Cable One, Inc. (“CABO”)

May 2016

@find_me_value

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58 Summary

Valuation Overview: Cable ONE, Inc.

- Cable ONE, Inc. is valued at the higher-end of current U.S. cable providers
- Their valuation “premium” is likely due to a few things, mostly:
  - Their focus on higher margin lines, and thus their margin profile (in theory) should be superior to other MSOs
  - Their focus on faster growing lines, less so telephone and video, and (in theory) their growth should be superior
  - The footprint of CABO has less competition than the larger MSOs, with minimal FTTH and only 25% DSL
  - Acquisition target; as the cable industry is under consolidation (see: Altice/Cablevision, Charter/BHN/Time Warner Cable), there is an emphasis on scale by the larger MSOs. Being only ~$3.1 billion EV and having a poor video product/no programming scale, a larger MSO could easily acquire CABO, revamp their video product, use their rate card for programming, and have tremendous amount of synergies on video alone.
- I estimate that CABO has video programming of 63% of video revenues, equating to ~ $47/month per subscriber in programming costs. If a larger MSO came in and lowered their programming to 55%, the immediate cost savings based on the current subscriber base is $25 million (lowering current EV/EBITDA by 0.75)
- *If CABO were to be acquired, I wouldn’t be surprised if it got taken out around ~10x post-immediate synergy numbers, in the $500 - $550/share range. Why?*
  - High programming cost currently per subscriber
  - Very low competition in their footprint
  - Inferior video and internet competition in their footprint based on the larger MSO products; should lead to faster growth, increased penetration
  - DirecTV is propped up by AT&T’s push to move subscribers from U-Verse to DirecTV, as well as the introduction of the “quad play”; otherwise, DirecTV is no longer superior to the larger cable companies in terms of quality of video product, and the larger cable companies have a substantial advantage on fixed broadband capabilities

Valuation Overview

- *Personally*, I would not buy Cable ONE unless it were to be in the low-$400/sh., to high $300/sh. only because there is still ample runway for their broadband product and penetration, and the ~30% upside to a likely acquisition premium price
- At mid-high $400's, and above 10x EV/EBITDA, there may be less likelihood of an acquisition and their strategy is inferior to the larger MSOs who:
  - Have the same capabilities as CABO on internet
  - Tremendous scale on video programming costs
  - Scale on national advertising
  - Scale on R&D for the user interface and product development
  - Offer a competitive video product, and thus have higher penetration numbers and "Cash Flow to Footprint" numbers

Cable ONE, Inc.

Financials updated as of:		*12/31/2015*	*Q1 2016*		
Current Stock Price	$	462.00			
Shares Outstanding (Diluted)		5860.089			
Market Capitalization	$	2,707,361			
(minus) Cash & Equiv.	$	119,199			
(minus) Investments in Aff.	$	-			
(add) Long Term Debt	$	545,301			
(add) Commercial Borrowing	$	3,750			
(add) Pension & OPEB	$	24,399			
Enterprise Value	$	3,161,612			
Trailing 12 Months			EV-to:	Market Cap-to:	Yield
FCF - Firm (post-tax)	$	96,596	32.73		*3.1%*
FCFE	$	80,506		33.63	*3.0%*
OCF (EBDA)	$	246,413		10.99	*9.1%*
EBIT	$	161,742	19.55		*5.1%*
Net Income	$	89,033		30.41	*3.3%*
EPS	$	15.19		30.41	*3.3%*
FCFFPS	$	16.48	32.73		*3.1%*
EBITDA	$	309,119	10.23		*9.8%*
EBITDA - Capex	$	152,983	20.67		*4.8%*
				Average Yield	*4.9%*
				Multiple	*20.2*

My (*Brief*) Thoughts on “CABO”

- In reading transcripts, looking over their annual report, presentations, and talking to others, my belief is that CABO’s management is more “*talk the talk*” than “*walk the walk*” (i.e. very promotional)
- Management tries to market themselves as being very capable, ahead of the trends, smarter than the competition, as well as appealing to the value investor community
- Target “value investor” community by saying/doing things that they know value investors are attracted to:
  - ‘Focusing on free cash flow per product, not gross margin like the other companies’
  - ‘as one astute Seeking Alpha contributor mentioned, we are where the puck is going’
  - Having Markel’s CIO Tom Gayner and fund manager Wally Weitz on the Board of Directors
  - Having an attorney (a Trial attorney, at that) from Charlie Munger’s firm
  - Announcing a new share repurchase program immediately after the spin-off from Graham Holdings Co.
- There are some positive implications of CABO’s strategy to focus on Residential HSD and Business Services:
  - Strong EBITDA Margin, as they focus heavily on the “highest margin profile” products, versus low/negative margin video and telephone
- However, there footprint and strategy may be limiting them in terms of growth potential, as their EBITDA-per-home passed and penetration rates are the lowest among the public MSOs
- While they do (and should) have comparable margins to Comcast, Charter, and Time Warner Cable, if they were able to offer a competitive video product they may sacrifice some margin on video but make up for it on triple-play, and obtain subscribers they currently may not (thus increasing penetration => increasing EBITDA-per-home-passed)

Overview of Cable ONE, Inc. (CABO)

- ~10th largest cable company in the U.S.
- Offers video, data and voice services in 19 states (Midwest, Texas, MS, northwest)
- Largest markets are: Treasure Valley (ID), Gulf Coast (MS), Prescott (AZ), Idaho-Falls (ID), Fargo (ND) – all outside the top 100 DMA based on size. These five markets make up 47% of their PSUs. The top 2 make up >25% of the PSUs.
- Differentiated strategy vs. other MSOs: focus squarely on residential data and business services, whereas other providers try to discount/bundle to obtain triple-play subscribers, then eventually upgrade them and retain them longer.
- Changed strategy in 2012, believing no margin in residential video business, the future is actually high speed data
- "linear TV model is dead, has no cash flow margin" is what their strategy is built on
- 45% of their customers are "broadband only"
- Most standard speed offered is now 100 mbps; will soon offer "GigaONE" 1 gbps speeds in some markets
- Financials
  - $800 million revenues
  - $300 million EBITDA
  - Spending 20-22% of revenues on capital expenditures last 3 years, expected to move towards 15-17% going forward
- Subscribers
  - 350k residential video (22% penetration)
  - 461k residential broadband (28% penetration)
  - 111k residential telephone (7% penetration)
  - 71k total business PSUs
- 1.64 million homes passed; limited expansion over the last few years

Overview of CABO's Strategy

Triple Play Package = **<u>NOT</u>** good

Preference for residential HSD and Business

Limited scale to negotiate programming expense kills video margins

Triple Play Package = good

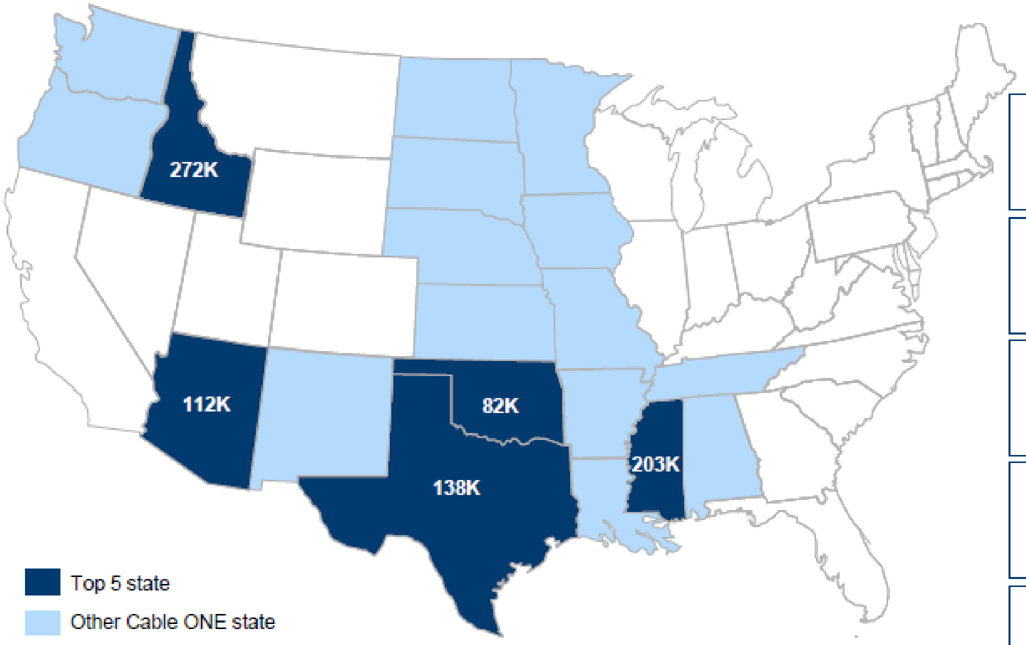
Using Video/Telephone to lower churn/obtain customer

Using scale to negotiate programming expense

Footprint: Rural – Midwest America

- 25% overbuild with DSL, including 20% with AT&T U-Verse
- <3% FTTH from competitors

▶ Two largest markets, Treasure Valley (Idaho) and Gulf Coast (Mississippi), represent over 25% of PSUs



Top 5 markets
(by PSUs)

Treasure Valley, ID *~151k*
Gulf Coast, MS *~129k*
Prescott, AZ *~69k*
Idaho Falls-Pocatello, ID *~68k*
Fargo, ND *~61k*

Source: Company estimates as of March 31, 2015

Cable ONE, Inc.

