

Letter from Ed

Welcome to the second issue of our DSM Industry Insights client newsletter. We were thrilled with the response to the inaugural issue, and plan to continue detailing trends that may affect your business. If you have any questions or comments that you would like to see addressed in a future issue, please call or e-mail. On the DSM front, we are delighted to have recently completed a couple additional deals that we will be able to tell you about soon.

Ed

Desser Sports Media, Inc.
715 15th St, Suite 200
Santa Monica, CA 90402
310 393 2WIN

www.desser.tv
info@desser.tv

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Table of Contents

1. Telco TV
2. State of Online Sports Video
3. Big Ten Network and NFL Network Update

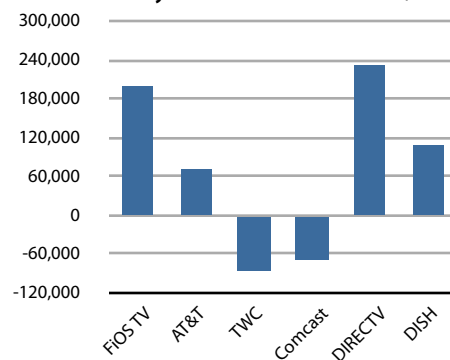
Telco TV

Summary

Over the last couple years, Verizon and AT&T have begun to expand into television video distribution and to compete with traditional cable and satellite providers. To facilitate this move, the telcos are making enormous investments in rebuilding and modernizing their infrastructure. This allows them to not only compete in the video space, but also to improve their broadband Internet offerings, pair those services with traditional wireline and wireless phone services, and offer a one-stop-shop “quadruple-play” bundle to consumers. These movements correspond with opposing offerings from traditional cable companies, like Comcast and Time Warner Cable, which are themselves offering voice telephone services with a “triple-play” bundle. The telcos are looking for new growth opportunities after downturns in the wireline sector, which has been impacted by wireless services and line reductions due to competitive broadband services and new cable telephone offerings. The cable companies, on the other hand, have similar motivations, as they find cable modem growth to be leveling off.

The debut of Telco TV is the first major change in the video distribution market since the arrival of DIRECTV in 1994 and EchoStar/DISH Network in 1995. Today, some lucky consumers looking for a home television service now have five choices available: traditional cable, DIRECTV, DISH Network, Telco TV, and Over

Pay Television Net Adds 3Q07



the Air broadcast, not counting video distributed over the Internet or the possibility of a cable over-builder. It can be imagined that the increased competition will cause major changes in the market, and sports programming can be counted on to play a typically pivotal role.

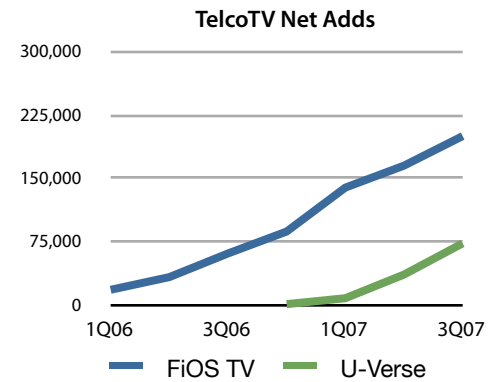
This article is designed to both introduce Telco TV to those who may not be familiar with it, as well as project and speculate on its broader impacts on the video and sports media marketplaces. The article is divided as follows:

- Effects on the Sports Media Marketplace
- Why Choose Telco TV for Your Home?
- Technology Review

Effects on the Sports Media Marketplace

Verizon and AT&T are both spending billions of dollars renovating their networks; it is hard to imagine that they will not attempt to maximize their investments. AT&T is aiming to penetrate 50-60% of their traditional landline phone footprint with its U-Verse service; Verizon, for its part, is aiming for 20-25% penetration of the video market within its footprint with its FiOS service. Although not aiming for total market dominance, those targets portend major competitive battles with cable and satellite systems. Additionally, if the telcos do not meet their targets, these giant corporations may be increasingly willing to make disruptive deals for sports rights or other differentiators that could help attract switchers. The increased competition could also spark marketing and discount wars like those now seen in the wireless sector. Already, disappointing 3Q07 results from Comcast and Time Warner Cable results revealed net subscriber losses over the quarter, with cable management admitting that increased competition from satellite and telcos was having an erosive effect on their subscriber bases. The news seriously spooked Wall Street, while AT&T and Verizon beat projections for net subscriber adds for FiOS and U-Verse video services. Meanwhile, Sprint has recently abandoned an initiative to partner with large cable companies to offer a version of the quadruple-play bundle, after seeing little traction among consumers.

