

## SNL Kagan Report: Over-the-Top Substitution Forecast to Erode Multichannel Subs

July 20, 2011

Internet delivery of television and movies has rocketed into the mainstream, but so-called over-the-top (OTT) substitution has remained a relatively small, though not inconsequential slice of the user base. The segment, often termed cord cutters, impacted the subscriber counts for multichannel service providers in 2010, and is expected to exert competitive pressure going forward.

SNL Kagan estimates nearly 4% of the occupied U.S. households will employ Internet video in lieu of subscribing to a multichannel video package at the end of 2011. Though the thin slice of households relying OTT substitution could be dismissed as evidence of a lack of momentum behind cord cutting, the 4.5 million households it represents are not inconsequential, particularly in light of the basic subscriber declines for the cable industry.

The evident subscriber plateau posted by multichannel service providers supports the moderate emergence of OTT substitution. The industry reversed the first-ever declines in the second and third quarters of 2010 to produce a small overall increase for the full year. The modest subscriber gain was neither convincing enough to dispatch the threat of cord cutting nor dismiss the impact of over-the-top substitution. At the end of 2010, we estimate 84.9% of the occupied U.S. households subscribed to a multichannel package after eliminating the overlap of customers with multiple subscriptions. The year-over-year dip from nearly 86% at the end of 2009 illustrates the potential peak in multichannel penetration.

Though we forecast continued absolute growth in subscribers, the pace is not expected to keep up with occupied household formation, leading to a long-term decline in penetrations for multichannel services. OTT substitution is the primary agent in the expected declines in traditional cable, DBS and telco video penetration. SNL Kagan estimates multichannel substitution via OTT delivery will grow from 2.5 million households at the end of 2010 to 12.1 million homes by 2015. The OTT substitution estimates account for nearly 10% of the occupied homes in the U.S. in the five-year forecast.

### Projected U.S. Multichannel Subscription Substitution with Over-the-Top Video Delivery (2010-2015)

|   |        | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|--------|------|------|------|------|------|------|
| <b>Total Multichannel Substitutes (OTT Households)^</b> | (mil.) | 2.5  | 4.5  | 6.6  | 8.6  | 10.4 | 12.1 |
| <b>% of Total Occupied HHs</b>                          | (%)    | 2%   | 4%   | 6%   | 7%   | 8%   | 10%  |

*^Multichannel Substitutes are households that rely on Internet-based OTT distribution to view professionally produced content in place of a traditional multichannel subscription packages. (C) 2011 SNL Kagan, a division of SNL Financial, LC. All rights reserved.*

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