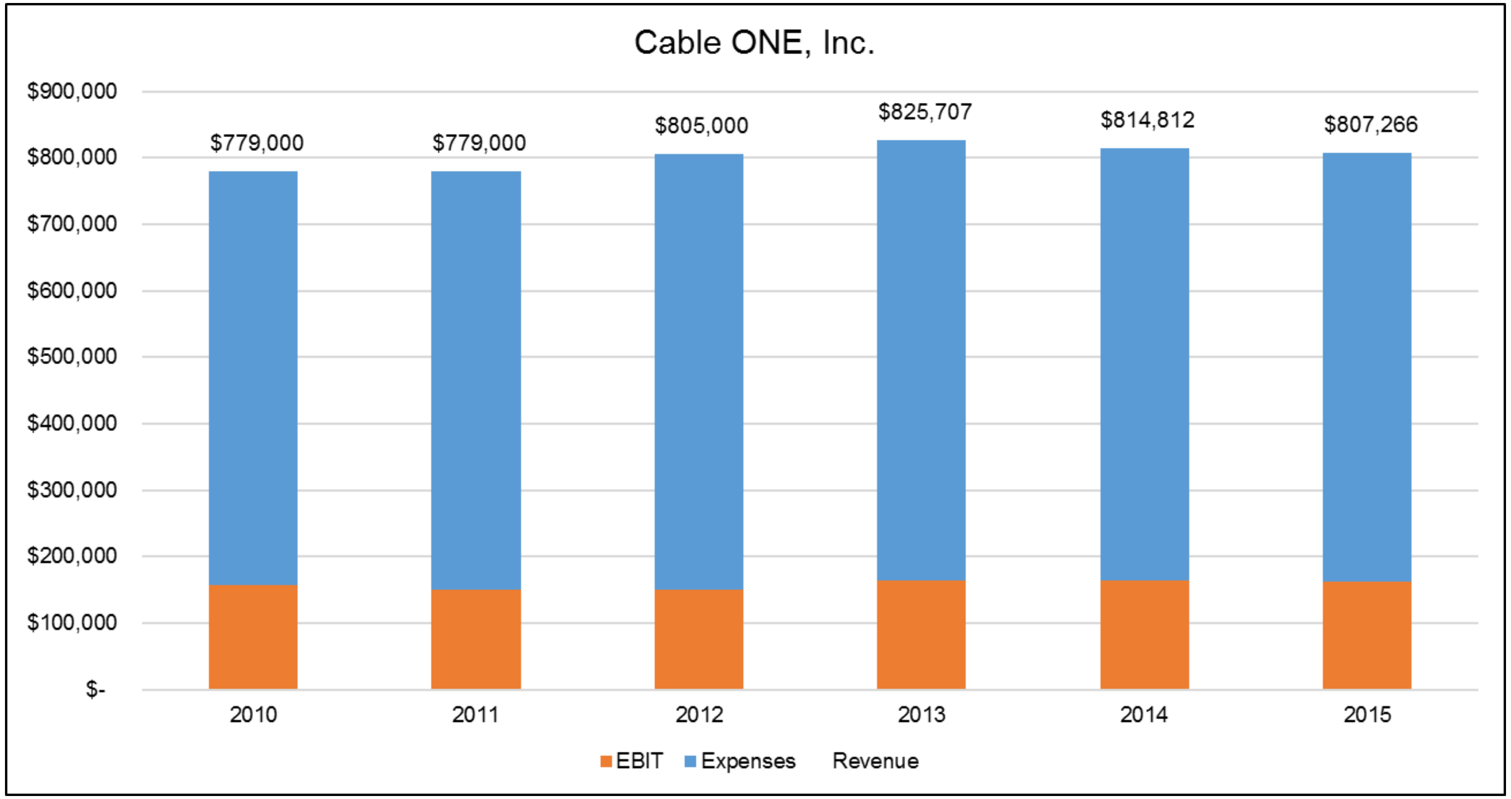
Brief History of Cable ONE, Inc.

- Founded in 1986 as Post-Newsweek Cable
- Spin-off from Graham Holdings (GHC) July 1, 2015
- Changed strategy in 2012 to focus mostly on (a) high speed data customers – residential, and (b) business services
- Preference for higher margin products likely due to lack of scale on the video programming side
- Hybrid Fiber Coaxial Cable (HFC) infrastructure, where most of their connections are fiber optical to the node, then coaxial cable from node to the homes (similar to other cable companies)
- Currently using DOCSIS 3.0

CABO: Financial Overview

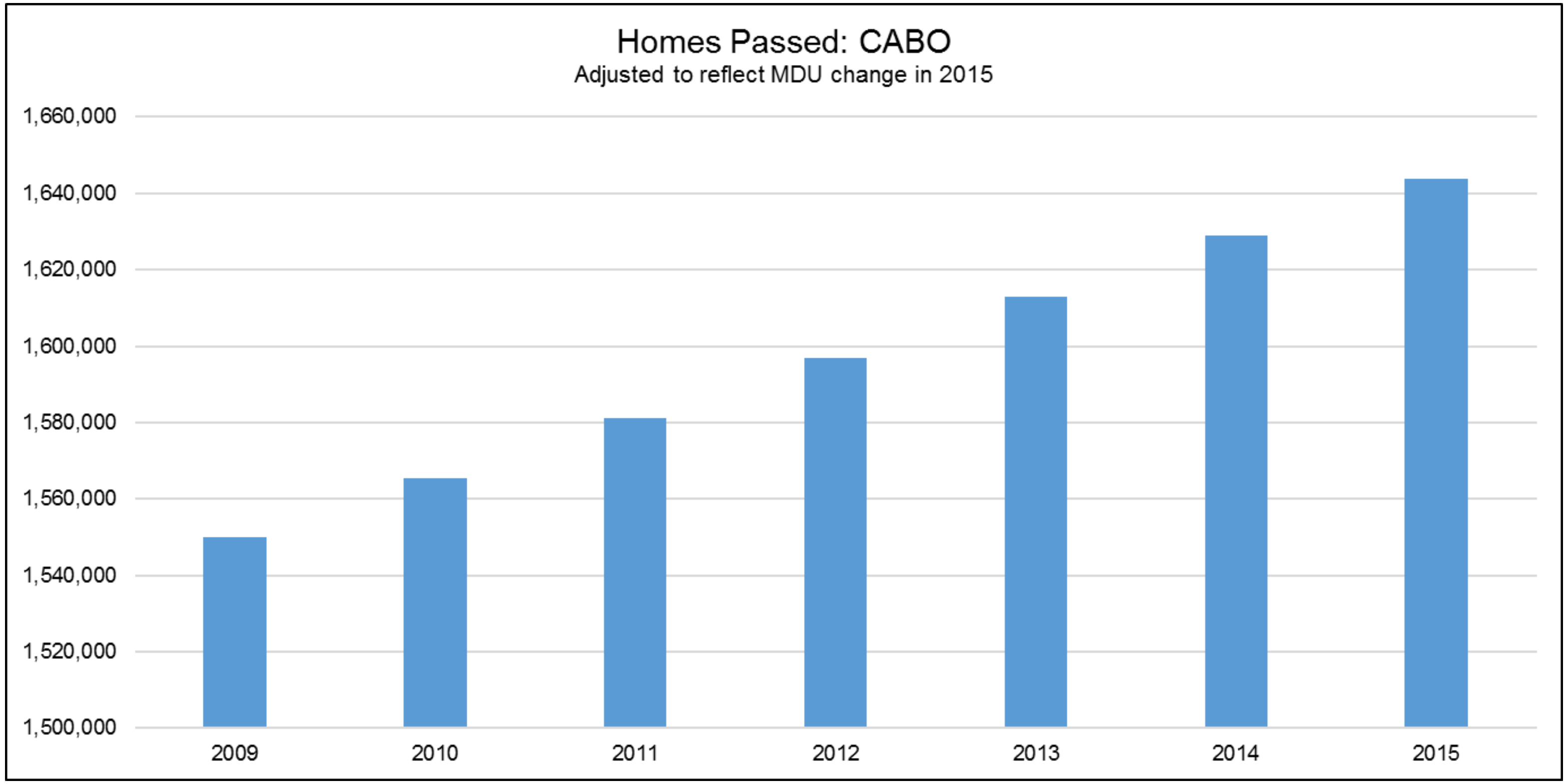
Revenue: EBIT + Expenses

- Operating Income has barely nudged in the last 5 years, mostly due to increased pressure on the residential video side from limited programming scale
- Revenue has increased 0.7% from 2010 – 2015; *from 2009 to 2015 the growth has been essentially 0%*
- *Meanwhile, from 2009 to 2015, total assets has increased at a 2.5% CAGR*



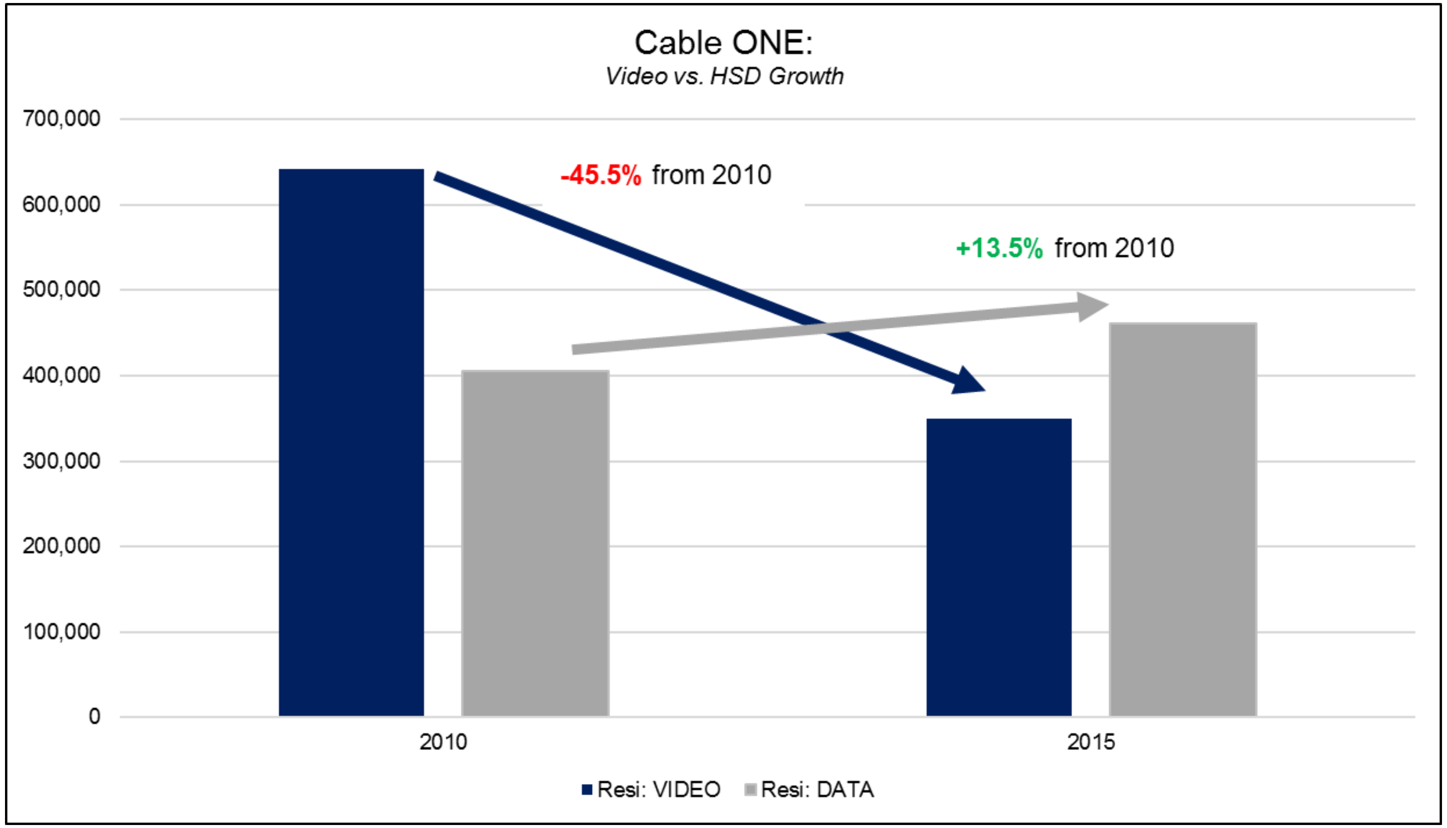
Homes Passed/ Footprint Expansion

- The “homes passed” metrics looks like it increased quite a bit from 2014 to 2015; this is misleading.
- In 2015, CABO changed their metric to reflect that each unit in a MDU counts as one unit, which increased “homes passed”
- From my conversations with them, about 1% growth per year in homes passed was more likely



