Opening Statement – Federal Communications Commission
Hearing Addressing Ownership Rules
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Opening

I am Victor Miller, the broadcasting Equity analyst for Bear Stearns. I have covered the industry for 15 years in a lending and analytic capacity. Today, I will discuss seven operating pressures facing broadcast networks and local stations as a context for my deregulatory stance.

The Operating Pressures Facing Broadcast Networks and Local Stations.

The First Pressure is Audience Fragmentation and Declining Ad Share

The national TV marketplace consists of 10 broadcast networks, 1,372 commercial TV stations [1]and 287 national and 56 regional cable networks[2]. In 2001, the typical local household had 82 channels available to it versus 10 in 1980.[3] This robust and option-filled marketplace, accelerated by deregulatory changes made by Congress and the FCC, has been good for consumers. However, robust competition has impacted TV industry economics. The ABC, CBS and NBC networks have seen primetime viewing shares drop to 38% this year from 90% in 1980.[4] Local TV stations' share of media ad dollars has fallen to 15.5% in 2001 from 18.3% in 1980.[5]

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[1] BIA Investing in Television – 4th Edition 2002, page 6
[2] Federal Communications Commission – Office of Planning and Policy Working Paper Series 37: "Broadcast Television: Survivor in a Sea of Competition – September 2002, page 40
[3] TV Dimensions – 2003, page 24
[4] Nielsen Media Research
[5] Bear Stearns TV Fact Book – November 2002, page 106; Robert J. Coen McCann-Erickson

The Second Pressure is Escalating Programming Costs

Even in the throes of declining ratings, the cost of network programming has increased by 30% for ½ hour sitcoms and by 50%+ for one-hour dramas despite networks' increasing ownership stake in these shows after financial syndication rules were struck down in 1994.[6] Escalation of some sports rights fees have priced sports off broadcast TV. Local ABC, CBS and NBC affiliates stations are investing more heavily in local news, spending $1.5 billion in the top 100 markets on programming that most differentiates stations from other media.[7]

The Third Pressure is High Operating Leverage

Recent financial results reported by broadcast TV players suggest that there are few operating efficiencies left in the business. High operating leverage means the broadcast TV business is exposed to significant cash flow swings with changes in advertising. In 2001, local TV station industry revenues fell by approximately 15%[8], but cash flow plummeted by 25% to 35%.[9] The broadcast business is not well insulated from short-term or long-term declines in the business.

The Fourth Pressure is A Consolidating Cable Business

Consolidation of the cable industry may be broadcast TV's greatest threat. In 2002, the top 5 multiple systems operators (MSOs) controlled 72% of the nation's 74 million cable households [10] and in 15 of the top 25 media markets, one MSO controls at least 75% of the local market's wireline subscriber base.[11] Increasing MSO concentration will make it

[6] FCC OPP Working Paper 37 – September 2002, page 116; National Cable Television Association
[7] National Association of Broadcasters – Television Financial Report – 2001, pages 3-21
[8] Television Bureau of Advertising Estimate
[9] Bear Stearns "Television Industry Summit 2002" – November 26, 2002 , page 73; Company reports
[10] National Cable Television Association; Bear, Stearns & Company estimates; Television Industry Summit 2002, page 33
[11] Bear, Stearns & Company – Television Industry Summit 2002, page 71; BIA Financial Networks - 2001

more difficult for local TV broadcasters to have meaningful retransmission discussions. MSO concentration creates competition for TV stations' local ad dollars and programming franchises as well. Comcast's estimated $1 billion in local cable advertising surpasses that earned by ABC's O&O (owned and operated) stations.[12] And perversely, 2002's Appeals Court ruling would allow an MSO to buy a local TV station while local TV and newspaper players are often restricted from such moves by current ownership rules. This anomaly alone begs for significant local TV market deregulation.

The Fifth Pressure is New Technology

Early adoption of personal video recorders suggests that users skip ads at a 75% clip, 5x that of the VCR (15%).[13] Advertising is free-over-the-air TV broadcasting's sole revenue stream. If the ad-only model breaks down, monthly subscriber fees would have to increase by $39 per month to replace broadcast TV's lost ad revenues.[14]

The Sixth Pressure is the Lack of Return on Investment in Digital TV

We estimate that local TV stations will spend $4 to $6 billion rolling out digital TV with little obvious return available on that invested capital and with many issues left to solve.[15]

The Seventh Pressure is Poor Broadcast Network Economics

Broadcast networks are not very profitable. From 2000 to 2002, we believe that the "big four" (ABC, CBS, NBC and Fox) networks generated only $2 billion in profits on approximately $39 billion in revenue, a 5% margin. Without the most profitable

[12] Bear, Stearns & Company estimates
[13] CNW Marketing Research; Bear, Stearns & Company – Television Industry Summit – 2002, page 41
[14] Bear, Stearns & Company – Television Industry Summit 2002, page 42
[15] Bear, Stearns & Company estimate

network, margins fall to 1%.[16] Economically unhealthy networks create unhealthy local TV stations, whether owned or not.

[16] Bear Stearns & Company estimate from industry sources

Conclusion

If these seven operating pressures continue unabated, and no deregulatory relief is afforded the industry, the viability of "free-over-the-air television" could be threatened.

Deregulation for Networks: In order to preserve the long-term viability of the broadcast networks, we believe that the FCC should relax the national station ownership rule to 50%. In the past, the networks have relied on launching cable networks and syndication to improve overall TV economics. We believe these options will prove less valuable now given the over-supply of cable ad inventory and static demand for syndicated programming from local stations.

Deregulation for Stations: In order to preserve the long-term competitive viability of the local station operators, we believe the FCC should:

- Substantially relax duopoly rules by extending this option to smaller TV markets, where operating efficiencies are really needed. We support a rule that focuses on cumulative local audience shares, such as the NAB's 10-10 proposal, Hearst-Argyles' 30% local audience share proposal and triopolies in large markets.
- Substantially relax or eliminate the newspaper-broadcast cross-ownership rules, given newspapers' declining circulation, declining ad share and 28-year run without deregulation. A newspaper-broadcast combination also has potential local news and public service benefits.

A Comment on Radio

We advocate the retention of the FCC's current radio market definition which was in place when Congress modified the local radio limits in 1996. Any change now would upset the Congressional scheme and potentially introduce new anomalies. Further, a change in market definition would be disruptive to the a) acquisition of radio properties, b) relative competitive positions of local radio broadcasters, c) disposition of radio properties and d) the capital markets.

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