August 2021

# Is Now the Time for Smaller Cable Operators to Enter the Wireless Market?


**Jeff Johnston**
*Lead Economist, Communications*


### Inside...



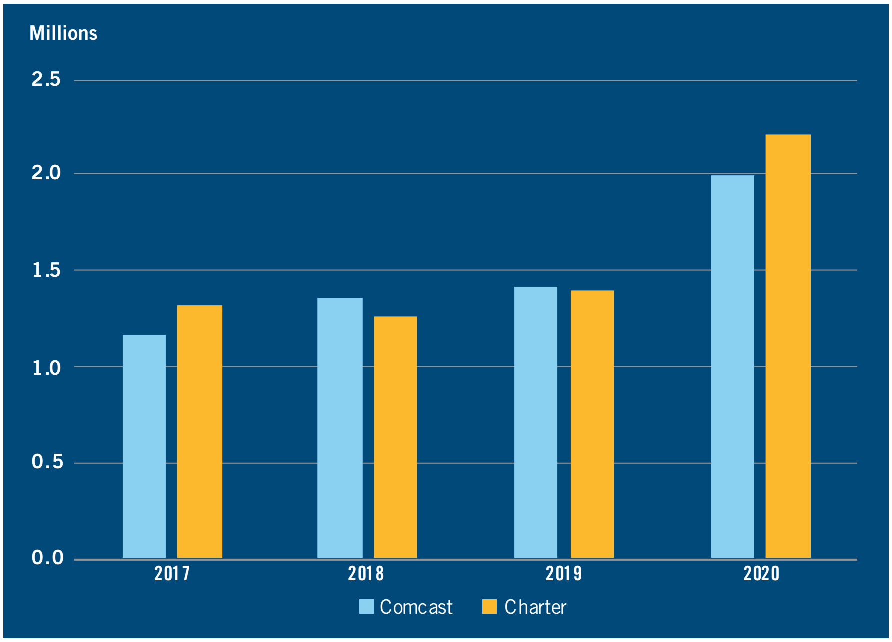
## *Key Points:*

- National wireless operators including Verizon and T-Mobile are setting their sights on the lucrative home broadband market to take market share from the incumbent cable providers.
- Technological advancements in wireless – coupled with large swaths of spectrum – have enabled national wireless operators to offer broadband via a competing fixed wireless service.
- Even though the fixed wireless threat is in its infancy, the large cable operators are not taking any chances. Charter, Comcast and Altice each launched a mobile virtual network operator (MVNO) business whereby they bundle their broadband service with smartphone plans and phones. The results have been impressive.
- Smaller cable operators have been watching from the sidelines, but might act now given their vulnerability to fixed wireless competition.
- However, launching an MVNO is no small task. Cable operators must consider several factors, including how to lower wholesale costs and address scale.

## *Introduction*

New advancements in wireless technologies and the flood of newly available spectrum are enabling national wireless operators to enter the home broadband market with a fixed wireless access (FWA) solution. The FWA threat to the cable operators is in its infancy, but Comcast, Charter Communications, and Altice USA are not taking any chances. These cable operators have launched their own wireless smartphone services, which they bundle with their cable broadband services. This bundling strategy is meant to prevent their broadband customers from switching to an FWA service, and is in response to evolving consumer video consumption trends. The cable operators' results are very encouraging, as they've reached major milestones and continue to grow their lucrative broadband business. Smaller cable operators have been watching from the sidelines, but it could now be time for them to go wireless. In this report we look at the business case for a cable/smartphone service bundle and the challenges, threats, and opportunities smaller cable operators face as they wade into the world of wireless titans and fierce competition.