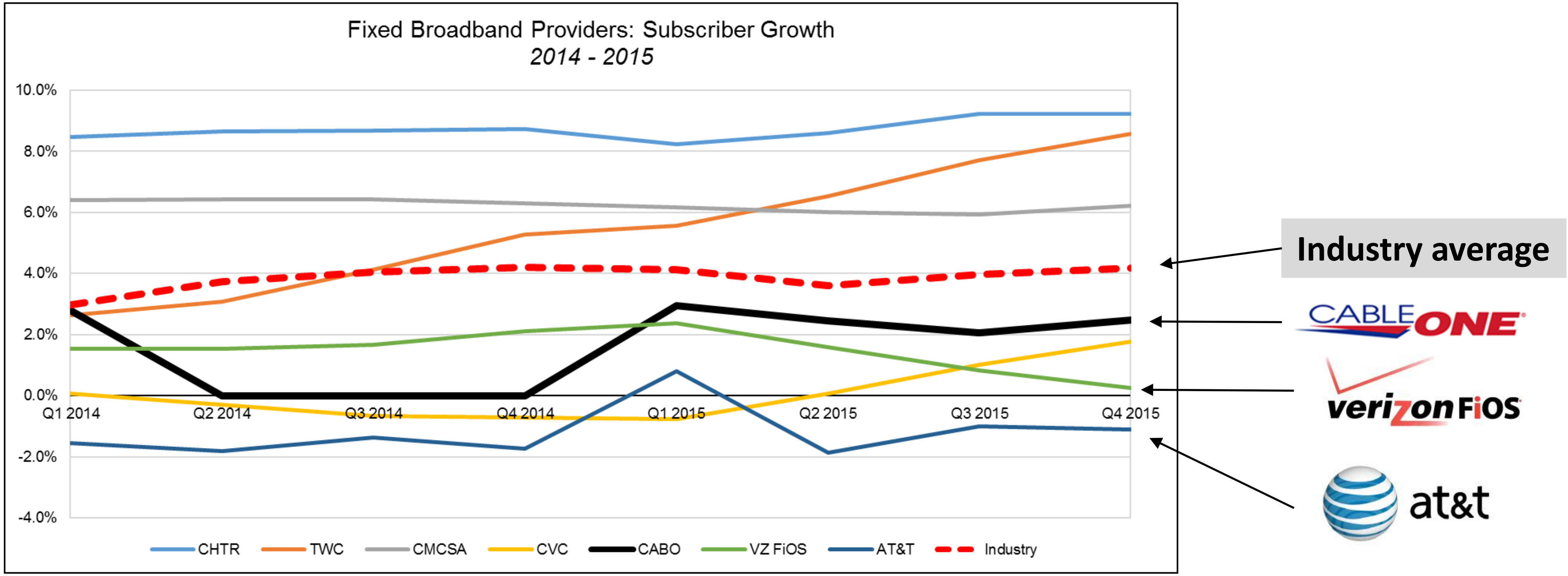
Growth in Residential Subscribers: Video vs. HSD

- The chart (see below) epitomizes the strategy change for Cable ONE, whereby there has been a tremendous de-emphasis on video, and heightened emphasis on residential high-speed data



Growth in Residential Subscribers: Video vs. HSD

- It is interesting that the companies with the **slowest** internet subscriber growth are the smaller MSOs and telco (AT&T and Verizon) companies, whereby the **fastest** growth comes from the largest MSOs (Comcast, Charter, Time Warner Cable)
- I find this slightly *discouraging* from a CABO-standpoint, considering the company spends more of their advertising and marketing dollars portraying the "*we are a high speed internet company*"



Return on "Invested Capital"

- It is my understanding that CABO believes there strategy will yield much higher returns on "invested capital". I believe CABO thinks:
    - By lowering/de-emphasizing video, which they believe is a "flat cash flow margin business" (using SNL's calculations, not CABO's, and using averages, instead of actual company by company examples), they will minimize some of the capital expenses and higher operating expenses associated with the video produce
    - This should lead to higher operating margins as well as lower capital required to run the business
    - At this point, CABO is focused on maximizing the already-existent footprint (historical capital outlayed) instead of newbuild, expanding footprint (which would cost more)
- How does their theory stack up against their expectations?
    - Higher margin than industry? Near the highest- CHECK ✓ **(but not much different than the larger cable companies)**
    - Lower capital intensity? Not true X – **CABO has spent 20-22% of revenues in 2013/2014/2015, despite a 40% decline in residential video subscribers from the end of 2012, and an -11% decline in video revenues.**
    - Now, CABO has stated that 2013-2015 were "investment years" with capital deployed in their new billing system, move to digital, and node splitting to free up bandwidth. They expect FY 2016 capital to be around 15-17% of revenues, similar to long-term estimates.
    - My problem with this is **three-fold**::
        1. The capital spent from 2013-2015 could have been mostly overlapped with the video product. Node splitting, move to digital from analog, improving the billing system are all "upgrades" that the video product can benefit from. Other cable companies that do similar upgrades but have more video scale for programming and earn adequate returns on video customers are maximizing the capital deployed more than CABO in this case.
        2. The capital outlay is no different than the larger cable companies during their "investment period", despite them having more video customers as a percentage of total customer base.
        3. The "longer term" capital intensity is similar to the capital intensity of much larger cable companies in their more "mature years"; in fact, some of the larger cable companies forecast even lower than the 15% - 17% range CABO is forecasting for their capital intensity.

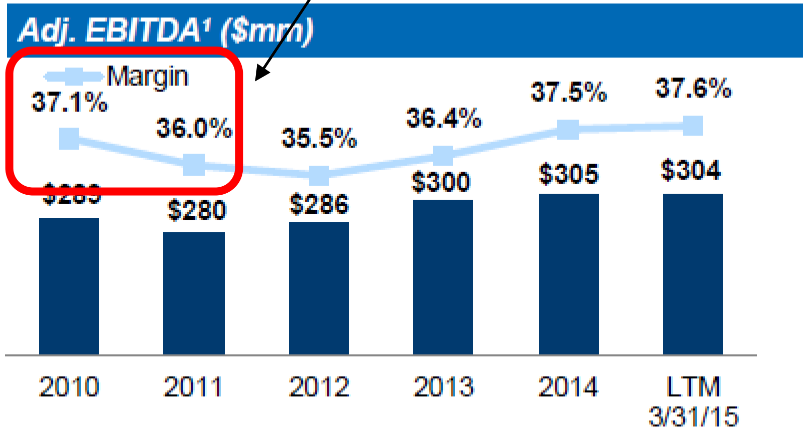
CABO’s “Unique Strategy”

CABO vs. Everyone Else

Strategy: “Unique” to the Cable Business

- CABO is a smaller MSO, has a **differentiated** strategy
- Compared to Comcast, they have 3% of the footprint/homes passed – obviously a much smaller player versus “the big boys” (CHTR/TWC/CMCSA)
- As CABO focuses on high speed data for residential subs, as well as business services, I will compare these metrics to check the effectiveness of their strategy:
  - EBITDA margin
  - FCF margin (based on estimated normal current capital spending)
  - Subscriber growth in both residential HSD and business (in theory, CABO should have at least as fast subscriber growth as the industry due to general penetration of HSD, as well as their focus on LTV subscribers, meaning lower churn and higher NET subscriber growth)
  - EBITDA per home passed (to check the effectiveness of them to utilize their footprint. CABO criticizes the use of “gross margin” per product, but EBITDA is more acceptable as it includes other indirect costs-per-product that show the true margin profile of the products/services. Given that HSD has a superior margin profile, CABO should have a high(er) margin than most MSOs given their focus on higher margin products)
  - Capital spending (given that CABO focuses less on video subscribers, there should be less capital spent as a percentage of revenue as less CPE is needed for video subscribers)
  - Programming Expense on video

Decline in EBITDA margin likely led to drastic change in strategy. Wouldn’t have changed due to limited scale due to size.



CABLE ONE

Strategy: “Unique” to the Cable Business

- CABO’s strategy is different than other MSOs. Instead of focusing on PSUs, triple play bundling, packaging, offering promotions and attempting to keep churn down they focus on:

1. **Long-term free cash flow trends per product** (adjusted EBITDA in CABO language), and free cash flow trends per product. Compare this to “gross margins” per product, where often people subtract programming expenses against video revenues to get gross margins. CABO believes there are other indirect costs and capital costs per PSU not reflected accurately in gross margin. Instead of costs being foxed, they are highly variable.
2. **Dislike for residential video and telephone**, stating the margins on those businesses are inadequate, and that the future of television is around broadband usage, not linear TV as cord cutting, trimming, shaving, etc. is a larger threat than given credit for.
3. Preference for only two types of products: (a) **residential high speed data**, and (b) **business/enterprise customers**. Reason is that HSD is much higher margin, requires no programming expense, has less capital intensity. Preference for business is that most business customers want HSD and spend much more than a residential customer, thus higher margins.
4. “**Lifetime Value” customers**, that churn less, need less promotions, and are more profitable long-term.
5. As the business moves from video/telephone and more to HSD/business services, the **margins should be superior** to other MSOs that have a supposedly zero margin video business.