The disruptive arrival of satellite providers in 1994 may serve as a valuable case study. The competition facilitated the arrival of a second wave of regional sports network launches, like YES, Altitude, and Comcast SportsNet, while satellite providers debuted exclusive packages like NFL Sunday Ticket, NBA League Pass, NHL Center Ice, and MLB Extra Innings.



NEW IMPORTANCE FOR PAY TELEVISION AS A MARKETING CATEGORY
 With these new entries into the pay television category, it can be expected that pay television as a marketing category will become more important and competitive in the future, much like wireless services in recent years.

AT&T uses a entirely new video distribution architecture that is known as IPTV. In the future, IPTV systems will not need Nielsen ratings to gauge viewership; instead, the back-end technology can track exact viewership data and customer habits. The theoretical flexibility and ease of customization on a per customer basis could bring close integration between “computer” or “traditional” Internet and television service. This close knowledge of the customer, like his/her demographic details and viewing habits, could enable Google-like relevant and micro-targeted programming and advertising to television. This type of advertising could bring higher CPMs and better feedback for advertisers. Watch for Google itself to make moves in this space; it is already trying to put together the beginnings of an infrastructure to support this information-rich advertising, using the DISH Network and Nielsen demographic data to build a pilot program for Google TV.

Why Choose Telco TV for Your Home?

For all the billions the telcos are investing in network upgrades and offering video services, finding key and compelling consumer differentiators remains difficult. Telco TV services today offer a host of incremental improvements that do provide a better consumer experience, but may not be enough on their own to convince customers to switch. However, the ongoing investment in rebuilding their networks with modern technologies may give them the flexibility, years down the road, to be leaders in bringing game-changing television services. Combined with the fact that the telcos have existing billing relationships with millions of potential video customers, the telcos do have some advantages.

MORE CHANNELS, MORE HD

While traditional cable and satellite systems are struggling to add more high-def and standard-def channels via their classic infrastructure, Telco TV systems have enough bandwidth to virtually side-step this problem. Verizon recently announced that they intend to offer 150 HD channels by the end of 2008, while AT&T’s technology, in particular, can theoretically deliver an unlimited number of channels. Additionally, Telco TV has the ability to offer a somewhat better picture and sound than traditional systems, but the difference is not so stark as to be a major point of differentiation.

Cable	Satellite	Telco
Less HD	More HD (150 channels)	More HD
VOD	No VOD*	VOD
Local, ground-based	No high-speed bundle	Local, ground-based
Large existing sub base	National footprint	Quadruple-play bundle
Widespread triple-play	No phone offering	

**DIRECTV is currently testing a VOD mechanism that delivers video content over a customer’s Internet connection.*

Telco TV's capacity to offer many channels lends itself well to small-audience programming like international channels and niche sports. The offering of international networks is a point of differentiation, and are featured prominently in Verizon FiOS TV marketing.

SET-TOP BOX IMPROVEMENTS

The ancillary benefits continue: both Verizon and AT&T are packing new, but probably low-impact, features into their set-top boxes. These include easier-to-use channel guide interfaces, mosaic views (like MLB.tv, where multiple channels are visible on one stream), community features like listings of what people are watching in your neighborhood, and games. In addition, they plan to offer multi-room DVR services, allowing recorded programs can be watched in any room in the house regardless of where they were originally recorded. AT&T's marketing touts the fact that their DVRs can record four shows at once.

ONE STOP SHOPPING

In addition, the telcos can offer a triple- or quadruple-play bundle to their customers, packaging together wireline telephone, wireless telephone, television, and broadband Internet access together in one bill, allowing customers to deal with only one vendor. Time Warner Cable and Comcast executives have stated that triple play customers have shown lower rates of churn (disconnects) and give the cable operators higher returns per customer.

Telco TV has the potential to offer the consumer a better experience. However, it remains to be seen whether these benefits will be sufficient to convince cable and satellite customers to switch their existing services. While there are many small benefits to Telco TV, in our opinion there has yet to be any dramatic game-changing benefits that would compel mass defections to Verizon or AT&T. Most benefits to date are related to price discounts when a consumer purchases multiple services from one provider, but simply getting one bill is not enough to cause most subscribers to endure the hassles of installation, changing e-mail addresses, etc. That is not to say that the telcos will not debut new game-changing features in the future, though—it just remains to be seen.

Technology Review

These network upgrades will host all the home consumer services provided by Verizon and AT&T: wireline phone, Internet, and now television.

