

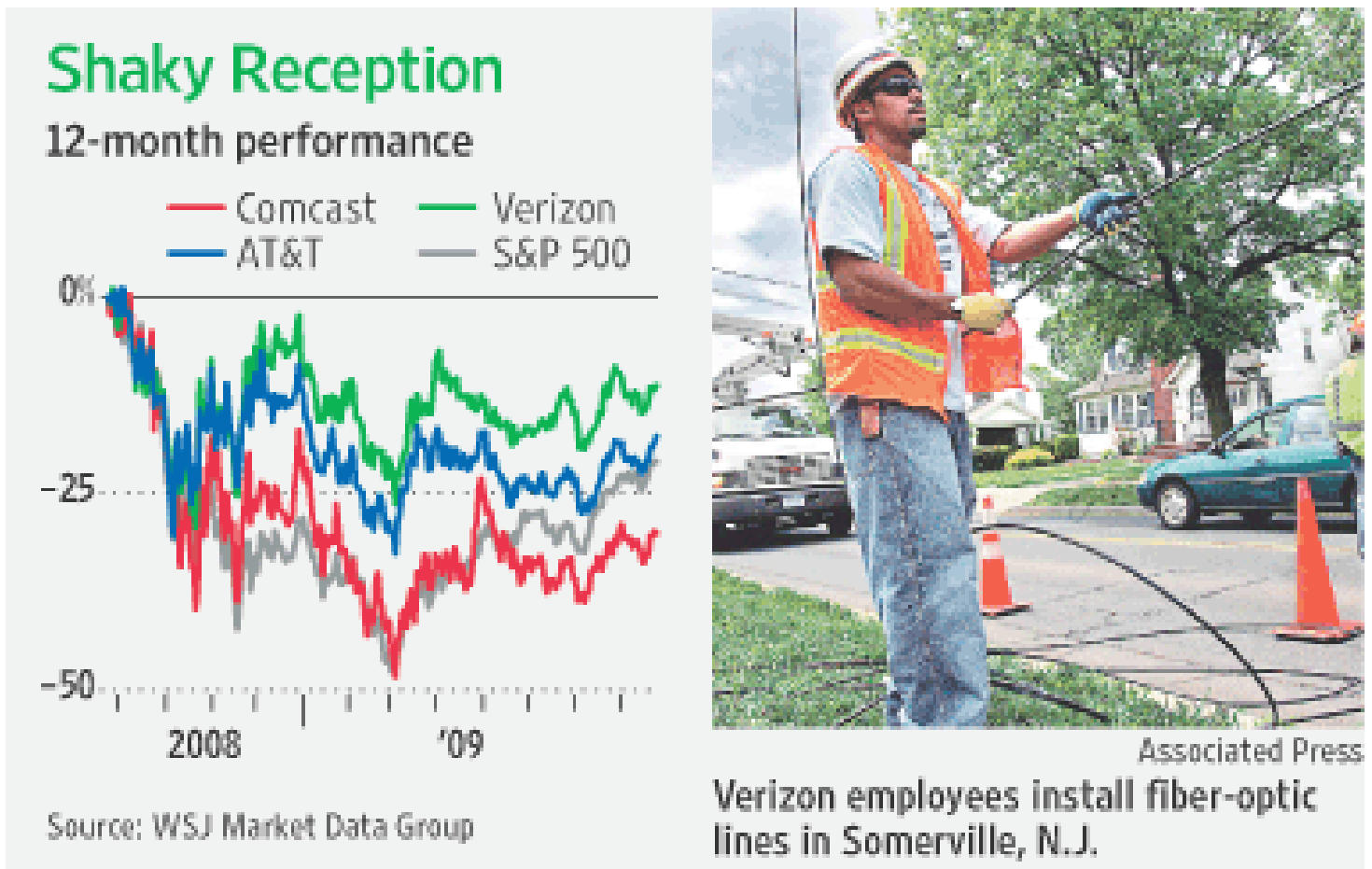
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## Looking for Cable's Moment in the Sun

By MARTIN PEERS

Chopped liver has nothing on cable and phone stocks.

Both have largely missed out on the rally. A relative shelter from the recent stock-market storm, they have suffered from a perception that telecommunications won't benefit from an economic upturn. The fact that cable and phone companies provide the infrastructure underpinning Internet use seems to be underappreciated.



On the face of it, Verizon Communications and AT&T look attractive. They have dividend yields of about 6%, not a bad return in a low interest-rate environment. Cable companies, in contrast, pay measly dividends at best.

At least partly for that reason, major cable stocks trade at or below phone-company valuations. The gulf is particularly marked on a 2009 free-cash-flow-per-share basis. AT&T and Verizon each are trading at about 10.5 times J.P. Morgan's 2009 estimate, while Comcast is at 8.4 and Time Warner Cable at 7.5.

While both sectors look cheap, cable is probably the better bet. Cable's long-term growth prospects are brighter than the phone sector's. Growth at both AT&T and Verizon is being driven by wireless, but that market is near saturation. Price cutting is likely to be a fact of life. Future growth will come from persuading subscribers to pay more for data services.

And while cable's video dominance has been eroded by competition from phone and satellite companies, cable has offset that by selling phone and Internet

services.

The value of cable's broadband networks won't likely be undermined by the growing popularity of wireless Internet use. The limits of wireless capacity suggest cellphone networks won't be able to handle smoothly the expanding volume of downloads from the Internet as smart phones and netbook computers proliferate. As Sanford C. Bernstein analyst Craig Moffett has argued, services such as video, which use lots of bandwidth, are likely "to remain the province" of wired networks. Wireless carriers already are putting some of their traffic onto them through Wi-Fi networks.

What is more, cable operators finally are cutting back on capital spending after years of promises, boosting free cash flow. Comcast's capital expenditures fell 17% in the first half, taking it down to 13% of revenue, putting it in the same range as AT&T and Verizon. Time Warner Cable's capital expenditures dropped 10% in the first half, although at 17% of revenue they are higher than the phone companies.

The pressure on wireless networks means that capital-expenditure requirements for wireless businesses won't diminish any time soon.

Phone companies will get some relief, as capital-expenditure-heavy wireline projects such as Verizon's FiOS upgrade should ease off. Even so, given the decline in the traditional telephone business, there is reason to question how much the phone companies can keep expanding, or maintaining, fat dividends long term. AT&T's \$4.8 billion in dividends was 57% of its free cash flow.

On the other hand, cable dividends should rise; indeed, they can hardly go down. Comcast paid out just \$375 million in dividends in the first half, or 15% of free cash flow. Time Warner Cable doesn't pay any regular dividend. Both companies are focused on paying down debt, but that will change.

The dividend disparity is an unpleasant reminder for investors about cable companies' history of poor capital allocation. Not only have hopes for free cash-flow growth been dashed in the past by spending on network upgrades, companies such as Comcast also have spent money elsewhere. In 2005, it blew \$250 million buying 20% of Metro-Goldwyn-Mayer, now struggling to stay afloat. It also tried buying Walt Disney in 2004.

Comcast and Time Warner Cable are likely to boost dividend payouts significantly. Investors could beat the rush by getting into the shares now.

Write to Martin Peers at [martin.peers@wsj.com](mailto:martin.peers@wsj.com)

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