Strategy in-Motion

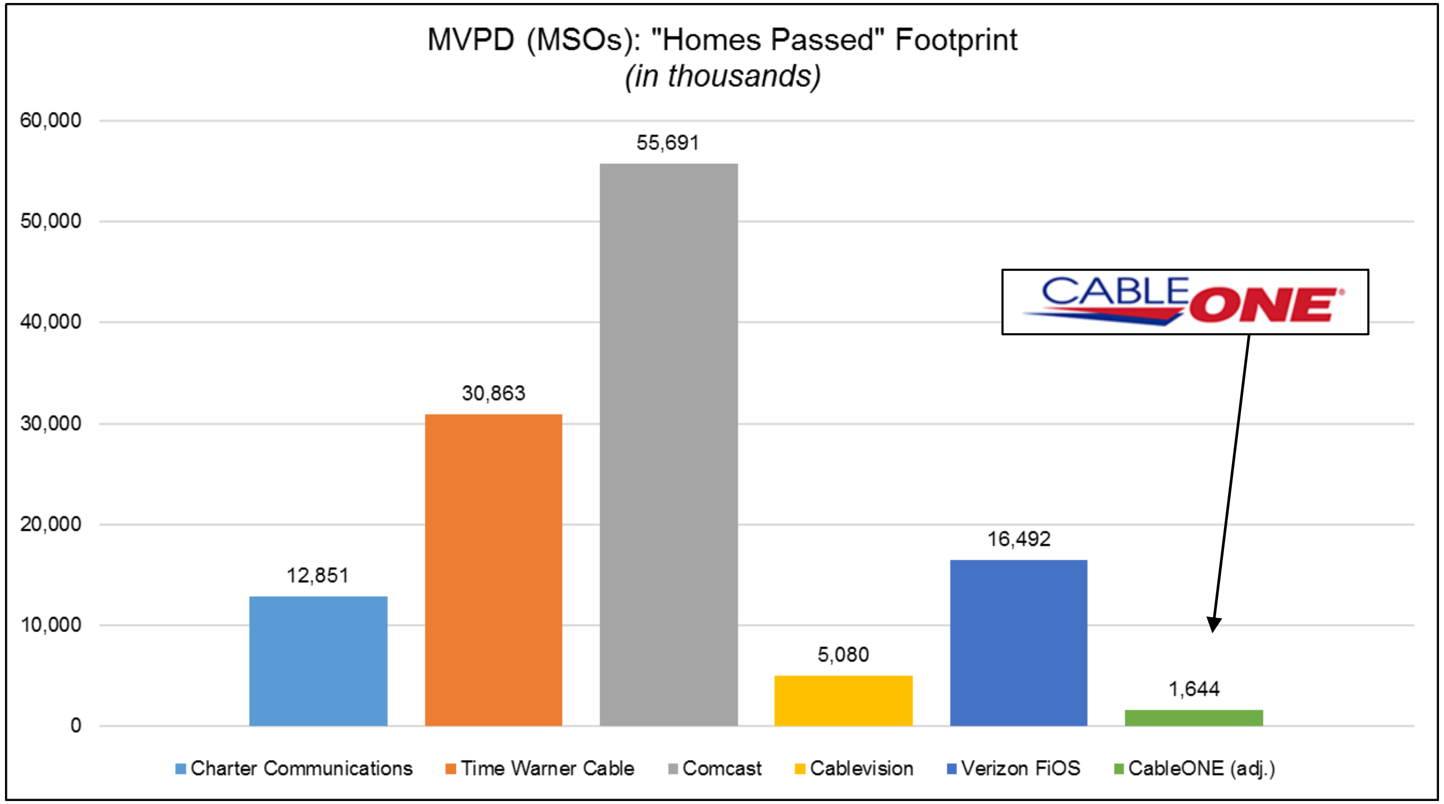
- $10 rate increase in residential video in February 2015, none planned for 2016.
- $5 residential high speed data adjustment (10% increase), due to doubling of speeds in **October 2015**. This is the first price increase in about 5 years. (*you can see the margin increase Q/Q that reflects this price increase*)
- Headcount reductions: down over 400 FTEs (17% reduction) in 4 years
- Capital spending as a percentage of revenues has been above 20% for past 3 years, expected to be mid-high teens going forward (15-17%)

CABO vs. Competition

How do they compare?

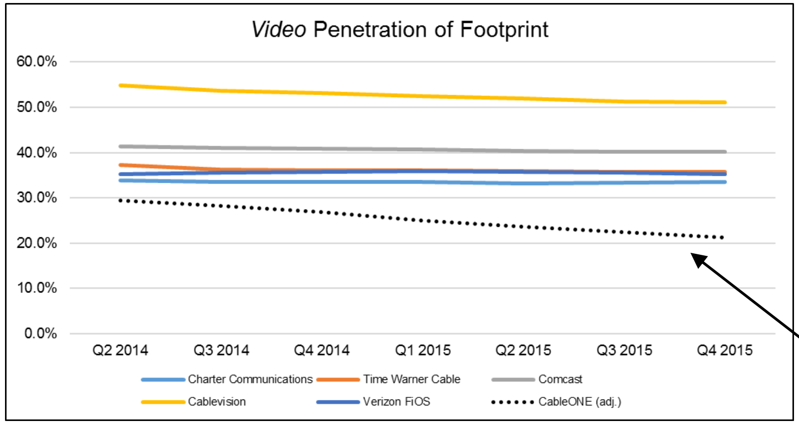
Homes Passed: Footprint

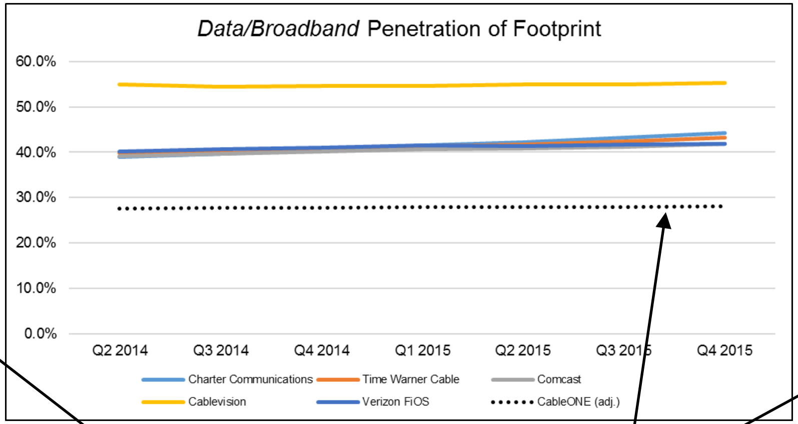
- CABO is only a *fraction* of the size of the larger MSOs, at around 5% the size of Time Warner Cable and 3% of Comcast
- “Homes Passed” metric calculation changed in 2015 due to new billing system/updated standard, whereby now a MDU no longer counts as just one unit but each unit in a MDU counts as a unit, thus the increase in MDUs over last few quarters
- *For whatever, reason, CABO did not adjust old financials/penetration rates based on this update*
- From 2012-2015, estimated around 1% CAGR in homes passed growth (per my discussion with CABO)

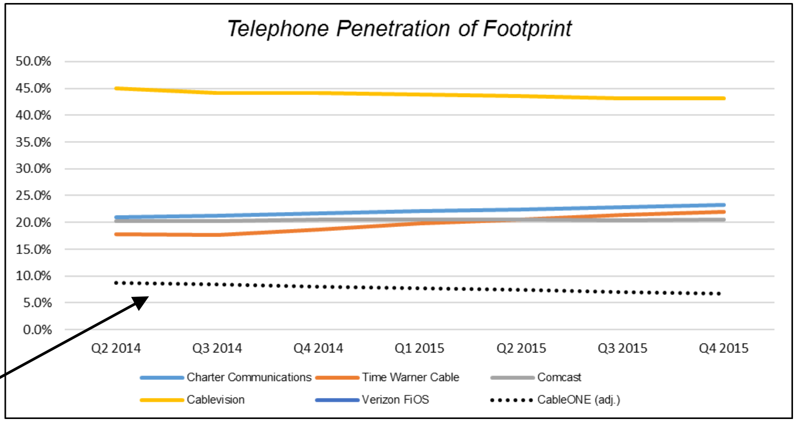


Penetration Rates: Video/ Data/ Telephone

- Compared to the other MSOs (and VZ FiOS), CABO has the lowest penetration in each product category.
- I believe CABO has a lower penetration rate for a few reasons:
  - Their strategy is focused more on HSD/Business and thus most of their marketing and promotions (lack of) encourages more HSD-only subscribers than a bundle
  - They TV offering is inferior to their competition (DirecTV, U-Verse…)
  - The location of their cable systems is in more blue-collar type locations, where if they don't offer promotions, people are not as interested compared to other providers. Also, their systems are located in areas where DirecTV has strong market share (and DTV does not partner with CABO on internet).
  - The penetration of internet is less in these very rural areas compared to highly dense locations and bigger cities (where most MSOs want to be)
  - *The bull-case sees these low penetration rates as opportunity; I see it as a combination of a flawed strategy, lower end demographics of subscribers, and only interested from an acquirer-standpoint to improve these numbers through changing the strategy/using video scale*

