

# US Equities Communication Services

Everything you wanted to know about cord cutting, but were afraid to ask | **29 January 2019**

**Chief Investment Office GWM**

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- TV viewership has been in decline since 2012.
- Consumers are burdened with a cable bill filled with fees and are paying for channels they never watch.
- The explosive growth of Netflix and proliferation of live streaming services has made it easier for consumers to walk away from cable.
- Ever wondered about cutting the cord yourself? If so, read on.

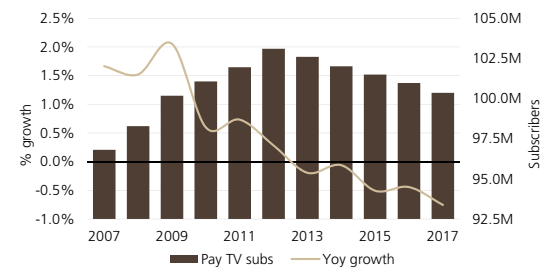
*Research assistance provided by Reid Gilligan*

We are often asked about the cord-cutting phenomenon when discussing the cable business within the communication services sector. It is having a real economic impact on cable companies and content providers because TV viewership has been declining for over 6 years.

While you may have heard of this trend in the news and developed views on the investment implications, you may not have embraced what this means to you personally. Investment implications can be found in our most recent communication services Equity Preference List report. This note is all about diving into what you want to know about cord cutting, but have been too afraid to ask.

We hope to explain the problem that millions of Americans face on a monthly basis - an expensive cable bill - then highlight the options available if you were to make the decision to reduce your expenses.

**Multi-channel video subscribers on the decline**



Source: UBS Investment Bank

### 1. What is the average monthly price of my cable bill?

The basic double-play monthly cable/internet bill is a whopping USD 120 before taxes. Since television viewership has been in decline since 2012, cable companies have been forced to alter their strategies in order to retain clients. This includes common tactics of bundling cable with Internet (broadband) and phone as well as price cuts. However, even with the promotions and lower prices, monthly cable bills still exceed USD 100.

See Figure 1 for the cost break-down analysis of various double-plays we reviewed. This analysis only accounted for a single television household, with approximately 150 channels (no premium channels like HBO or Showtime) and basic Internet speeds. Costs substantially increase with the number of televisions in the house as well as the need for faster broadband speeds with an increased number of devices (TVs, computers, phones, tablets) accessing the Internet.

**Fig. 1: Double-play internet and cable breakdown**

Verizon Fios		Charter Spectrum		Comcast Xfinity	
Internet	\$ 39.99	Internet	\$ 49.99	Internet ( <i>included</i> )	\$ -
Router	\$ 12.00	Router	\$ -	Router	\$ 13.00
Cable	\$ 55.00	Cable	\$ 44.99	Cable	\$ 79.99
Cost per cable box	\$ 12.00	Cost per cable box	\$ 7.50	Cost per cable box	\$ 2.68
RSN (regional sports network)	\$ 7.89	RSN (regional sports network)	\$ 7.89	RSN (regional sports network)	\$ 7.89
Fios TV Broadcast Fee	\$ 4.49	Broadcast fee	\$ 11.99	Broadcast Fee	\$ 10.00
<b>Total Per month</b>	<b>\$ 131.37</b>	<b>Total Per month</b>	<b>\$ 122.36</b>	<b>Total Per month</b>	<b>\$ 113.56</b>

Internet Only		Internet Only		Internet Only	
Level 1 Internet Speed (100 Mbps)	\$ 39.99	Level 1 Internet Speed (100 Mbps)	\$ 49.99	Level 1 Internet Speed (60 Mbps)	\$ 39.99
Level 2 Internet Speed (300 Mbps)	\$ 59.99	Level 2 Internet Speed (400 Mbps)	\$ 69.99	Level 2 Internet Speed (400 Mbps)	\$ 79.99
Level 3 Internet Speed (940/880 Mbps)	\$ 79.99	Level 3 Internet Speed (940 Mbps)	\$ 104.99	Level 3 Internet Speed (1000 Mbps)	\$ 89.99
Router	\$ 12.00	Router	\$ -	Router	\$ 13.00
<b>Level 1 Total Per month</b>	<b>\$ 51.99</b>	<b>Level 1 Total Per month</b>	<b>\$ 49.99</b>	<b>Level 1 Total Per month</b>	<b>\$ 52.99</b>
One-time router purchase	\$ 199.99	One-time router purchase	N/A	One-time router purchase	\$ 169.99
Months until breakeven	16.7	Months until breakeven	N/A	Months until breakeven	13.1

