

# Competitive Analysis of DSL and Cable Modems

Quarterly Analysis

4th Quarter 2004



Communications Media Analysis Group



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## Quarterly Report Analysis – Q4 2004

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### Competitive Analysis of DSL and Cable Modems

Internet users migrated to broadband services at a healthy clip over the course of 2004, boosting revenue streams for both cable companies and telcos. Our analysis finds that the number of people subscribing to high-speed Internet service from a top cable operator or telco grew by 8 mil. during the year to hit 30.5 mil. That represents a 35% increase from the 22.5 mil. broadband customers at the end of 2003.

Increasingly, DSL users are making up a bigger share of that sum. The regional Bell companies narrowed cable's lead in the high-speed Internet market during 2004, ending the year with a market share approaching 40%.

DSL's accelerated growth occurred during a year in which the RBOCs stepped up their marketing, created a variety of bundles and speed tiers, and rolled out aggressive pricing for residential broadband in an attempt to undercut cable operators. The cable companies generally resisted the pricing pressure, but instead boosted bandwidth and added features to distinguish themselves from telco competitors.

The Bell companies' strategy didn't overcome cable's lead in the residential broadband space, but appears to have succeeded in clipping it. But cable operators could recapture some market dominance this year as they bolster their bundles with the addition of IP telephony services to compete with the telcos. With the exception of Verizon, which launched a nationwide VoIP service last year, the RBOCs are well behind many of the cable operators in getting broadband telephony services to market.



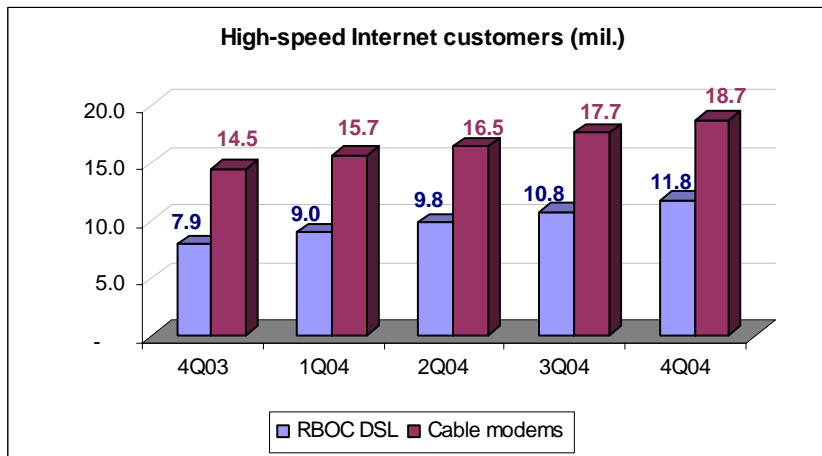
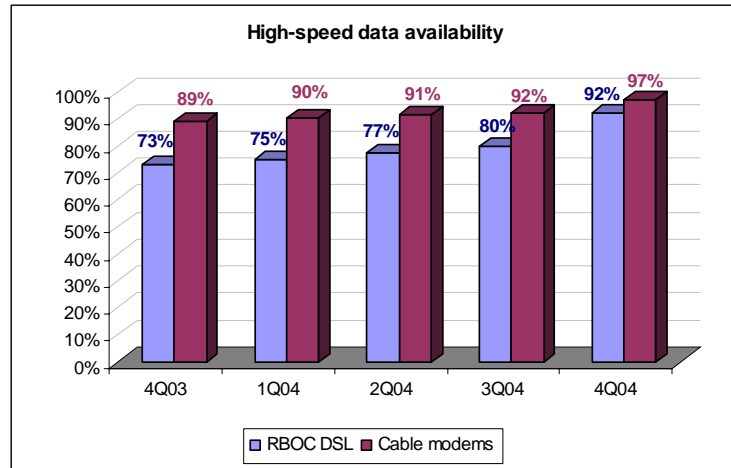
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### Availability

Helping to fuel the acceleration of broadband adoption is the growth in its availability. From Q4 03 to Q4 04, the top four incumbent telcos<sup>1</sup> expanded the availability of DSL from 73% of lines to 92% of lines. Meanwhile, cable operators<sup>2</sup> ended 2004 reaching 97% of homes passed, compared to 89% at year-end 2003.

By the end of Q4 04, the RBOCs had a total of 11.8 million DSL subscribers, while the top cable operators had 18.7 million modem customers. The cable industry's tally represents a 29% gain year over year. But the phone companies' DSL sub. count is nearly 50% over Q4 03 levels.

DSL customers make up 38.7% of the 30.5 million high-speed subs. among the companies examined in this study. That compares to 35.3% a year earlier.



### Quarterly growth

Cable's weakening lead in the broadband market is reflected in quarterly net add trends. The top cable operators and telcos garnered a collective 2.1 mil. net additional high-speed Internet customers in the fourth quarter, with the RBOCs' 1,036K new DSL subscriptions making up 48.9% of that total.

<sup>1</sup> BellSouth, Qwest, SBC and Verizon were examined for this analysis.