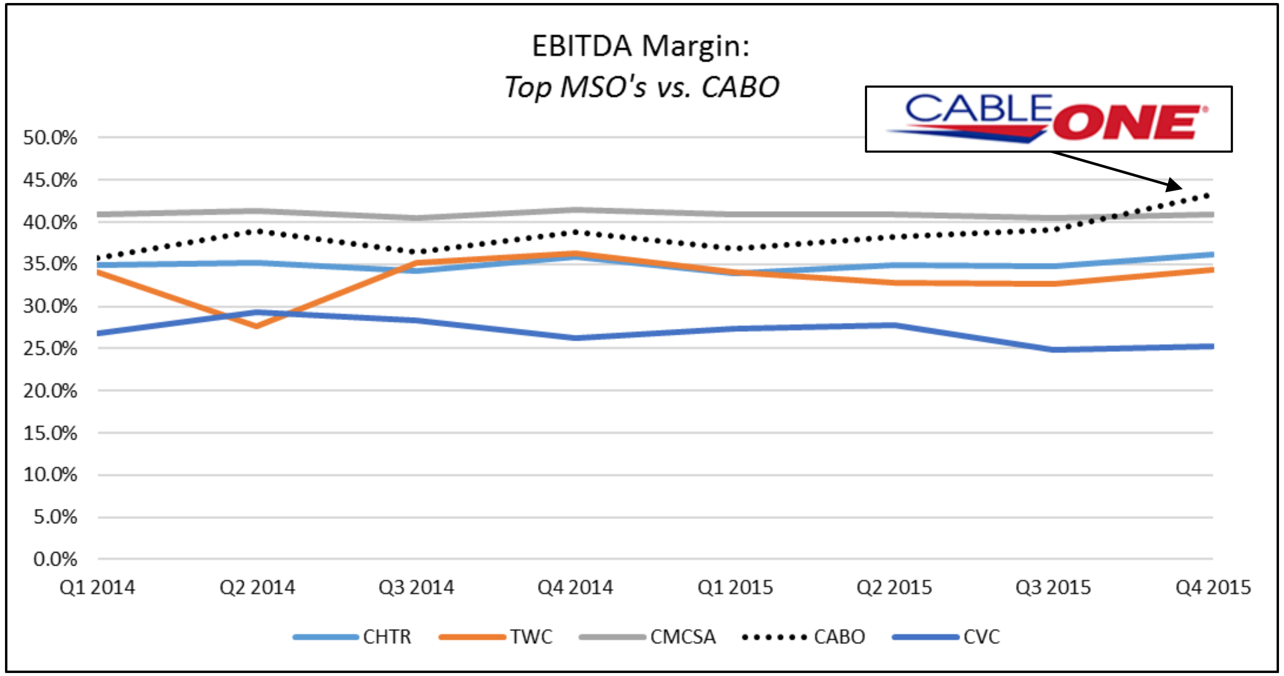






EBITDA Margin

- EBITDA margin should be high or higher than other MSOs due to product mix (more HSD/business services as a percentage of total customers)
- CABO does have a higher "last quarter" margin compared to other larger MSOs, but they also did take a rate increase of 10% for their HSD customers in the last quarter ($5.00/month) that was implemented in October 2015
- Based on the last quarter, CABO actually has the 2nd most video subscribers as a percentage of residential PSUs of the larger MSOs, but has by far the lowest telephone percentage (due to highest HSD %)



Percentage of product of overall residential PSUs

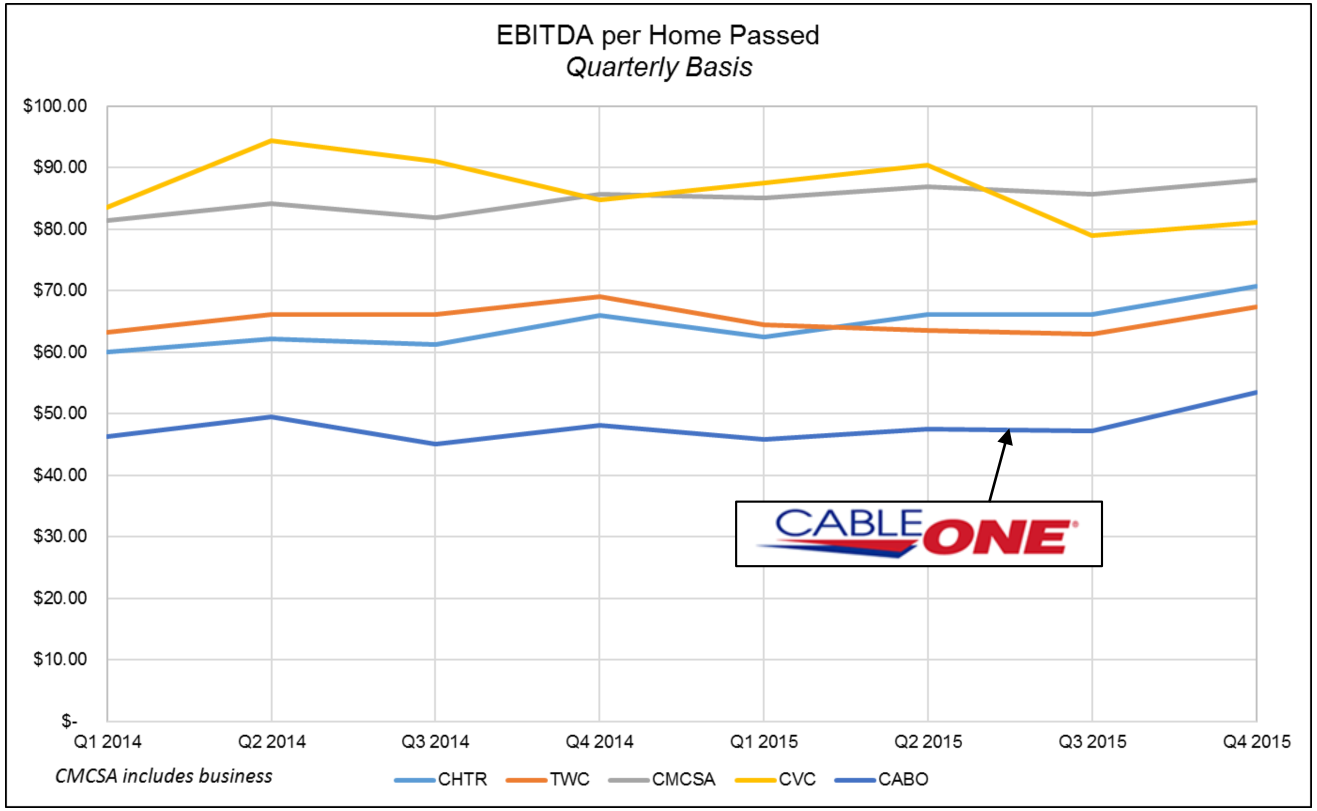
* As of Qtr ending Dec. 2015

	CHTR	TWC	CMCSA	CVC	CABO
Video	34.8%	36.3%	39.1%	34.1%	38.0%
Data	43.5%	42.5%	40.8%	37.0%	50.0%
Telephone	21.7%	21.2%	20.1%	28.9%	12.0%
EBITDA Margin	36.1%	34.3%	40.9%	25.3%	43.2%

Highest % of Category
Lowest % of Category

EBITDA-per-"home passed"

- EBITDA-per-home passed in a metric often used as a measurement of maximizing the large infrastructure costs and footprint from a cash flow statement
- This metric is helpful as it takes into consideration: margins, promotional impact, subscriber numbers, pricing, and effectiveness of strategy, as well as how they compare to their competition.
- In the last quarter there was some uptick in CABO's metrics, but there was also uptick in other MSO's as well.
- For the bulls, it was encouraging that CABO's cash flow per home passed grew the most of the others, some of which was due to increased pricing.
- Still, CABO is not utilizing the gross investment in infrastructure/footprint compared to others; in theory, they should be much higher/highest if video and telephone are "zero margin businesses"
- Another reason is their penetration is lower, which is likely a strategy issue. If there penetration were the same, it would be easier to make the case their strategy were working more effectively and to illustrate that video/telephone are poor business lines to be in.



Do Larger Cable Companies have ***NO*** Scale?

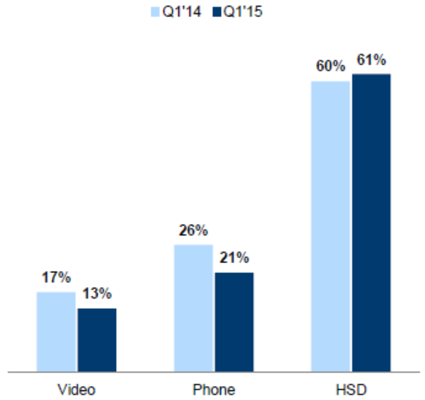
From CABO’s 2015 Investor Presentation

3 Limited free cash flow in video

Cable ONE thesis on video

- The benefits of economies of scale in the cable industry are overstated because there are limited fixed costs
- Focusing on product cash flows and not contributions clarifies the true value of the product
- ***There is little operating cash flow…and no free cash flow***

Average cable industry residential OCF by segment[1]



Illustrative cable industry video cost accounting[2]

	Cable Operator Average
Video Average Revenue Per Unit	$81.03
Less: programming & retrans cost[3]	(45.86)
Contribution per video sub[3]	**$35.17**
% contribution margin[3]	*43%*
Less: indirect cost per PSU	(24.55)
OCF per video sub	**$10.61**
% OCF margin	*13%*
Less: capex per PSU[3]	(11.58)
FCF per video sub	**($0.96)**
% FCF margin	*(1%)*

Source: Company filings, SNL Kagan
[1] Based on SNL Kagan Industry data as of May 2015 for Charter, Comcast and Time Warner Cable, data is pro forma
[2] Based on SNL Kagan Industry data for cable operators for 1Q 2015
[3] Based on SNL Kagan Industry data for cable operators for 2014

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From CABO’s Nov. 2015 Wells Fargo Preso.

WALL STREET MYTHS ABOUT MSOs TODAY

Slide from SNL Kagan Cable Investor Conference – November 11, 2013

CONTRIBUTION vs. FREE CASH FLOW

WALL STREET MYTH #1

The $40 of Contribution per video sub equals profit , so video sub counts still matter a lot to MSO value.

REALITY

All MSO Expenses and Capex are variable.

There is no meaningful video Free Cash Flow left. MSOs are successfully harvesting video subs.

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Do Larger Cable Companies have ***NO*** Scale?

- CABO claims that the strategy departure from an emphasis on video was due to the *indirect costs* and *associated capital expenses* with providing video. At first glance, video looks to be beneficial if you subtract only programming expenses – which would get around 45% gross margin.
- CABO also states to be "Danaher-like" on their cost controls. If we look (see figure below) on a per PSU and Customer Relationship basis, the numbers make sense:
  - CABO has the most expensive on a per PSU basis (as they are disadvantaged on video, have low amount of telephone), but advantaged on a per-customer relationship basis as over half of their customers are broadband-only, which has less specific operating expenses.
  - Comcast has the least monthly cost per PSU as they have more scale on video/are vertically integrated with NBC, etc., but have a higher percentage of video subs versus CABO on a percentage-of-total basis, and thus they have the highest per-customer relationship cost.
- The strategy is different: CABO wants less PSU's, more broadband-only PSU's, and thus more broadband-only customer relationships. CMCSA/TWC/CHTR want more customer relationships, then more PSU's per customer relationship, then higher value products per PSU to drive margin.

