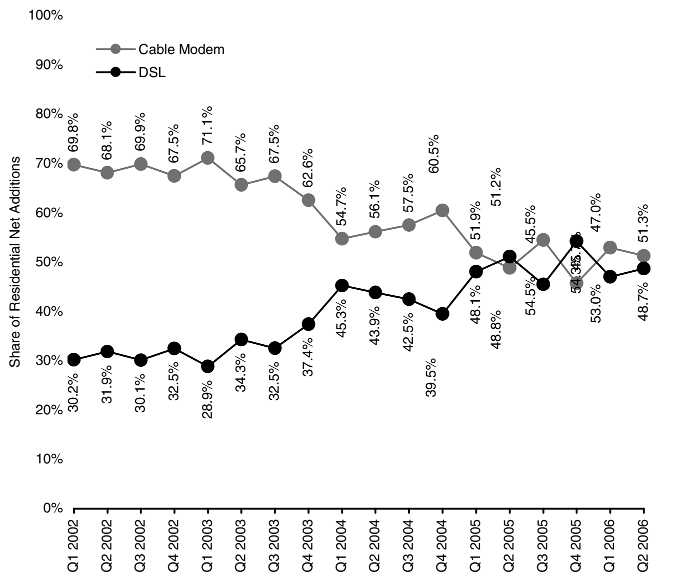
Exhibit 9

Subscriber Share of Broadband Net Additions – Cable vs. DSL



Source: Bernstein estimates and analysis

On the back of these share gains in net subscriber additions, the RBOCs have increased their share of total broadband subscribers from 31% of the market in early 2003 to over 39% today, a CAGR of 12%.

AOL's reduced marketing could accelerate the RBOCs' subscriber share gains. The "non-tenured" subscribers likely to be "released" to broadband are likely the markets' most price/promotion sensitive. To the extent that these subscribers opt for broadband rather than alternative dial-up services, we would therefore anticipate that they would be disproportionately likely to choose DSL over cable modem offerings.

For the cable MSOs, the availability of low-priced VoIP in the bundle could help mitigate this impact among price sensitive new subscribers. At the same time, there is some evidence of an offsetting conversion *from* DSL to cable modem service among veteran broadband users. For example, Comcast reported back in Q1 that more than 30% of new broadband subscribers had converted from DSL to cable. This migration might also be expected to mitigate DSL's share gains.

Exhibit 10 and **Exhibit 11** provide summaries of the quarterly broadband and narrowband market trends over the past several years. **Exhibit 12** provides a summary of our annual broadband subscriber estimates.

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Exhibit 10
Residential Broadband Market 2Q:06 (in 000)

	Q2 2005	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Y/Y Change	Q/Q Change	2Q06 Net Adds	12 Month Net Adds
Cable Modem									
Comcast	7,705	8,142	8,520	8,957	9,344	21.3%	4.3%	387	1,639
Time Warner Cable	4,323	4,557	4,822	5,168	5,398	24.9%	4.5%	230	1,075
Cablevision	1,520	1,600	1,694	1,807	1,891	24.4%	4.7%	85	372
Charter Communications	2,022	2,120	2,196	2,322	2,375	17.5%	2.3%	53	353
Insight	391	439	470	515	535	36.6%	3.8%	20	143
Mediacom	426	453	478	504	516	21.1%	2.4%	12	90
Adelphia	1,557	1,657	1,707	1,761	1,808	16.2%	2.7%	47	251
Top 7 Public MSOs	17,944	18,968	19,889	21,034	21,867	21.9%	**4.0%**	833	3,923
Other	5,521	5,768	6,081	6,522	6,797	23.1%	4.2%	275	1,276
Total cable modem	**23,465**	**24,736**	**25,969**	**27,556**	**28,665**	22.2%	**4.0%**	**1,108**	**5,199**
DSL (Residential Only)									
AT&T	4,908	5,309	5,713	6,167	6,570	33.9%	6.5%	403	1,662
Verizon	3,685	4,026	4,597	5,103	5,505	49.4%	7.9%	402	1,820
Bell South	2,114	2,298	2,482	2,589	2,604	23.2%	0.6%	15	491
Qwest	952	1,072	1,184	1,342	1,438	51.1%	7.2%	96	486
Top 4 RBOCs	11,659	12,705	13,976	15,202	16,118	38.2%	6.0%	916	4,459
Other	1,889	1,906	2,096	2,280	2,418	28.0%	6.0%	137	529
Total	**13,548**	**14,610**	**16,073**	**17,482**	**18,535**	36.8%	6.0%	**1,053**	4,987
Cable Share	63.4%	62.9%	61.8%	61.2%	60.7%	-4.2%	-0.7%	51.3%	51.0%
DSL Share	36.6%	37.1%	38.2%	38.8%	39.3%	7.3%	1.2%	48.7%	49.0%

Note: Other Cable Modem category includes Cox Communications.
Other DSL category is forecasted presuming a growth rate parallel to the weighted average for the RBOCS.

