

STRATEGY ANALYTICS INSIGHT

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Verizon Rolls Out FiOS TV: Not Necessarily Seismic, But a Smart Start

Snapshot

In its first commercial launch of multichannel TV service, Verizon is using a mix of lower prices, new services and bundling to target a wide range of potential customers. While advanced features such as High Definition TV (HDTV) and Video On Demand (VOD) have received the biggest marketing push, lower prices and better features for basic TV services will likely attract more customers in the near term. Cable operators such as Comcast, Time Warner Cable and Cox Communications must ensure that triple play TV/data/voice bundles are widely available. The options for satellite operators DirecTV and EchoStar are less clear: video specialist or broadband partnership strategies are likely to be the way forward for these competitors.

Analysis

On September 22, 2005, Verizon Communications began selling its FiOS (Fiber Optic Services) TV product to consumers in the Dallas suburb of Keller, Texas. The launch comes 16 months after Verizon announced it would build out advanced fiber networks capable of delivering TV along with broadband Internet services to millions of homes in its 28-state territory. Verizon plans to launch FiOS TV in another five markets by the end of this year.

Like most telcos developing IPTV services, Verizon has positioned FiOS TV as a quantum leap forward in terms of the features, flexibility and quality of service it will offer viewers. Executives continued to take this approach at the Keller system's launch ceremonies, describing FiOS as "a revolutionary, new entertainment experience" and "a seismic shift in pop culture."

Defining IPTV as an entirely new form of multichannel TV makes strategic sense for telcos facing entrenched competition from cable and satellite operators, who already serve over 80 percent of US households. But the most

striking thing about FiOS so far is not its technology, but the way in which it targets its competitors' vulnerable customers.

For consumers at the high end of the market (an important segment in Keller, where annual household income averages nearly \$100,000) FiOS offers plenty of advanced video services, including 22 high-definition channels and digital video recorder (DVR) functions built into Motorola set top boxes.

Equally important, Verizon also bundles TV with DSL Internet access and wireline telephony, a key advantage for more sophisticated consumers seeking multiple services, greater convenience and simplified billing. In contrast, local cable operator Charter Communications has yet to launch Voice Over IP (VOIP) phone service in the area, while satellite operators DirecTV and EchoStar can only provide triple-play bundles through partnerships with telcos.

But even with these advantages, FiOS also offers pricing options designed to attract entry-level or value-conscious customers as well. Verizon's main service in Keller is an expanded-basic tier package that includes 180 video and audio channels as well as access to 600 free and pay VOD titles priced at \$39.95 a month. This configuration puts Verizon ahead of Charter and DirecTV in terms of channels and pricing, with Charter offering 70 channels for \$46.99 and DirecTV 135 channels for \$41.99. EchoStar provides a package of 120 channels for \$37.99 a month.

Finally, FiOS also offers an entry-level service tier that delivers 35 local broadcast, community access and weather channels for just \$12.95 a month. Unlike broadcast-only packages available from most cable operators, the digital version of this service will also offer access to VOD.

Implications

Though initially limited to one small city, Verizon's first FiOS deployment clearly suggests the company's broader strategy for competing in multichannel TV. While we expect Verizon and other telcos to continue talking up advanced TV services and bundling, a majority of early customers will likely be attracted by more basic benefits. By offering less expensive, more functional extended-basic and broadcast-only packages, Verizon is addressing several undervalued consumer segments. These include:

- **New households adopting multichannel TV for the first time.** In recent years most of these new customers have opted for satellite over cable, attracted by lower prices and aggressive promotions and

marketing. But DirecTV and EchoStar should expect strong competition for this segment in markets where telco TV becomes available.

- **Basic cable subscribers.** While digital cable service is available to the vast majority of customers, digital penetration in the US remains relatively low. Only 41 percent of all cable customers subscribed to digital service as June, 2005; the other 59 percent (about 38 million homes) use basic-tier service delivered via analog technology. These analog customers are often most sensitive to cable price increases, and may prove especially susceptible to less costly alternatives – particularly if they offer additional benefits such as VOD.
- **Late adopters who have never used cable or satellite TV.** Despite the maturity of the US market, there are still nearly 20 million homes that still do not use any form of multichannel TV. Verizon's \$12.95 broadcast-only package could help convert some of these late adopters.

How will cable and satellite operators respond to Verizon and other RBOCs as they begin their long-awaited push into the market? For leading cable companies such as Comcast, Time Warner Cable and Cox Communications, making sure that triple-play bundles combining TV, cable modems and VOIP are widely available and heavily marketed will be critical. Local markets where cable operators are not triple-play-ready (such as Keller, Texas) will be targeted first by the telcos. The first wave of telco TV deployments will also increase pressure on these operators to accelerate existing plans for digital simulcasting, which could allow them to offer more low-cost digital services of their own.

For satellite providers, the options are less clear. Although they still lead cable in video subscriber growth, both DirecTV and EchoStar have no clear path toward triple-play bundling beyond their partnerships with Verizon, SBC and other telcos. This deficiency leaves them to choose between positioning themselves as video specialists (an increasingly tough sell as cable improves services and telcos boost competition) or to pursue new partnerships with alternate broadband providers (such as local utilities) or investments in emerging technologies such as WiMax or satellite-delivered broadband.

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