Total Cable Expenses per:	PSU	Customer
Charter Communications	$ 42.87	$ 82.57
Time Warner Cable	$ 43.30	$ 83.44
Comcast	$ 41.06	$ 84.52
CableONE	$ 51.68	$ 79.62
Average	$ 44.73	$ 82.54

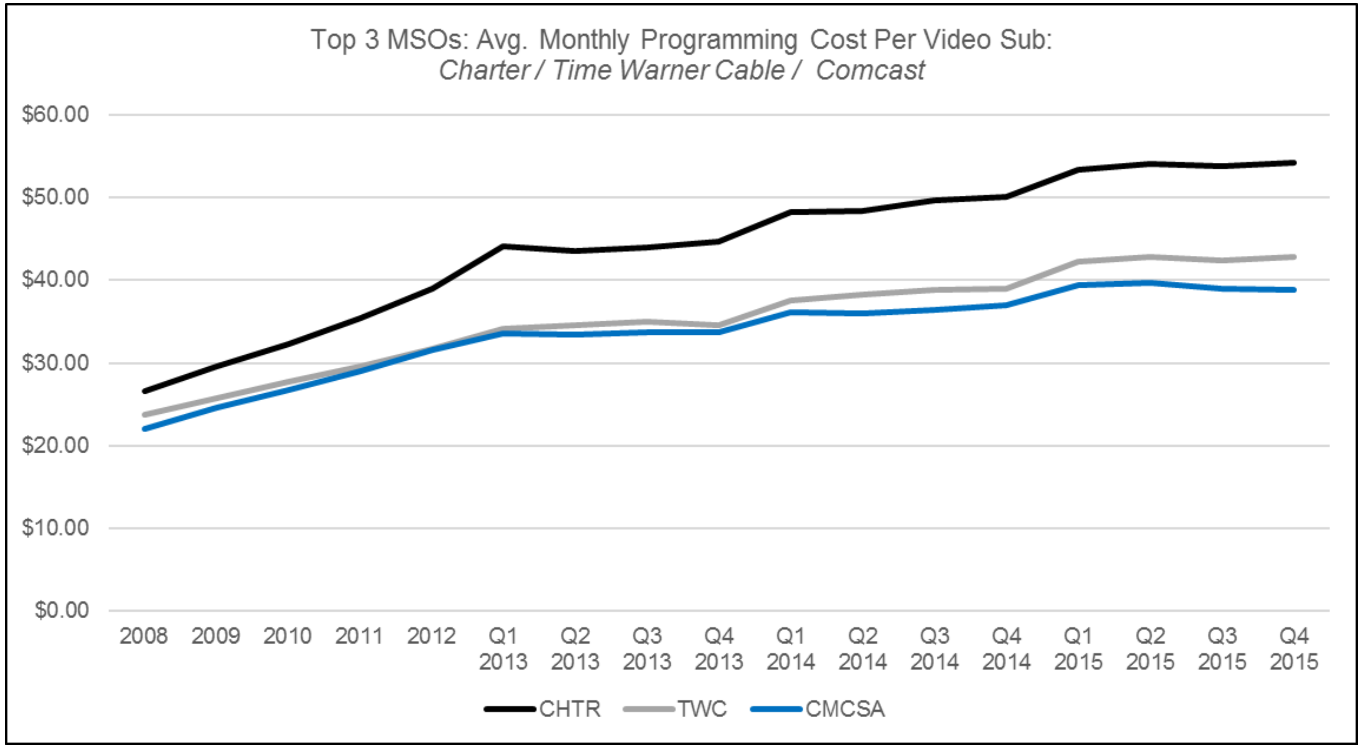
Avg. PSU/Customer, on a per-month basis; includes business numbers

Cable Companies & “Scale”

- I believe it is *lack of* scale that caused Cable ONE to change strategy in 2012
- Faced with declining video subscribers, similar to other cable companies, but with far less of a video subscriber base than other larger MSOs, Cable ONE knew their fate may be “death by video programming companies” that would have negotiating power over them
- In CABO’s 2015 spin-off presentation, they only share SNL Kagan’s financial information on the top 3 cable companies and their estimated FCF margin (misleading because TWC/ CHTR/ and CMCSA have different margins, CABO illustrated the highest programming expense as % of revenue to illustrate their point)
- CABO has stated that cable companies and investors think video is still a worthwhile product because if you subtract the programming expense, there is still mid-40% gross margin. CABO argues there are indirect costs and capital expenses that make video at barely a breakeven cash flow product.
- Does Cable ONE ever disclose their programming expense? Do they ever even give a hint of how much they are spending?
- I find it odd (but it makes sense) that the smaller MSOs – Cablevision, CableONE, Mediacom, and even the Telco’s – AT&T and Verizon – don’t disclose their video programming expense. I believe it is likely those expenses are above 60% of revenue, making video a negative cash flow contributor to these companies.
- Examples of some evidence:
    - Charter’s acquisition of TWC and BHN estimates are for ~$800m programming synergies as CHTR and BHN move to TWC (larger MSO) rate card
    - Compare Comcast’s video cost per sub vs. TWC vs. CHTR (the only three that disclose) and there is evidence of programming scale
    - Altice’s pending acquisition of Cablevision should have some programming “synergies”

Cable Companies & “Scale”

- There are only 3 cable companies that disclose their programming costs: Comcast, Time Warner Cable, and Charter Communications
- Comcast has 5x as many video subscribers as CHTR, and 2x as many as Time Warner Cable
- Comparing video programming costs per subscriber, per month – illustrates the programming scale of a larger video subscriber base



Footprint and Markets

“Rural” America

Footprint and Top Markets:

- Cable ONE has 665k total customers
- Top 2 markets make up over 25% of their PSUs, top 5 markets almost 50% of their PSUs
- **Top markets: (in order, as of June 2015)**
  1. Treasure Valley, ID
  2. Gulf Coast, MS
  3. Prescott, AZ
  4. Idaho Falls-Pocatello, ID
  5. Fargo, ND
- Total video HH in the U.S. declined from 114.456 million in 2010 to 113.314m at the end of 2015
- None of CABO’s markets are in the top 100 DMA in terms of size

Footprint and Top Markets:

- Cable ONE's top 5 markets (see below) represent over 50% of their PSUs
- Their top markets are highlighted by:
  - Lower than national average penetration in cable
  - Above average penetration of broadcast-only
  - Above average penetration of satellite services
- What does this infer? (*all estimates*)
  - While not certain, could imply their footprint was traditionally better served by DirecTV and DISH and are more loyal to those providers
  - Could imply the HH in their footprint are more price sensitive, and Cable ONE's higher speeds ***but*** higher prices are not affordable for the average HH
  - Their footprint is lower income than average, and prefers using mobile broadband instead of fixed home broadband
  - CABO having difficulty penetrating due to inferior video product, service reputation

			Penetration		
	DMA	CABO Rank	Cable	Satellite	Broadcast Only
Treasure Valley, ID	107	1	16.7%	50.3%	33.0%
Gulf Coast, MS	158	2	49.1%	39.4%	11.5%
Prescott, AZ	?	3			
Idaho-Falls - Pocatello, ID	163	4	21.8%	52.0%	26.2%
Fargo, ND	115	5	52.6%	35.1%	12.3%
Cable ONE average			35.1%	44.2%	20.8%
National Average			55.7%	30.0%	11.6%

#1 Treasure Valley, ID

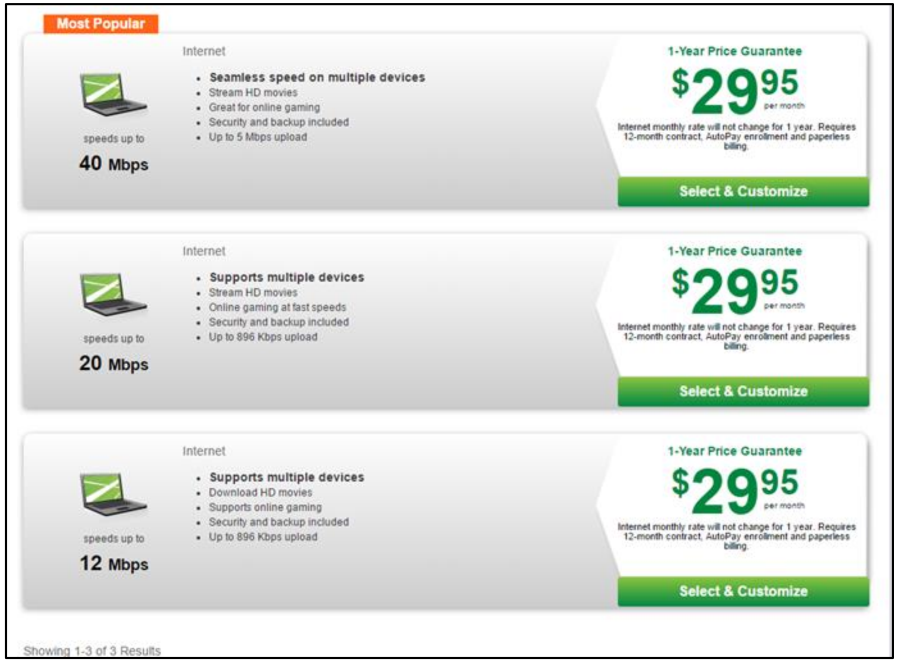
- Includes Boise **(#107 DMA)** with 265,580 TV Homes [2010 HH = 262,800]
- Boise has population of 690,474
- 50.3% of Boise uses satellite (ADS)
- 16.7% of HH use cable
- Median Income $49,182
- Largest competitor for CABO on internet is: CenturyLink
- Internet speeds:
  - CABO = 50 mbps up is standard, up to 100 mbps
  - CenturyLink = max is 40 mbps
- Internet Costs
  - CABO: $40 after 3 months for 50 mbps, must also use DOCSIS 3.0 for $8/month or use one that is compatible
  - CenturyLink: $30 per month for 40 mbps, must pay $10/month for modem as well.
- Thoughts:
  - The main two providers of fixed broadband are: CenturyLink (DSL) and Cable ONE (HFC Cable) with different speed capabilities and pricing
  - I believe CableONE is at a huge advantage from the home broadband capabilities and competitive pricing; however, when a HH bundles the superior video from DirecTV and has reasonably fast DSL at 40 mbps for a highly competitive price, it is not surprising that Cable ONE could lose a customer to the better "bundle"
  - If CABO reinvested in their video product (or if an acquirer did) they should be able to take huge market share away from both CenturyLink and DirecTV as their video product could be more competitive (better programming costs, higher quality channels) and their broadband is already superior.