Source: Company Reports, Bernstein Estimates

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Exhibit 11
Dial-Up Market 2Q:06 (in 000)

	Q2 2004	Q3 2004	Q4 2004	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Q1 2006	Q2 2006
Subscribers									
United Online*	3,102	3,111	3,100	3,130	3,078	2,980	2,855	2,751	2,556
MSN**	4,300	3,800	3,500	3,000	2,700	2,600	2,400	2,300	2,070
Earthlink	3,976	3,973	3,880	3,776	3,753	3,650	3,580	3,526	3,411
AOL***	19,200	18,000	17,500	16,800	15,600	14,674	13,725	12,801	11,458
Total	**30,578**	**28,884**	**27,980**	**26,706**	**25,131**	**23,904**	**22,560**	**21,378**	**19,495**
Change (Q/Q)	(692)	(1,694)	(904)	(1,274)	(1,575)	(1,227)	(1,344)	(1,182)	(1,883)
Net Additions (losses)									
United Online*	19	9	(11)	30	(52)	(98)	(125)	(104)	(195)
MSN**	(300)	(500)	(300)	(500)	(300)	(100)	(200)	(100)	(230)
Earthlink	(11)	(3)	(93)	(104)	(23)	(103)	(70)	(54)	(115)
AOL***	(400)	(1,200)	(500)	(700)	(1,200)	(926)	(949)	(924)	(1,343)
Total	**(692)**	**(1,694)**	**(904)**	**(1,274)**	**(1,575)**	**(1,227)**	**(1,344)**	**(1,182)**	**(1,883)**
% Change (Y/Y)									
United Online	21.8%	14.4%	7.3%	1.5%	-0.8%	-4.2%	-7.9%	-12.1%	-17.0%
MSN	-33.8%	-32.1%	-32.7%	-34.8%	-37.2%	-31.6%	-31.4%	-23.3%	-23.3%
Earthlink	2.4%	3.4%	-2.6%	-5.3%	-5.6%	-8.1%	-7.7%	-6.6%	-9.1%
AOL	-16.9%	-18.6%	-17.8%	-14.3%	-18.8%	-18.5%	-21.6%	-23.8%	-26.6%
Total	-15.1%	-15.7%	-16.2%	-14.6%	-17.8%	-17.2%	-19.4%	-20.0%	-22.4%
% Change (Q/Q)									
United Online	0.6%	0.3%	-0.4%	1.0%	-1.7%	-3.2%	-4.2%	-3.6%	-7.1%
MSN	-6.5%	-11.6%	-7.9%	-14.3%	-10.0%	-3.7%	-7.7%	-4.2%	-10.0%
Earthlink	-0.3%	-0.1%	-2.3%	-2.7%	-0.6%	-2.7%	-1.9%	-1.5%	-3.3%
AOL	-2.0%	-6.3%	-2.8%	-4.0%	-7.1%	-5.9%	-6.5%	-6.7%	-10.5%
Total	-2.2%	-5.5%	-3.1%	-4.6%	-5.9%	-4.9%	-5.6%	-5.2%	-8.8%

*United Online subscribers do not include About,Inc. or Classmates acquired active accounts

**MSN include all classes of active users

***AOL includes total users less HSD in the US

Source: Company Reports, Bernstein Estimates

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Exhibit 12

Broadband Market Subscriber Market Estimates – 2004 - 2010E (in 000)

Broadband Subscribers (in 000's)