Source: Company websites, UBS

### 2. How much would I save by cutting the cord and streaming instead?

Assuming you just pay for basic Internet access (Level 1 Internet speed in Figure 1), you would save at least 20-25% a month by getting rid of cable and switching to a live streaming service. This number could be higher given the number of cable boxes in your house that you will no longer need and other fees and taxes that you will no longer pay. You will obviously still need to pay for broadband as the ability to access the Internet is a requirement in this day and age. This will cost roughly USD 50 per month for basic internet speeds. A live streaming service costs USD 40/month on average, bringing your total monthly bill to around USD 90/month.

We should point out that there are not just cost savings that come with cutting the cord. Some other benefits include:

- **Cancel anytime.** Unlike cable, there is no contract to sign when you switch to a live streaming service. Service is paid for on a monthly basis and you can cancel whenever you like with no cancellation fees!

**Fig. 2: Your new monthly cost after cutting the cord**

YouTube TV + FIOS Internet	
Level 1 Internet Speed (100 Mbps)	\$ 39.99
Router	\$ 12.00
YouTube TV	\$ 40.00
<b>Total Per month</b>	<b>\$ 91.99</b>

Source: Company websites, UBS

- **Aesthetically pleasing.** Say goodbye to ugly wires running from your television as there is no more need for a cable box.
- **Record as many shows as your heart desires.** Most live streaming services come with high DVR storage limits, allowing you to simultaneously record as many shows as you like, without ever running out of storage space.

**3. I've cut the cord, now what are my options?**

Cutting the cord and switching to an over-the-top (OTT) service by using Internet instead is split into two categories. The first is called vMVPD which stands for virtual multichannel video programming distributor. Put simply, this option is for live streaming television. The second category is DTC, or direct-to-consumer.

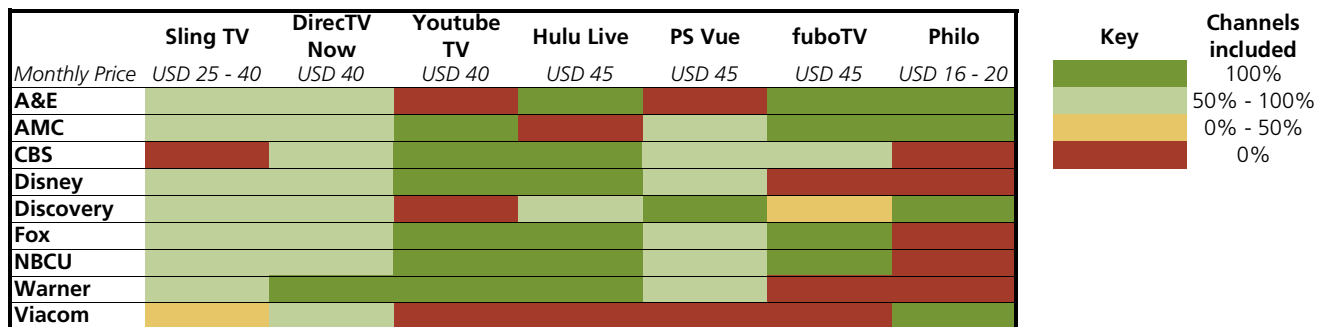
**vMVPDs, or live streaming television**

vMVPDs are the most common substitute for cord cutters because of the similarity of service at a cheaper price. Examples include YouTube TV, DirectTV Now and Sling TV. Cable companies typically bundle hundreds of channels together and promote the wide variety offered. A vMVPD, however, offers an online selection of channels and content that is less vast, but cheaper, than what typical cable TV offers. Premium channels like HBO, Showtime, and Starz can be added as well for an extra cost. The average price of popular vMVPDs is USD 40/month compared to the USD 70-80/month price tag for cable.

