

HollAnd

Advisors

Holland Notes – DIRECTV (Price: \$43.06, MCap: \$28.3bn)

Bingo! A great model priced to fade

Excellent Investment Metrics

- Low starting valuation (PE's = 10.8x, 10.2x, 9.4x 2011, 2012, 2013 respectively)
- High returns and likely very high marginal returns due to operational gearing
- DIREC TV (DTV) has strong growth in revenue, profits and cash – Both reported in the past and expected by management.
- Strong franchise value and significant Moat. Also makes significant investment for growth in P/L (Subscriber Acquisition Costs)
- Very shareholder focused – returned \$21bn since 2006 (currently buying \$100m per week)
- We think the group's complex monopoly position may be harder to displace than Mr Market discounts. The group is impressive in each area of Content, Service, Technology, Innovation and Branding. Each has a barrier to entry but the combined ability to replicate them all suggests group is maybe more impenetrable than some investors realise.

Background

- Now fully independent and cleanly quoted post News Corp and Liberty Transactions
- US Pay TV market = 100m subscribers
- M/Shares = 60% cable, 19% Direct TV (on 19.2m subscriptions in 2010), 14% DISH network
- Group negotiates with local Telcos to provide bundled (TV/Internet/ Phone) products
- All DTV channels are able to be provided in HD format vs. Far fewer on DISH (competitor) due DTV's better past technology investment (admitted openly in DISH 10K)
- DTV also has sizeable LATAM operations – c.25% Market share

Company Targets – By end 2013

- (From 2010 investor day)
 - 30 million subscriptions
 - \$30bn revenues
 - \$5 of free cash flow per share and earnings per share
- FY 2011 results CEO "*I am confident we will meet and exceed all of the targets*"
- Except cash flow target - likely delayed one year due to more investment

Strengths

- Satellite technology = more channels available in HD and targeted advertising possible
- Attention to Customer service by the group is almost religious in its focus:
 - Want customers to "*have lifetime loyalty*" and to "*delight*" them
- Customer Service, Installation and satellite and technology ownership is all in house vs. outsourced at Dish/Ecostar
- Whole Home DVR being installed at higher cost, but a stickier product to then displace?
- DTV has dominance of Latam markets in Brand, Content and Market share
- Benefits accruing in content negotiation and other areas due to local (N.A and Latam) and group scale.

DIRECTV U.S. Sources of Historical Competitive Advantage



<p>Advanced Technology</p> 	<p>Distinctive content</p> 	<p>Outstanding Customer Service</p> <p>DIRECTV ranks higher than Cable in Customer Satisfaction. That's for 10 years running!</p> <p><i>2010 American Customer Satisfaction Index</i></p>																					
<p>Negotiating Scale</p>  <table border="1"> <caption>ACPU as % of revenue vs Millions of subs</caption> <thead> <tr> <th>Millions of subs</th> <th>DIRECTV ACPU (%)</th> <th>Comcast ACPU (%)</th> </tr> </thead> <tbody> <tr> <td>0</td> <td>42</td> <td>38</td> </tr> <tr> <td>5</td> <td>41</td> <td>37</td> </tr> <tr> <td>10</td> <td>40</td> <td>36</td> </tr> <tr> <td>15</td> <td>39</td> <td>35</td> </tr> <tr> <td>20</td> <td>38</td> <td>34</td> </tr> <tr> <td>25</td> <td>37</td> <td>33</td> </tr> </tbody> </table>	Millions of subs	DIRECTV ACPU (%)	Comcast ACPU (%)	0	42	38	5	41	37	10	40	36	15	39	35	20	38	34	25	37	33	<p>Strong Brand</p> 	<p>Great Team with a Drive to Win</p> 
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Pressures/Threats

- Higher content costs – A regular feature
- A Highly competitive market
- Some regulatory complexity in spectrum and broadcasting rules
- Pricing and product differentials to customer are less clear to us at this point than our knowledge of Sky
- New competitive capacity could be added in satellites/cable – On further reading we suggest this is actually more of an asset than a threat to the group due to its past investments.

Changing Emphasis 2011/2012

- Selective price rises put though, segmenting customer base much more
- Focusing more on customer loyalty/lower churn/higher ARPU
- Still making significant investments in higher end SAC and heavily focused on efficiency gains and their re-investment

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

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