**EXHIBIT 1: Broadband Subscriber Growth**




Source: Company Filings

This multiple system operator (MSO) strategy is paying off. Over the last 12 months, cable operators' wireless sales represented approximately 30% of the total wireless industry phone net additions. And in recent months, the cable MSOs reached major milestones. Altice USA, which recently launched its MVNO, saw a 20% to 30% improvement in its churn rate in Q4 2020. Charter grew its mobile revenue by 90.7% in the first quarter of 2021. But the most impressive metric came from Comcast. The cable giant announced that its mobile business broke even in April for the first time. And all the while, Comcast and Charter have been growing their high-value broadband subscriber base at a four-year, 14% compound annual growth rate (CAGR) *(Exhibit 1).*

Over the next five years, the cable MSOs are expected to grow their mobile subscriber base and service revenues at a 24% and 19% CAGR respectively *(Exhibits 2 and 3).*

## *Big Cable Goes Wireless*

Three or four years ago, cable giants Comcast and Charter Communications launched their wireless services via an MVNO model. This model enabled them to resell Verizon network's wireless service under their respective brands. This strategy was in part a response to changing consumer trends such as video streaming, which some estimates put at approximately 80% of total broadband usage. And while consumers were once satisfied confining their video consumption to in-home, they now want to seamlessly consume video in and out of the home.

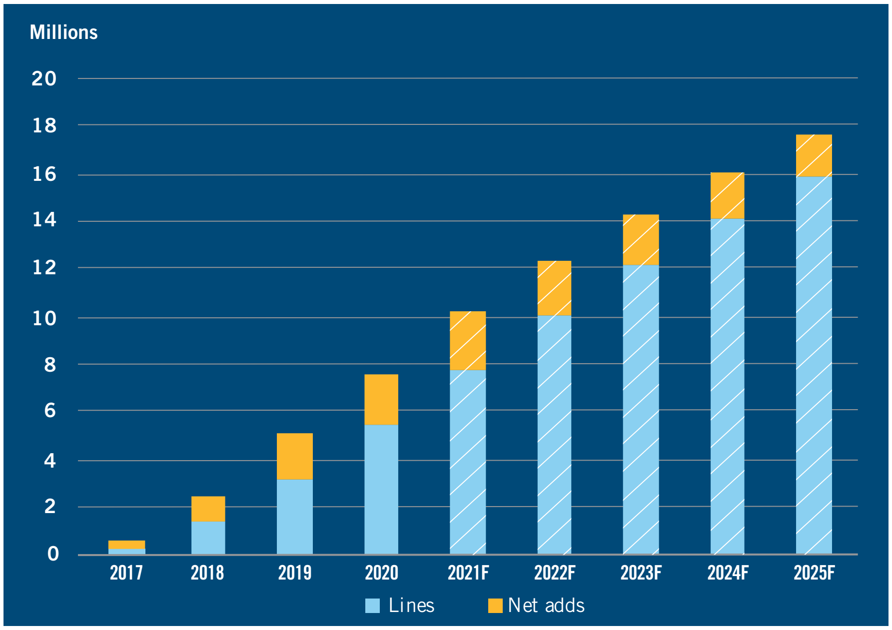
The cable operators' strategy was also a defensive response to the competitive threat from the national wireless operators. Wireless operators started laying the groundwork for their FWA service several years ago as an alternative to fixed-line broadband. The threat of a competitive alternative to fixed-line broadband service – coupled with a wireless smartphone plan – forced cable to respond with its own smartphone service/broadband bundle.

## *Fixed Wireless Threat*

Verizon and T-Mobile's FWA plans are the most ambitious and represent the biggest threat to cable. Verizon plans to reach 15 million homes this year, nearly 30 million in 2023, and 50 million by 2025. T-Mobile announced that 30 million homes are currently eligible for its FWA service. AT&T is taking a more fiber-first approach, but is planning to deploy fixed wireless in high-cost rural areas or with an "edge-out" strategy (that is, cost-effectively deploying in markets adjacent to an existing network).