Figure 3 below contains a list of the various vMVPD services and the major networks that they offer. When deciding on a streaming option, we recommend ranking the networks that you want, and compare it to this chart. Competition between the major streaming services is intense, which leads to a number of promotions such as first month free and even free Roku devices.

SlingTV currently has the largest number of users, partly due to its early start in 2015, with over 2.4 million subscribers, followed closely behind by DirecTV Now with approximately 2 million subscribers. The number of vMVPD subscribers are growing at a more moderate pace over the past few quarters, and total approximately 8 million.

**Fig. 3: vMVPD Network Coverage**



Source: Company reports, UBS

Note: ESPN is owned by Disney and is included in the Disney row above.

**Direct-to-consumer (DTC)**

Direct-to-consumer, on the other hand, is much more popular than vMVPD, largely due to its lower price and entertainment viewing preferences of the millennial generation. Netflix alone has over 58 million paid US subscribers.

DTC offerings are split into three video-on-demand (VOD) categories: AVOD, SVOD, and TVOD. AVOD, standing for advertising, is the free video content distributors who make their money by selling ad time. Youtube has been offering AVOD entertainment since 2005. Other examples include Facebook, Instagram, and CBSN.

SVOD, meaning subscription video-on-demand, is the most popular and highest growth DTC segment. Users can watch as much content without advertisements as they desire for a recurring fee, often in the USD 7-15/month range. Popular services include Netflix, Hulu, Amazon Prime Video, HBO Now, Showtime, and Starz. You may not know that your Amazon Prime membership (USD 12.99/month) gives you access to thousands of TV shows and movies, in addition to Prime two day shipping and discounts at Whole Foods. Amazon is diving into original TV programming as well with successful shows like *The Marvelous Mrs. Maisel*, *The Man in the High Castle*, and *The Grand Tour* (Top Gear cast).

There are AVOD and SVOD hybrids that offer a lower monthly fee, but still resign the viewer to advertisements during their viewing experience. The most popular hybrid offer comes from Hulu. Hulu has a limited commercial service for USD 7.99/month and a commercial free version for USD 11.99/month.

Finally TVOD, or transactional video on-demand, represents a one-time transaction of specific content, both live (pay-per-view) and video rentals / purchases. TVOD platforms include iTunes, Google Play, and Fandango.

**Not all content is consumed the same way**

Different types of content is best consumed in different ways. News and sports are more often than not best viewed live, thus the need for continued live television even after cutting the cord. Entertainment on the other hand, such as HBO's *Game of Thrones*, Netflix's *Stranger Things* or Hulu's *The Handmaid's Tale*, does not need to be watched live and the content can be consumed at any time of your choosing. In fact, "binge" watching has become quite popular with the SVOD services. An entire season of a show is released on a single day, allowing the subscriber to consume the series over a weekend.

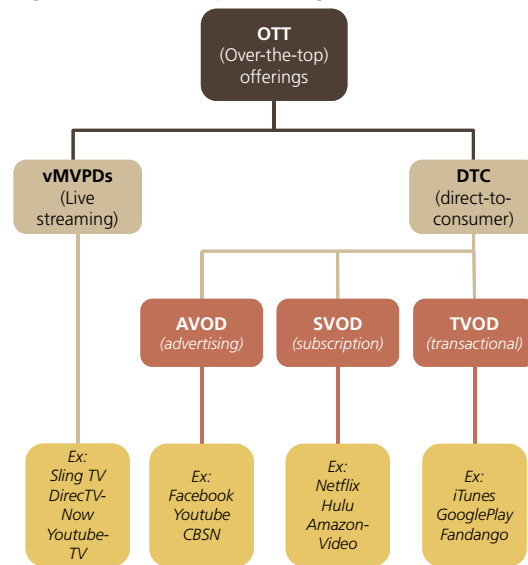
**4. What is a skinny bundle?**

A skinny bundle represents a reduced number of channels for a lower cost. While skinny bundle offerings are available with many cable providers, the live streaming vMVPDs are now called skinny bundles because of the assortment of live viewing options at a cheaper price.