	Fiber Architecture	Delivery Technology	Install Cost Per Home	Final Projected Homes Passed
Verizon	Fiber to the Home	Multichannel, cable-like	~\$800 (4Q06: \$933, E2010: \$650)	20-25%, 3-4 mil subs (2010)
AT&T	Fiber to the Node	IPTV	Low \$300s (3Q07)	50-60%

VERIZON FIOS-FTTH ARCHITECTURE

Technically known as Fiber To The Home (FTTH), rolling out FiOS service entails running fiber optic cable from local Verizon offices to each individual dwelling. This installation is very expensive (\$933/install in 4Q06), but once installed, provides a robust, flexible, and high-capacity pipe to each home. Through this infrastructure, Verizon delivers extremely high-speed Internet broadband (up to 20 mbps) and video service. Verizon is currently concentrating on single-family homes, due to the complexity of multi-family dwelling installs. Not all homes that have FiOS data (Internet) service have access to FiOS TV; availability is dependent on both technical factors and the availability of video franchises in the city or state. In FiOS's early stages, there was a large gap between those who got FiOS data only and those who got both FiOS services; as the service has begun to mature, however, that gap has narrowed considerably. This suggests that those consumers willing to try FiOS Internet services are warming up to FiOS TV, and that Verizon is narrowing the differing paces of FiOS TV and FiOS Internet rollouts.

AT&T U-VERSE-ARCHITECTURE OF "PROJECT LIGHTSPEED"

The buildout of "Project Lightspeed," as AT&T's network upgrade effort was originally known, resembles a blend of Verizon's approach and AT&T's current DSL service. Lightspeed consists of fiber runs from local AT&T offices to local utility boxes in residential neighborhoods, from which it uses existing copper phone lines to each home that provide phone, Internet, and video service. The use of copper lines for the final hop to each living unit provides considerable cost savings and a speedier service roll-out, and does not preclude a later rollout of a Verizon-like full-fiber network. However, the hybrid approach is technically tougher; there have been concerns about scalability, although AT&T executives have dismissed them, saying that with over 125,000 subscribers, the system has already passed major scalability bumps. Despite this, its roll-out was delayed for many months, and there was a major day-long U-Verse outage in October. Additionally, the next-gen U-Verse set-top box, developed by Microsoft and known as Mediaroom, is again encountering delays and technical problems. In

November 2007, AT&T revised their U-Verse roll-out projections to eventually pass 17 million dwellings, down from 18 million, and expects to spend \$500 mil. more doing it.

U-Verse is a true IPTV service; IPTV is a new video delivery technology that has not yet seen broad rollout in North America. FiOS uses technology that more closely resembles classic cable multichannel delivery systems, though delivered via fiber. IPTV stands for Television over Internet Protocol, meaning that the video is delivered over an internal network that uses the same technology as the broader Internet, although U-Verse's internal network is not connected to the global Internet. In practice, this difference is invisible to consumers.

IPTV systems like U-Verse deliver channels to the set-top box only as they are requested, instead of sending all available video down the pipe like FiOS and traditional multichannel systems. The process of requesting specific channels uses much less bandwidth, and allows U-Verse to carry a virtually unlimited number of channels without squeezing others out. However, this presents the problem of lag time when switching channels, which Microsoft and AT&T have worked to minimize. Executives claim that switching is now virtually instantaneous, and in fact use it as a U-Verse marketing point.

State of Online Sports Video

Overview

The landscape of online sports video has yet to coalesce and form major market leaders; the nature of sports footage has meant that it has yet to quite find its place online, although a variety of organizations are trying different tactics and formats to see what shakes out. General online video features clear market leaders like YouTube, but with a very long tail of different, often fly-by-night, sites that host a variety of video. These video-sharing sites, where users can upload videos themselves—that they may or may not own the copyright to—are now facing competition from conventional content outlets like television networks, or of special importance in our case, leagues and teams that are hosting professional video on their own sites.

Types of Official Video Available

HIGHLIGHTS

Sources for sports highlights are almost as numerous as there are sports websites; features that allow cross-posting video highlights from site to site make it impossible to track with comprehensive certainty where highlights are going. YouTube made part of its fame from sports highlights; they range from fans

Current Types of Online Sports Video

Official league/team site highlights

Official league/team site full games

YouTube Channels

User-generated, unauthorized highlights

Out-of-market sites like MLB.tv and

NHLVERSION

Video+ like NASCAR TrackPass,

Jacked.com

pointing their camcorders at their televisions to professional video uploaded with relatively little quality loss. As YouTube gained in popularity and momentum, professional content providers like leagues and television networks moved to provide official content to the site, at the price of YouTube cooperating with the content providers to remove unauthorized content that may violate copyright laws. The NHL was the first sports league to do so, striking a deal for highlights and full length games in November 2006. The NBA followed in February 2007, after abandoning a Google Video venture that sold completed full-length games for \$3.95.

All four major leagues and their team sites now feature extensive libraries of free content, including highlights, interviews, and other ancillary content. What differentiates the positions of the leagues is what they are doing with Internet video beyond the simple hosting of highlights and similar content on their main marquee websites.