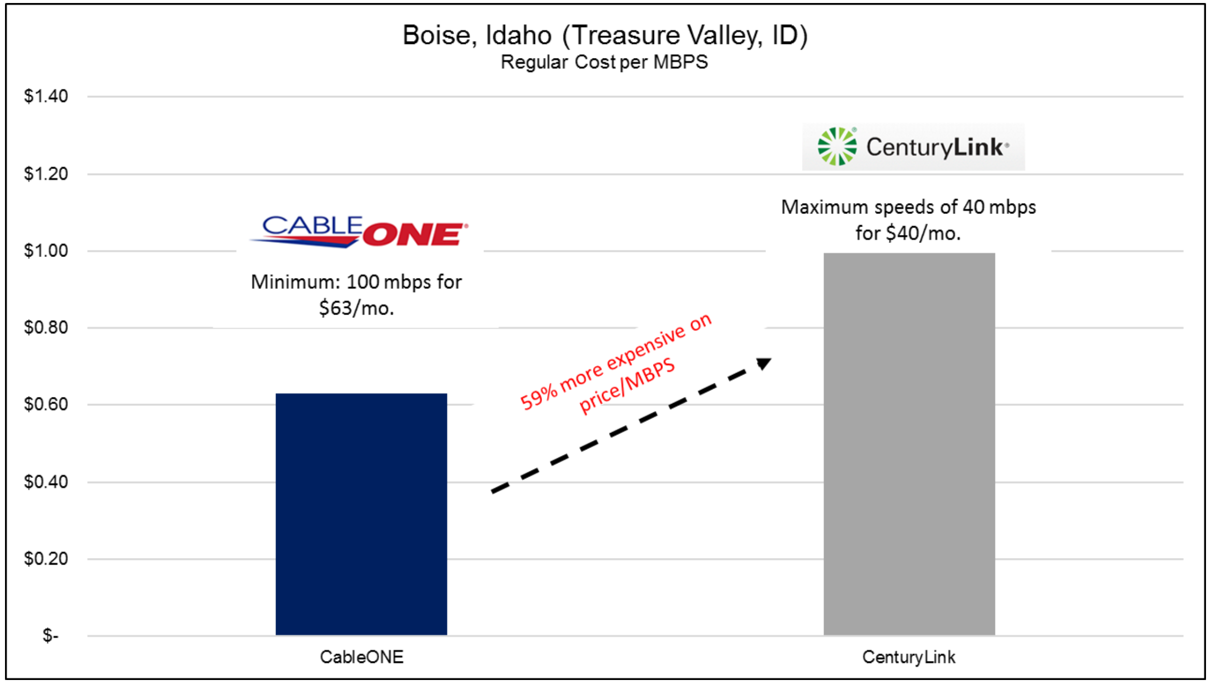
#1 Treasure Valley, ID: CenturyLink vs. CABO

- In reading old reviews and articles, CenturyLink used to be much more expensive for their 40 mbps package – around $70/month not including the modem. Compared to current pricing by Cable ONE at 100 mbps at $63/month once off the 3 month promotion, CenturyLink was substantially overpriced.

- Now – CenturyLink is running a special for 40 mbps for $29.95/month, not including the $10/month for the modem.

- The top video provider in the area is DirecTV, who also partners with CenturyLink on the internet product, which is a huge advantage for CenturyLink, and huge disadvantage for CABO as they have a worse video product, less channels, and do not market their video much.



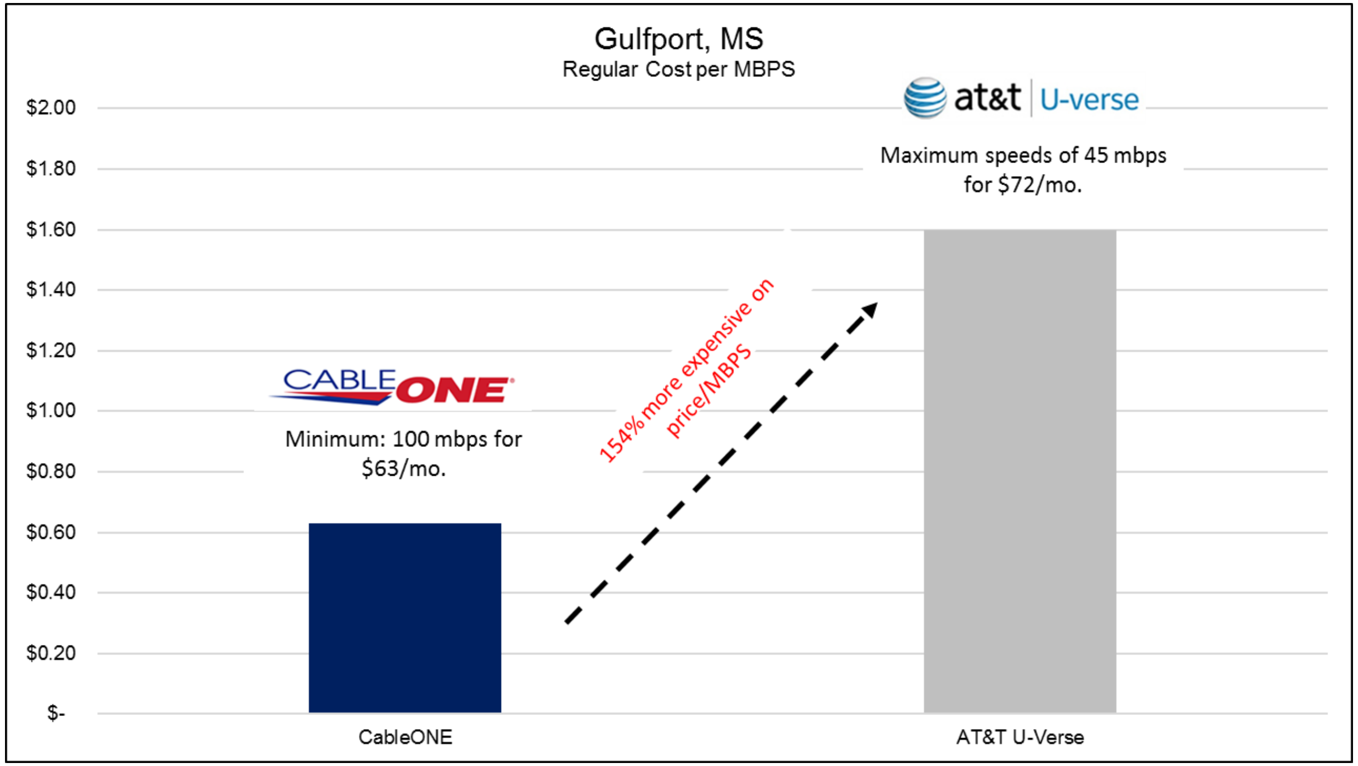


#2 Gulf Coast, MS

- Includes Biloxi, Gulfport (MS)
- **DMA rank # 158**
- TV households in 2010: 122,740, compared to the end of 2015 at 128,260 (slight growth)
- Population ~ 324,853
- Cable Penetration of 49.1% versus Satellite at 39.1%
- Gulfport, MS has unattractive qualities for Pay-TV/broadband provider
  - Average HH income = $33,807
  - Avg. house value = $82,133
  - Lower income + lower home value = likely much more price sensitive to offerings

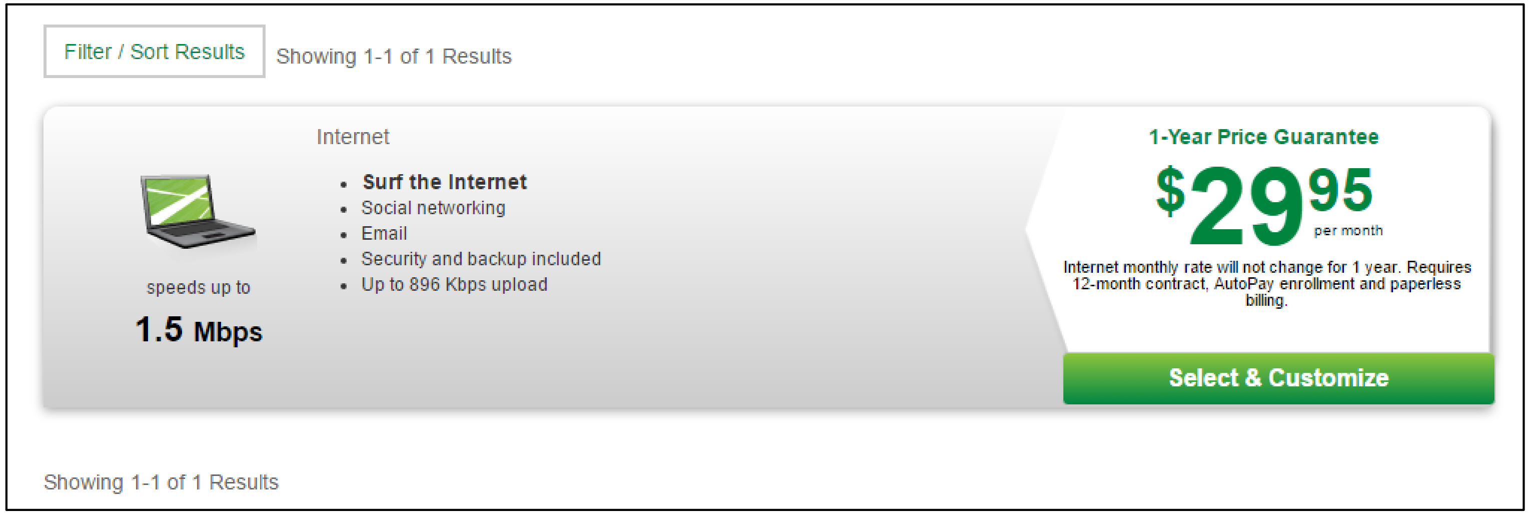
#2 Gulf Coast, MS: AT&T U-Verse vs. CABO

- Based on internet capabilities and pricing alone, Cable ONE should have a very high market share in the area
- Primarily compete against AT&T U-Verse
- AT&T U-Verse speeds: 6 /18/ 45 mbps download versus Cable ONE with a minimum of 100 mbps



#3 Prescott, AZ: CenturyLink vs. CABO

- 2010 census population of 39,843
- I imagine CABO's footprint includes areas around Flagstaff as well
- 69,000 PSUs
- Median HH income of $43,391
- Based on the inferior capabilities/products/speeds of CenturyLink in Prescott, would assume CABO has very high market share in Prescott, AZ
- Competition: CenturyLink
  - In some areas, CenturyLink as only one broadband speed offering, often very low, ranging from 1.5 mbps to 12 mbps
  - I searched three different addresses around Prescott, all had very little options from CenturyLink (see offer below)



#4 Idaho Falls-Pocatello, ID

- 2015 TV Homes in the market of 121,940, compared to 2012 of 125,710 (slight decline)
- DMA market #163
- Population in the area of 330,563
- Cable penetration very low at 21.8% compared to Satellite of 52%
- Idaho Falls HH income of $67,450
- *Thoughts:*
  - Based on their competition, CABO should have very high market share in this DMA as well
  - Highly competitive pricing on internet, and 10x faster speeds
  - What is interesting is the low cable penetration in this area – **why so?** Possibly due to video still being dominated by DirecTV and DISH, and once again, Cable ONE does not invest much in their video product or promote it well.