**5. If I cut the cord, how do I watch my streaming options?**

The most common option for cord cutters is a smart TV. The difference between a normal television and a smart TV is an Internet connection

**Fig. 4: Over-the-top offerings**



Source: UBS

(ethernet or wifi). The latter uses its connection to stream from the various vMVPD and DTC applications such as ESPN and Netflix. Once the app is downloaded on the TV, customers can log into their various streaming accounts and link up all of their devices. You can start watching a movie on Netflix in the living room, pause, and continue watching from the exact same spot on your iPad in the bedroom.

We recognize that not everyone has a smart TV but there are still many options to stream. These include Google's Chromecast, Roku, Amazon Fire TV, and Apple TV. Below is a brief description of each:

**Chromecast** - Google's Chromecast is a small circular device that plugs into the back of a television and facilitates the connection to mobile, tablet, or PC. It is the conduit for streaming from the device onto the television. Cost of the Chromecast device starts at USD 35 for the 3rd generation (1080p) and USD 70 for the Ultra (4k UHD) version.

**Roku** - Roku is a very popular option for making older TVs smart. It comes with a small device that connects to the television and an incredibly simple remote (only 12 buttons - great for the tech newbie). Roku has its unique and easy to use interface with pre-downloaded apps such as Netflix, Amazon Prime, and Hulu as well as the option to download many more. The Roku device costs USD 29.99. Roku also has a mobile app, which can help control the TV.

**Amazon Fire TV** - Similar to Roku as it comes with its own remote and has a very easy to use interface. The Amazon stick is the size of a thumb drive and sticks into the back of any TV. A differentiator is the access to Alexa voice control through the remote, echo, or dot. One flaw Amazon Fire TV has is the absence of a Youtube application due to disagreements between Amazon and Google. Users can use the Firefox web-browsing app to access Youtube, although it is not as user friendly as the app. The price comes in at USD 39.99.

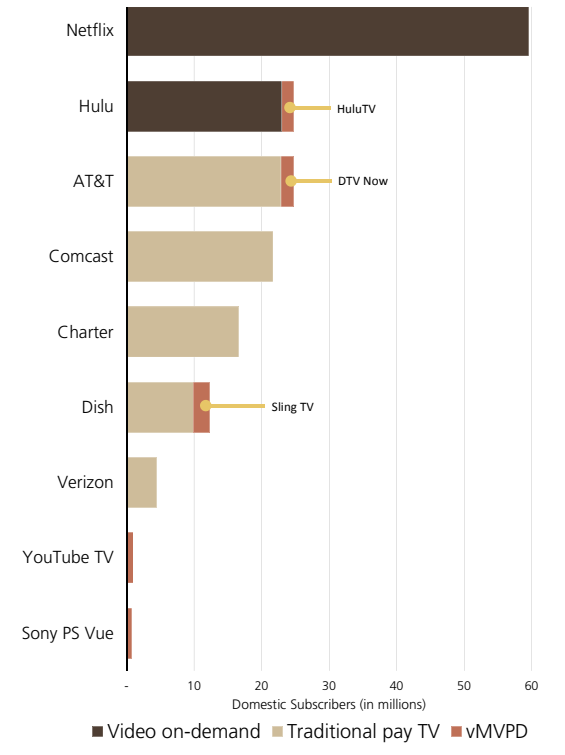
**Apple TV** - Apple TV helps stream video, music, and entertainment. It comes with a connection device and simple remote with Siri voice control included. Customers who own a number of other Apple devices will find it is easy to use and stream their personal music, photos and videos to the television. The main drawback is price, which starts at USD 149.