Policies and initiatives, categorized by league:

NFL

The NFL limits access to online video to NFL.com; even news use of practice site interviews is being limited by the league. The NFL Network-branded video that is available on NFL.com, though, is easy to use, plentiful, and high-quality. However, there are no other approved outlets for NFL video. Major sports sites like ESPN.com and SI.com are limited to ancillary NFL programming, and it does not have a YouTube deal. It does sell game footage on the iTunes Store, including a feature called "Follow Your Team," which for \$1.99 offers consolidated highlights from each game over the season.

MLB

MLB's Advanced Media division maintains strict control over distribution of MLB game footage, but does license online to major video suppliers like ESPN. It does not have a YouTube deal. MLB.com additionally offers comprehensive video through its "Baseballchannel.tv" feature. MLB.TV streams all out-of-market regular season games for a flat subscription fee. MLB.TV offers a notable "mosaic" feature that allows the user to watch multiple live games at once on the same screen.

NBA

The NBA is making a number of inroads towards adopting the best application of online video for its purposes. In addition to substantial video offerings on NBA.com, the NBA is licensing video to online video sites, providing "widgets" that allow bloggers to embed highlights in their own pages, and have a deal with YouTube for official highlights. The NBA recently inked a deal with ESPN and MediaFLO that will provide for more than 70 games to be broadcast live to some

Verizon cell phones, the first league to make a distribution deal in this new mobile television technology. The NBA also offers League Pass Broadband, which allows League Pass television subscribers to watch games over the Internet.

NHL

The NHL has been quick to adopt new technologies and distribution mediums. NHL.com features a healthy amount of highlights content through its “NHL TV” feature, and streaming of live games, similar to the multi-game mosaic pioneered by MLB.tv. The NHL was additionally the first league to sign deals with YouTube, Google, and online television service Joost. The NHL has also begun to permit teams to distribute live game video within their respective territories, subject to league control.

FULL-LENGTH GAMES

The vast majority of video sports content on the Internet takes the form of highlights. Short, easily digestible clips fit well with the traditional conceptions of Internet behavior, and do not require much computer horsepower, widening their potential audiences; in addition, they are easier to deal with from a rights perspective. However, longer-form content is gradually gaining mindshare and usage on the Internet, with major broadcast networks feeling their way into the proper way to distribute full-length content in this medium.

Live sports programming carries a natural hedge against time-shifting and other non-live distribution; additionally, many fans would prefer to follow their team by the most comfortable means possible—usually their television. However, some have used the same argument to maintain that the Internet does not pose a real threat to conventional series television programming—that viewers would prefer to watch their favorite shows from their couch, on a traditional television, often in HD. This seems overwhelmingly true, at least for now; however, more and more people are watching, and getting used to watching, television content on their computer screen. It seems unlikely that the smaller computer screen will replace the television, but in the future, it will likely end up taking a bigger slice of the viewership pie.

FREE OR PAY?

All caveats aside, sports enterprises are experimenting with how to profitably make full-length games available. In 2006 the NBA and Google began to sell full-length games through Google Video. On the iTunes Store, MLBAM is selling full-length games. Increased acceptance of watching long-form content on the computer will open new opportunities, like monetizing archives of historical and classic games.

RSNs looking for “whole package” of game broadcast rights
RSNs negotiating with teams for television broadcast rights are also looking towards the future, asking for the rights to stream games over the Internet, should leagues make those rights available to teams in the future.

ESPN360

ESPN360 is an effort by ESPN to stream multiple live sporting events over the Internet. They showcase full games, both domestic and international; one of the stated aims of the site is to provide the viewer with a live sporting event at all times. They aim to stream over 2500 live sporting events in the next twelve months. The site has had an uneven history, and the site had a recent re-launch in an effort to improve the user experience. ESPN360 has a unique Internet business model; ESPN strikes deals with Internet Service Providers for access to the site, similar to television networks striking deals with cable operators. This has the effect that most Internet users cannot get to ESPN360, potentially limiting advertising revenues, but with the hopes that the subscription fees from the Internet providers will offset that. ISPs that currently offer ESPN360 include Verizon, AT&T, RCN, and some Charter systems, among other smaller operators.

New Networks Distribution Update

In the last edition of DSM Industry Insights, we provided a detailed look at the Big Ten Network's (BTN) progress in achieving distribution (check www.desser.tv for back issue). Since then, very little has changed. The major MSOs have held firm in their refusal to allocate precious "expanded basic" bandwidth to the network. The NFL Network has also faced similar resistance, as has Comcast in gaining distribution of the new Portland-area RSN featuring the Trail Blazers. In each case, the issues are price and tier placement. However, the year is coming to an end, and cable operators typically increase their prices at the start of a new year. In order to blunt the increases, many networks are added to line-ups at the same time. Look for some action on one or more of these networks around the new year.