	2004	2005	2006E	2007E	2008E	2009E	2010E
Major Players							
Verizon	3,485	5,121	6,885	8,697	10,501	12,155	13,553
AT&T	5,104	6,921	8,717	10,331	11,782	13,049	14,092
BellSouth	2,096	2,882	3,728	4,502	5,200	5,820	6,272
Comcast	6,994	8,520	10,883	13,106	14,499	15,524	16,419
Cablevision	1,353	1,694	2,029	2,295	2,524	2,600	2,686
Time Warner Cable	4,747	5,750	7,226	8,522	9,566	10,484	11,276
Note: RBOC Estimates include both DSL and fiber subscribers.							
Market Data							
Total U.S. Households	111,207	112,430	113,667	114,917	116,181	117,459	118,751
Total Internet Connections	76,409	79,806	83,298	86,347	89,473	92,794	96,196
Memo: Penetration of Households	*69%*	*71%*	*73%*	*75%*	*77%*	*79%*	*81%*
Internet Access Data							
Total Dial-up Subscribers	42,846	36,397	27,849	20,637	14,544	10,493	7,492
Total DSL and Fiber Subscribers	11,321	15,992	21,006	25,728	30,156	34,118	37,391
Total Cable Modem Subscribers	21,267	25,992	32,043	36,581	40,173	42,584	44,713
Atlernative Technologies (Wi-Max, BPL)	975	1,425	2,400	3,400	4,600	5,600	6,600
Total Internet Market	**76,409**	**79,806**	**83,298**	**86,347**	**89,473**	**92,794**	**96,196**
Broadband Market Composition	**33,563**	**43,409**	**55,449**	**65,709**	**74,929**	**82,302**	**88,704**
DSL & Fiber % of Broadband Market	33.7%	36.8%	37.9%	39.2%	40.2%	41.5%	42.2%
Cable % of Broadband Market	63.4%	59.9%	57.8%	55.7%	53.6%	51.7%	50.4%
Atlernative Technologies % of Broadband Market	2.9%	3.3%	4.3%	5.2%	6.1%	6.8%	7.4%
Broadband Net Additions							
DSL and Fiber	3,901	4,671	5,014	4,723	4,427	3,962	3,273
Cable Modem	4,818	4,725	6,051	4,538	3,593	2,410	2,129
Alternative Technologies	400	450	975	1,000	1,200	1,000	1,000
Total Broadband Net Additions	9,119	9,846	12,040	10,260	9,220	7,373	6,402
Broadband Net Addition Composition							
DSL and Fiber	42.8%	47.4%	41.6%	46.0%	48.0%	53.7%	51.1%
Cable Modem	52.8%	48.0%	50.3%	44.2%	39.0%	32.7%	33.3%
Alternative Technologies	4.4%	4.6%	8.1%	9.7%	13.0%	13.6%	15.6%

Source: Company Reports, Bernstein Estimates

Valuation Methodology

We value all of the U.S. carriers in our coverage based on a combination of discounted cash flow (primary mechanism for setting price targets), EV/EBITDA (for running comparative valuation analyses across similarly structured companies, and price to 12-month forward earnings (for assessing a company's relative over-/under-valuation versus its own two-, three- and five-year history).

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We value Comcast and Cablevision on a sum-of-the-parts basis. We value the core cable businesses on a blend of a forward-12-months EV/EBITDA multiple, and EV/EBITDA multiple relative to the S&P 500 P/FE. We value other consolidated and non-consolidated operations and nonpublic equity investments on various bases as appropriate, generally based on their own industry norms, primarily including EV/EBITDA multiples and value per subscriber. Publicly traded investments are carried at current market value.

Time Warner is valued on CY 2007 relative price to earnings. Our target relative multiple is based on our estimated 2007-10E EPS growth relative to the expected growth in S&P 500 EPS over the same time period. Logically, we assign a higher target multiple to companies that we think will grow earnings at an above market rate. We assume that S&P 500 earnings will grow by 7-10% over from 2007-10E. Our target relative multiple for Time Warner is 120% given that we estimate long-term EPS growth of 19%. On this basis our Time Warner target price is $18, 10% above the current price.

Risks

Risks to the Bells' wireline businesses stem from competition with the cable MSOs and other providers of broadband and/or VoIP service, including those using alternative technologies such as Wi-Max or BPL. Planned capital expenditures for fiber deployment present additional risks: that they may not generate adequate returns on investment, and that the Bells' entry into the video market will be delayed by franchising hurdles or an inability to sign necessary content agreements.

Our investment thesis for the cable group continues to be underpinned by our view that the competitive pricing environment will be less aggressive than consensus expectations, as none of the RBOCs, DBS operators, or cable MSOs can economically justify aggressive pricing strategies on the basis of market share gain, market elasticity, or retention of other products in the bundle. Notwithstanding our analysis of rational pricing strategies, however, players may adopt irrational pricing behavior; indeed, we believe AT&T's recent pricing decisions in DSL appear impossible to justify based on retention or elasticity economics. Alternatively, expectations of a more challenging pricing environment may continue to weigh on the stocks for some time.

For Time Warner, the cable division will face increasing competition in the coming years as the RBOCs' push ahead with their fiber roll-out, which will allow them to launch a competing video service. The emergence of a third video competitor, in addition to satellite, will likely limit price increases and could result in price decrease in the event that a price war erupts.

There is execution risk with AOL's new strategy of offering its AOL services for free to broadband subscribers, especially if advertising growth is slower than expected, churn is faster than expected or the timing of cost cuts is misaligned with the decline in subscription revenue.

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