**6. What is my best option if I am getting a new TV?**

Going to Best Buy to purchase a TV has become an overwhelming experience with all of the options and variety of prices. While there are lots of different brands to choose from, here is some help in choosing the television that is right for you.

If your highest priority is visual quality, and price is no option, we recommend looking at the LG OLED 8B series. It is a smart TV with an OLED screen that comes in at USD 1,500 for the 55" size. This TV has been ranked as one of the best OLED TVs on the market with stunning quality.

**Fig. 5. US video subscriber base dominated by Video on-demand**



Source: UBS Investment Bank

For those consumers that don't want to spend USD 1,500 on a new TV, we would recommend researching the TLC LED 4 Series (4K UHD). For a 55" television, the cost comes out to be USD 355. It is a slight step down in quality because it is not an OLED model, but the TLC series has a built in Roku - making it a smart TV with a great interface.

If low cost is your top priority, the Insignia LED 1080p HDTV receives good customer reviews and comes in below USD 300 for the 55" model.

### **7. I want to cut the cord, but I don't want to lose sports. What do I do?**

We have found that the biggest concern most consumers have with regards to cutting the cord is the amount of sports content they fear losing. We are here to tell you that there is nothing to worry about. vMVPDs realize that sports and news are the most sought after channels and focus on their inclusion when building their offering. There are over 13 major television networks that offer varying degrees of sports programming. However, there is currently not a single streaming option that includes the same amount of content as a traditional cable offering. We believe that prioritizing which networks you absolutely need to have - and the corresponding sports they offer - is essential when choosing a streaming offering.

For example, most consumers desire the major broadcast networks (ABC, CBS, FOX and NBC) because of the amount of sports programming that they offer. Of course, Disney's ESPN and its family of networks is also a must have for any sports lover. NBA enthusiasts cannot do without Turner networks, which includes TNT, and die-hard football and baseball fans need to be able to watch the NFL Network and MLB Network. Throw in the Golf Channel, Tennis Channel, NBA TV, Olympic Channel and all of the regional sports networks and the amount of available sports content is almost overwhelming.

Now you may have heard of ESPN+. We think this should be viewed as an add-on and not a core service. For USD 5/month, subscribers gain access to hundreds of hours of programming, including MLB, NHL boxing, tennis, golf, college sports, rugby, and cricket. The problem is that users cannot pick which MLB or NHL games to watch and are often limited to out-of-state games due to regional blackout restrictions. The service does not provide access to SportsCenter or Monday Night Football. The core ESPN channels are offered on most of the major vMVPDs.

### **Our advice . . .**

In our opinion, for the best well-rounded option, we would recommend Youtube TV. It stands out among its peers because it offers a huge variety of sporting options: AMC, Big Ten Network, CBS Sports Network, SNY, ESPN, ESPN2, ESPNU, ESPNNews, Fox Sports 1, Fox Sports 2, Golf Channel, NBCSN, Olympic Channel, SEC Network, Telemundo, Tennis Channel, TBS, TNT, MLB Network, and NBA TV. The only network that is missing is the NFL Network and hopefully that gets included at some point down the road. An added bonus is unlimited cloud DVR storage.

## **8. I heard that Disney is coming out with a streaming service. What does that entail?**

Disney announced that the company is developing its own DTC streaming service that will compete with the likes of Netflix. The target release date is late 2019 and will be labeled *Disney+*. While there are still plenty of unknowns with *Disney+*, including the monthly price tag, here is what we do know.

*Disney+* will tap into the vast library of content across its brands, including Disney, Marvel, Pixar, Lucasfilm and National Geographic (acquired in the Fox deal). Initial reports suggest that Disney plans to have roughly 7,000 episodes of television series and 400-500 movies available on the service at launch. Disney also announced that is in-development on a number of new movies and television shows that will be exclusive to the *Disney+* service. These include television series with Marvel characters such as *Loki* (from *Avengers*) and a live-action *Star Wars* series titled *The Mandalorian* that is being developed by Jon Favreau. A new series set in the world of Pixar's *Monsters Inc.* is also currently in the works as well as a show based on the Disney Channel's *High School Musical* franchise. All of these are in addition to the studio's upcoming movie slate including *Frozen 2*, *Toy Story 4*, *Star Wars: Episode IX*, and the live-action remakes of *Aladdin* and *The Lion King*, which in all likelihood will have exclusive streaming availability on the new service.