Despite the wireless carriers' push into FWA, there are doubters. The reality is FWA will never be as good as a fiber connection, but it could be "good enough" for a large segment of the market. A very small number

**EXHIBIT 2: Historical and Projected Mobile Lines***




Source: S&P Global Market Intelligence
*Companies included: Comcast, Charter, Altice USA

competitive market that warrants defensive moves by the incumbents. However, for some larger regional operators, it's less black and white.

of consumers need, or even use anything close to a 500Mbps download connection, let alone a gig. According to BroadbandNow, the average download speed in the U.S. is 93.37 Mbps. So an FWA service at 100-150Mbps could be good enough for many consumers. And if the service is bundled with a wireless smartphone plan that saves the consumer money, the temptation to switch could be strong.

## *Regional and Rural Cable Operators*

Now that the tier one MSOs have proven out the MVNO/cable business model, should smaller operators follow suit? Our answer is: it depends. For most small rural operators, it's hard to believe that a postpaid MVNO makes sense. Postpaid customers carry the highest value and the national wireless operators compete aggressively to defend and grow this segment of the market. For rural cable operators, lack of scale and the cost uncertainties associated with postpaid unlimited plans would make it very difficult for them to succeed in this market. The issue in rural America is more about connecting people with at least one operator, less about a vibrant and competitive market that warrants defensive moves by the incumbents. However, for some larger regional operators, it's less black and white.

These operators should explore three areas when evaluating an MVNO strategy: competitive environment, scale, and capabilities.

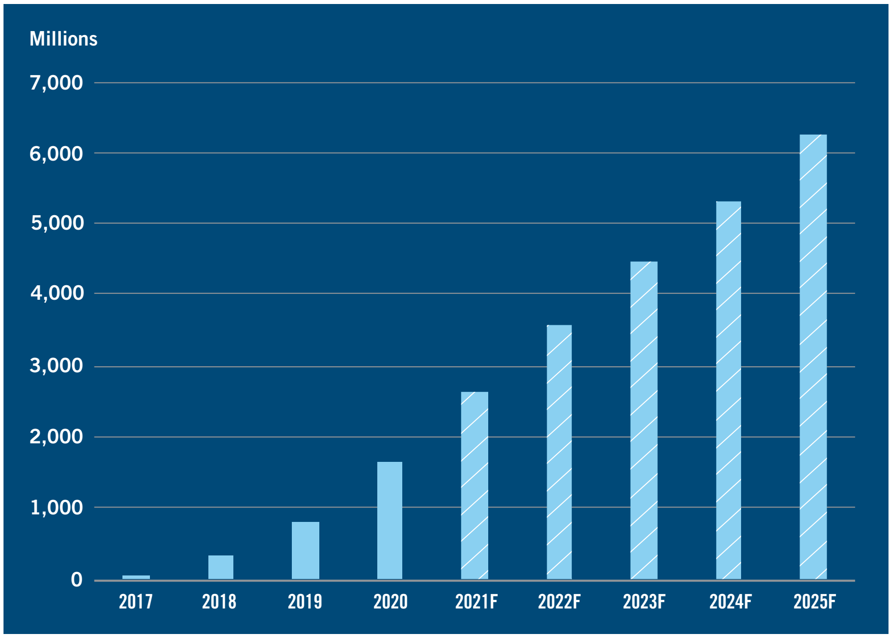
### Competitive Environment

Whether or not a market is at risk of an FWA overbuild from a national wireless operator is an important question to answer. A cable operator could choose a reactive strategy and wait for a wireless operator's FWA service to materialize and see how it goes. If the cable operator starts losing share, they could either drop their price or offer faster data speeds without a price increase. Broadband margins are very high, so cable operators have pricing power. Or they could launch an MVNO. The rationale here is that launching an MVNO is a major undertaking, and it diverts resources away from investing in the broadband network. The problem with this approach is cable operators could lose share and business momentum during the many quarters/years it takes to launch a competing wireless service. For cable operators in tier two and three markets, a reactive strategy may be ill advised given their vulnerability.