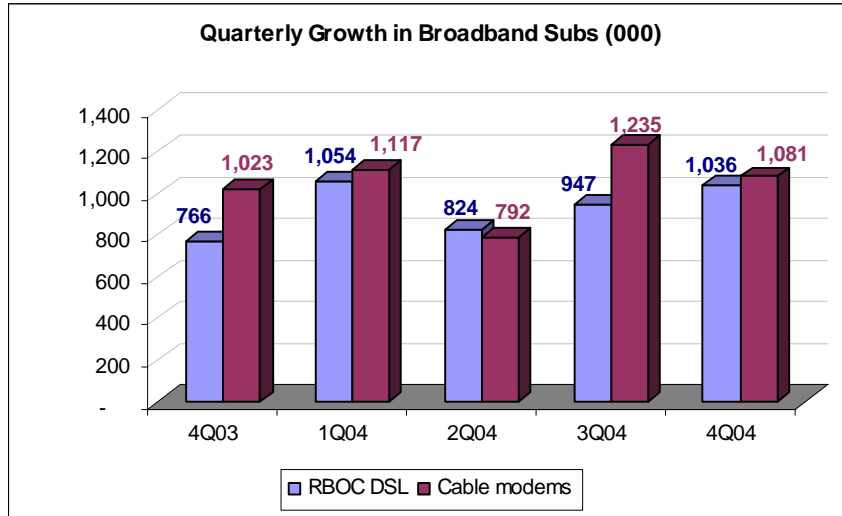
<sup>2</sup> Adelphia, Cablevision Systems, Charter, Comcast, Cox, Insight, Mediacom and Time Warner were examined for this analysis.



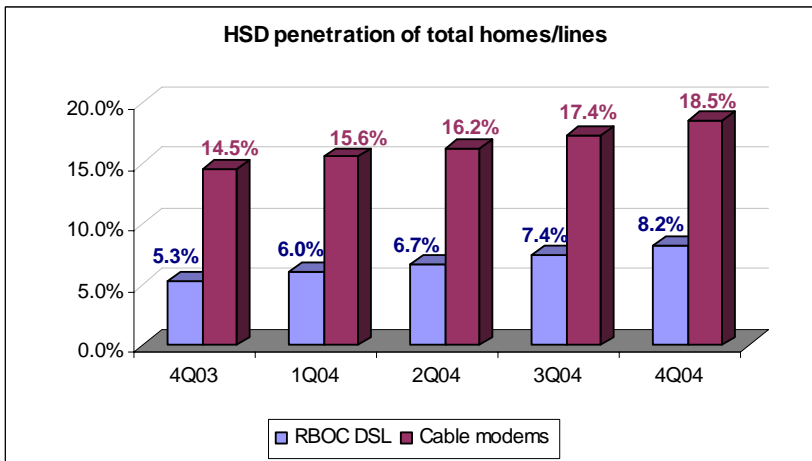
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Cable operators had picked up steam in the third quarter in terms of Internet customer growth, but for most of the year, the RBOCs were able to keep their net adds above 48% of total high-speed Internet adds, and in Q2 even edged slightly ahead of cable on that metric. For most of 2003, DSL had represented only about 37.2% of total high-speed Internet customer adds.

Cable-modem net adds still managed to surpass DSL net adds during the quarter, but cable's high-speed-data customer adds of 1,081K marked a relatively sluggish 5.7% increase year over year, and a 12.5% decline sequentially. The cable operators net adds for the quarter exceeded the RBOCs' DSL count by only 45K, compared to 257K in Q403.



The RBOCs market share is clearly accelerating. At the beginning of 2003, the telcos claimed only 34.2% of the high-speed Internet market. Over the course of that year, the industry's total customer count climbed about 29%, while cable's base rose 33.9%.



#### Penetration

Still, cable appears to remain far ahead of the RBOCs when it comes to HSD penetration, although it's not easy to measure that comparison given that some telcos report their DSL availability in terms of total lines but provide no further breakdown in terms of residential vs. commercial reach. Moreover, neither

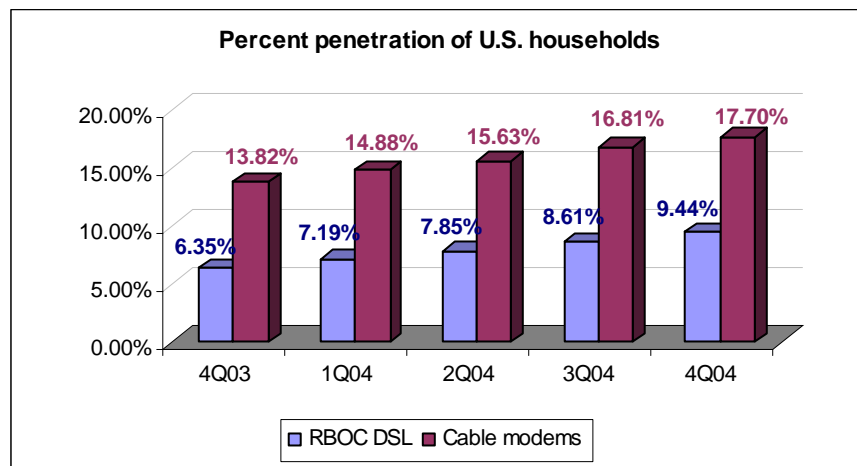


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phone companies nor cable operators provide, good, consistent breakdowns of how many high-speed customers are residential vs. small business.

For this analysis, we look at how well-penetrated cable modems are as a percentage of capable homes and how well-penetrated DSL subscriptions are as a percentage of total DSL-enabled lines. According to this measure, cable modem service was more than twice as highly penetrated as DSL—18.5% vs. 8.2%.

But this measure doesn't reflect the performance of the two industries in the residential market, given that both cable operators and phone companies also sell high-speed services to businesses. Plus, phone companies provide multiple phone lines to businesses, and to a lesser extent homes, and thus DSL penetration of phone lines is a misleading measure.



To get around these problems, we made estimates of residential high-speed penetration that assume 80% of ILEC DSL customers are residential households while 95% of cable modem subs. are residential. According to that measure, cable's high-speed penetration of American households stood at 17%, nearly double DSL's 9.44%. That represents progress for the RBOCs, however. In Q4 03, cable's 12.2% penetration of residential households *more* than doubled DSL's 5.4%.