We should note that *Disney+* will not include original Disney, Marvel, or *Star Wars* content that is currently on competing platforms such as Netflix. The end of Disney's partnership with Netflix does offer a few problems with the upcoming service. Netflix made five original Marvel Defenders shows: *Daredevil*, *Luke Cage*, *Jessica Jones*, *The Punisher*, and *Iron Fist*. *Daredevil*, *Luke Cage*, and *Iron Fist* have since been canceled by Netflix with rumors the other two will be following close behind. Fans of the shows will have to wait in order to see their characters again because Netflix's deal with Marvel prevents the characters from appearing in non-Netflix series or films for at least two years after cancellation. Also, the availability of the first six films in the *Star Wars* franchise is also uncertain as Disney sold the US broadcast rights to the films, which also includes streaming rights, to Turner in a deal that goes through 2024.

## **Who else is launching new streaming services?**

Other notable upcoming launches include a Warner streaming service and Viacom streaming service. As a broader theme, watch for content providers to develop their own DTC services and remove their intellectual property from others. Disney is taking its content away from Netflix to make their service more exclusive and there are reports that Warner will be following suit by only being able to stream their shows - most notably *Friends* - on their new service. Netflix, like others, is investing more heavily in developing their own original content.

## **9. OK I am sold, how do I cut the cord?**

Cable companies unfortunately make it very difficult to cancel and eventually you will have to talk to someone over the phone. We all know how frustrating those conversations can be. The most efficient

way is to call your cable provider's service number (if you can find it) and request your cable service be canceled. Remember, you still need Internet! You could e-mail the cancellation request as well, but the provider will call you directly within a few hours to confirm cancellation and attempt to negotiate a lower price in order to keep you as a customer. Hold firm and don't give in to this temptation as you will save money in the long-run by cutting the cord.

vMVPDs, on the other hand, are incredibly easy to sign up for and you can cancel at anytime with the click of a mouse. The ease of joining and canceling streaming services increases competition and, in turn, the number of promotions offered. We would recommend poking around to see if any services you are interested in are offering a 'First month free' or 'USD 10/month' promotion. If so, try out the service and see if you still believe the hefty cable bill is worth it at then end of your trial.

**10. In our view, what is the ideal setup?**

After having cut the cord ourselves, we believe that a combination of YouTube TV and Netflix is an ideal option to save money and enjoy live television and must-see shows. The YouTube TV interface is very intuitive and easy to navigate and you can record all of your favorite shows with cloud DVR that has no storage limits. Also, the service allows up to six accounts per household and a user can stream wherever they go. Finally, for an additional USD 12.99/month, Netflix offers a wide-variety of television shows and movies, all commercial free. And remember, there is no commitment with either YouTube TV or Netflix so if you decide that these services aren't for you it's very easy to cancel online anytime.

**Fig. 6. How much you will pay with just YouTube TV and Netflix**

	Best Value
Internet	\$ 39.99
Router	\$ 12.00
<i>Live Streaming:</i>	
YouTube TV	\$ 40.00
<i>Entertainment:</i>	
Netflix	\$ 12.99
<b>Total Per month</b>	<b>\$ 104.98</b>

Source: Company reports, UBS



## Appendix

### Statement of Risk

**Equities** - Stock market returns are difficult to forecast because of fluctuations in the economy, investor psychology, geopolitical conditions and other important variables.

### Terms and Abbreviations

Term / Abbreviation	Description / Definition	Term / Abbreviation	Description / Definition
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WMR	UBS Wealth Management Research	CIO	UBS Chief Investment Office

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### Disclosures (29 January 2019)

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