Cable’s Broadband Growth Set to Accelerate in The US

April 21, 2019 by Jonathan Chaplin

In our last weekly comment on the broadband market we sketched a decade-away view of a single connectivity market with whatever remains of today’s wireless and wired companies competing for the entire market. We argued that cable is best positioned for the fight given that they are attacking a market that is twice the size of the one they are defending, and they have time and infrastructure advantages. This week we focus on more proximate trends in the run up to the first set of results in what we believe will be a strong year for Cable broadband growth and for Cable equities.

Starting off with the very near-term…

We have been making the call that broadband growth is back. We hope to see this thesis reflected in strong broadband growth at the Cable companies this quarter.

We expect continued strong growth for the broadband industry in 1Q19. Growth accelerated through 2018 from a low of 2% at the start of the year, back to 2.5% at the end of the year. Two sources of pressure had weighed on broadband industry growth: slower household formation and wireless substitution (following the launch of unlimited wireless plans) . Both pressures have abated, and we don’t expect them to return any time soon.

We expect Cable to report strong share gains within a robust industry. Net adds for the three public companies should increase ~50k year-over-year in 1Q19. Consensus estimates look a little low for this quarter and for the next three. Comcast will lead the group with results on Thursday. Consensus expectations for ARPU and margins also look to low for them. We are hoping to see strong cable results at Comcast provide a lift to the multiples for the group next week.

And this is just the start; we expect continued strong growth at Comcast throughout the year, and accelerating growth at Charter. The three public cable companies should see net adds rise to ~3.6k for 2019 and ~3.9k for 2020. These are better than the trends that the market was anticipating in mid-2017, when these stocks were trading at multiples that were one or two turns higher. If multiples get back to mid-2017 levels, we see upside of 17-60% for the shares.

And that too is just the start. We have made the argument that cable companies ought to be valued like broadband infrastructure companies (at least 10-12x EBITDA!). We have backed off this pitch recently amid disappointing growth trends; we will be making it loudly by the end of the year as growth re-accelerates. We have also backed off the pitch that wireless will be a material source of value; we will be making this claim again towards the end of the year as wireless growth ramps and losses slow.

…And then the medium-term…

There are two threats to our Cable thesis: regulation and new entrants to the broadband market. Regulation is not a threat under this administration and with the companies who were the most influential proponents of legislation facing regulation themselves, the future threat of cable regulation seems more remote.

New wireless broadband entrants armed with 5G have been the bigger threat. We examined a version of this threat in our recent Broadband Trends report; specifically, we examined whether T-Mobile would be able to meet their objective of capturing 10MM broadband households by 2024 (LINK). We conclude that they don't have enough excess capacity for 10MM broadband subscribers; they may capture 5MM at most. This is unlikely to have a material impact on the Cable companies.

More importantly, the report argues that while they could support 5MM broadband subscribers, they almost certainly won't. Our excess capacity framework assumes that T-Mobile, pro forma for the Sprint acquisition, adds 15MM wireless customers over the next five years. Their market share would increase from 29% to 33%. They could create twice as much value adding another 11MM wireless customers, taking their market share to 38%, than they would by using that capacity for home broadband.

Alternatively, they could use the capacity to offer customers higher usage caps and faster speeds and capture value through higher ARPU. If T-Mobile increased its wireless ARPU by ~$2 it would create the same value for shareholders as adding 5MM home broadband customers. T-Mobile is priced at about an $5 discount to Verizon and AT&T; with higher caps and faster speeds they could price at a premium. Offering a better product at a higher price could create multiples of the value created by home broadband.

T-Mobile's home broadband ambitions will disappear if their acquisition of Sprint is blocked; an outcome that looks increasingly likely . The capacity framework we built has value outside of this specific application though. We lay out a seven-step process for estimating the number of home broadband customers that can be supported by a band of spectrum (Slides 28 to 48). The framework can be applied to other bands. We used a similar approach in our analysis of wireless carriers using the C-Band for home broadband (LINK). We will look at this again, from the perspective of cable companies, in our next iteration of the C-Band series (coming soon).

...and finally, the long term

We have argued that the threat of wireless incursions into home broadband is dwarfed by the opportunity that cable companies face by entering the wireless market. We articulated this view most recently in this forum a couple of weeks ago (LINK), and it is one we will examine again in more detail in due course.

Click here for our global multiples excel: LINK

Click here for a summary of this weeks' research and a pdf of our global multiples: LINK

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