In national wireless networks, the extra capacity tends to be found in mid-tier markets that are less dense. As a result, these are the markets that are being targeted, and will continue to be targeted with FWA solutions. For example, Verizon thought it could disrupt the urban broadband market with FWA running on millimeter wave spectrum, which offers a tremendous amount of capacity and fast speeds. But it soon realized this strategy was flawed due to poor propagation of the spectrum. Verizon is now focusing its FWA efforts in markets with lower population density.



**EXHIBIT 3: Estimated and Projected Cable* Mobile Subscription Revenues**




Source: S&P Global Market Intelligence
*Companies included: Comcast, Charter, Altice USA

**Scale**
The biggest cost to an MVNO is the price it pays its mobile network operator (MNO) partner for data, and lack of scale can lead to higher wholesale costs. In the era of unlimited plans, the risk of runaway wholesale costs for a small MVNO is a serious issue. It can be mitigated by slowing down data speeds – which is not great for the customer experience – or by instituting data caps. We note that most plans offered by the national carriers come with unlimited data. Lack of scale also leads to a higher cost of acquisition, which is another major line item in the business.

**Capabilities**
Developing and integrating back office systems to support a wireless business is not trivial, a challenge made even more difficult when systems are integrated with multiple wireless networks. In the case of Altice, the company developed its own network core, giving it greater control over the services it offers. The network core also helps Altice manage the traffic across networks, both those owned by the company and its MVNO partners. This forward-thinking strategy will make Altice's wireless service more competitive, but building a wireless network core demands engineering resources and experience. Altice was able to do this, in part, by leveraging insights from its affiliates who operate MVNO businesses in Portugal, France, and Israel.

Over time, cable operators need to employ a heterogeneous network strategy to reduce costs. This network strategy includes combining Wi-Fi networks, the MVNO wholesale network, and the cable operator's own regional wireless networks. Building and managing a wireless network introduces new challenges for smaller cable operators. Important factors to consider include cell site/network handoffs, handset testing and certification, and overall network operations.

## *Creative Business Models*

Most postpaid MVNOs fail because they have an uncompetitive cost structure and/or a poor value proposition. For small to mid-sized cable operators the value proposition isn't necessarily the issue – it's cost.

Data wholesale costs represent an MVNO's largest expense line, so special attention needs to be paid here. To mitigate these costs, smaller cable operators should explore concepts like establishing a buying consortium of likeminded cable operators. By aggregating wireless data usage across multiple cable operators, the buying consortium should be able to negotiate lower wholesale rates than any of the members would get on their own.

But other options exist to make an MVNO agreement more strategic and a "win-win" for all parties.



The members could offer their fiber networks for backhaul and other services to their MNO partner. They could also include their pole attachment rights. By making the agreement more of a quid pro quo, it could reduce backhaul costs and streamline the small cell site acquisition process for the MNO while lowering MVNO wholesale costs.

Cable operators can also look to public-private partnerships that build regional wireless networks utilizing CBRS spectrum, funded in part with public funds. Such partnerships could give a city its own network for "smart city" capabilities, remote learning, etc. And it gives the cable operator a lower-cost option to their MNO partner. These networks could also generate new sources of revenue by leasing capacity back to the MNO, or any other operator needing coverage.

## *Conclusion*

The FWA threat to fixed-line cable is in its infancy, and the high broadband margins the cable industry enjoys gives it pricing power and optionality. But forward-thinking MSOs are not waiting around to see if the threat becomes a problem. They have shown that with the right model, wireless can be a profitable business and help insulate their high-value broadband subscribers. For smaller cable companies operating in mid-tier markets, entering the wireless market before FWA alternatives arrive may be a prudent strategy. The national wireless operators typically have excess capacity in these markets, which is one of the reasons why they are focusing their FWA efforts there. This makes cable companies in mid-tier markets more vulnerable compared to their urban counterparts. A creative strategy that includes a buying consortium to reduce MVNO network costs, and building Citizens Broadband Radio Service networks to generate wholesale revenue (and reduce costs), should be explored. ■

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