Provider	Availability	Rating	Speed	Pricing
CenturyLink DSL				$34.95 for 10 mbps
CABLE ONE CABLE				$35.00 for 100 mbps
DIRECT COMMUNICATIONS CABLE				$49.95 for 10 mbps
DIRECT COMMUNICATIONS DSL				$54.95 for 10 mbps
DIRECT COMMUNICATIONS FIBER				$54.95 for 10 mbps

#5 Fargo, ND

- Fargo/ Valley City has 247,000 HH in the market (compared to 2010 census of 240,330)
- Cable penetration is near U.S. average, at around 52.6% as of 2/2016
- Satellite penetration of 35.1% (near national average)
- Median HH income of $44,304
- Pricing competition is similar to that of Treasure Valley, ID (#1 market for Cable ONE)

Provider	Availability	Rating	Speed	Pricing
CABLE ONE CABLE				$35.00 for 100 mbps
CenturyLink DSL				$34.95 for 10 mbps
702 Communications DSL				$34.99 for 20 mbps

Does Cable ONE, Inc. *Live Up to The Hype?*

Management Tries to Say ‘All the Right Things’, *but*…

Management attempts to be the perfect investment to investors. I say this based on their strategy, how they market, talk in conference calls, how they share information in presentations, who they choose to have on their “Board of Directors”, how they pay the B.O.D., and so on. **Examples**:

- “We plan rate increases to optimize long-term results and not to smooth earnings.” (Q3-2015 Call)
- “Fully allocated cost models. We strongly believe it is more important to look at long-term operating cash flow trends by product, which we also refer to as adjusted EBITDA, and free cash flow trends by product, rather than contribution or gross margins by product” (Q3-2015 Call)
- “So that is where we are investing: In the future rather than in the past.” (Q3-2015)
- “Lifetime value matters to us. The lifetime values of customers and potential new starts vary dramatically as well. Not only by package, but also by demographics. Historically, many of our new starts were unprofitable and subtracted from our bottom line a lot. Other starts are highly profitable. Letting go of large quantities of unprofitable starts that used to prop up PSU counts has reduced PSUs significantly, but has also increased our cash flow.” (Q3-2015 Call)
- “We have been methodically investigating organic and inorganic ways to expand our business with superior long-term free cash flow growth opportunities.” (Q3-2015 Call)
- “In the meantime, we repurchased stock in the first 6 months at prices we consider very attractive given the trajectory of our strategy.” (Q3-2015 Call)

I’m choosing a lot of material from their Q3-2015 call; however, this language is persistent throughout all of their conference calls and presentations.

Is it *ALL* Just "Value Investor" Talk?

As I go through their presentations, filings, conference calls, proxies, I kept feeling as if their strategy and what they say is like a "*mating call*" for value investors:

- Share repurchase (but limited shares have been repurchased thus far)
- Wally Weitz and Tom Gayner on BOD
- Differentiated strategy, "where the puck is going"
- Our operating strategy is like Danaher, if you've heard of them
- The dominance of HSD for us will be similar to the smartphone with Apple
- Focus on cash flow instead of gross margins
- Sounds wise to say they are doing things differently than everyone else
- "***In the meantime, we repurchased stock in the first 6 months at prices we consider very attractive given the trajectory of our strategy."*** (Q3-2015 Call) My problem with this is the actual dollar amount repurchased was meaningless, a mere $16.4 million for full year 2015 (three quarters as public company). $16.4 million is 0.6% of the market cap. Is this really something that investors should salivate over, considering the company is underleveraged at 1.4x operating cash flow and these prices were supposedly "very attractive".

<u>Liquidity</u>

During 2015, our cash and cash equivalents increased by $112.8 million, and at December 31, 2015, we had approximately $119.2 million of cash on hand, compared to $6.4 million on December 31, 2014. We repurchased 38,136 shares under our stock repurchase program at an aggregate cost of $16.4 million during 2015.

Should Investors Be Impressed by the "Seeking Alpha" Name-drop?

I may be picking on the management a little too much, but openly stating that they read "Seeking Alpha" blog posts is a bit concerning to me.

- Seeking Alpha = majority is retail, novice investor write-ups
- Many prominent investors do not read Seeking Alpha, unless they are skimming through to check the sentiment around the stock
- Management's job is not to try to make "investors happy" as a top priority (in my opinion). Instead, if they run the business well, allocate capital well, and treat the shareholder's with respect, then you will attract a better investor base and investors will have a stronger desire to partner with a management team that does these things.
- If management is too focused only on the things investors want – higher share price – they may ultimately make poor decisions due the stress of trying to meet investor expectations all the time.
- Here is the comment by CEO Thomas Might in their *first* conference call as a public company (Q2-2015)

> HSD is the primary source of today's approximately $300 million of operating cash flow. However, business services or commercial sales is the primary growth engine for new cash flow. Both of these products have much higher margins than residential video or phone, and their volumes are growing, not shrinking. As some Seeking Alpha contributor observed, Cable ONE is skating to the puck. However, if I may add, with skating to the puck, timing is everything, and only time will tell if we have timed our brake just right.

Monitoring CABO

How to monitor the business?

Monitoring Cable ONE's progress:

These are the metrics I would follow as a shareholder/potential shareholder in Cable ONE:

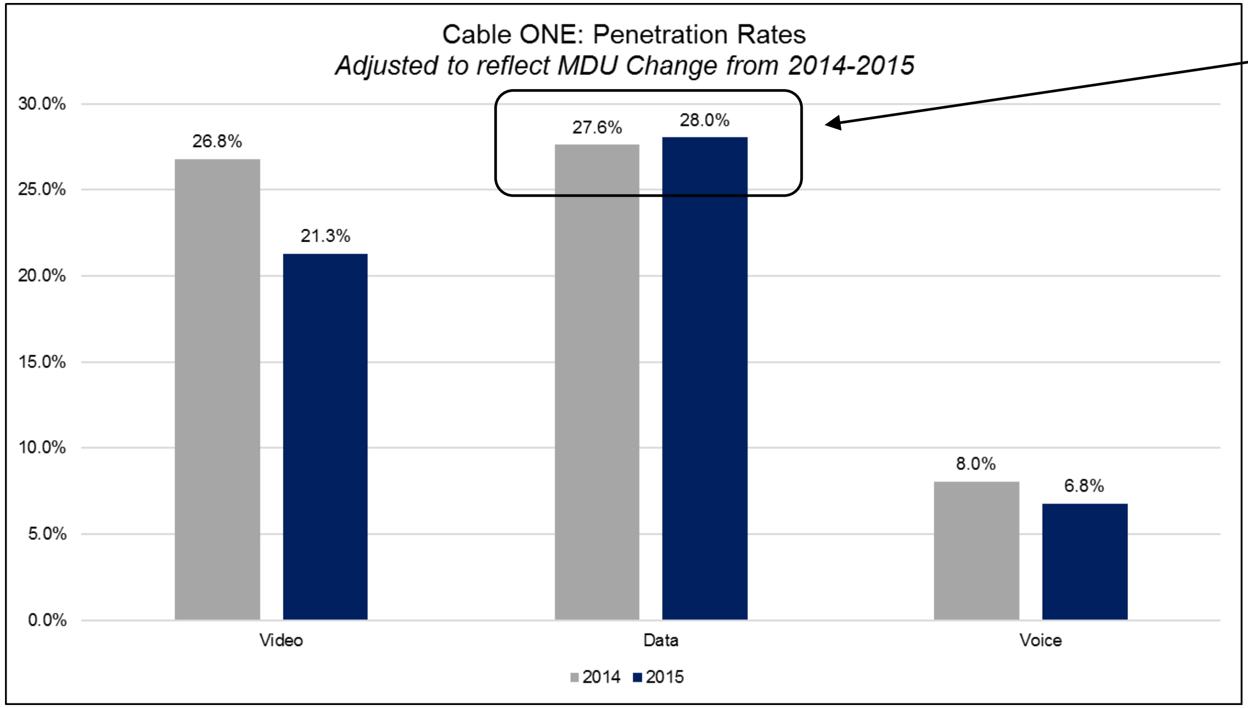
- Subscriber numbers and growth, specifically trends in residential video and residential HSD
  - Growth should be at-least around industry rates, due to their limited competition in their footprint, lower pricing per mbps, heavy advertising of the broadband product, and their focus on the supposed "lifetime value customers" that churn less (which means less gross adds flow to become net adds)
- Penetration of HSD and video in their footprint
  - *If HSD penetration is diverging compared to video, they <u>SHOULD</u> have higher operating margins as there are more broadband-only subscribers on an incremental basis*
  - *Their HSD product IS superior compared to their competition in their footprint, both on a price-standpoint and speeds*
- Pricing around both video and HSD; HSD increased 10% in October 2015, their first increase in 4-5 years. Video pricing increased in February 2015, a necessity for trying to have some margin in the video product.
  - Just a guess, but their video product must be inferior in their customers as, and thus not worth the price increase, as from Q4-2014 to Q4-2015, in which the price increase was in Q1-2015, their video subscriber base declined by 86k.
  - CABO targets 2-3% growth in pricing over time - - is this achievable, or does CABO have to display how they are worthy of increasing prices, such as in October 2015 due to "we doubled the internet speeds"
- EBITDA margin. This should increase if their strategy is paying dividends.
  - Compare this to the larger MSOs that supposedly have limited scale, according to CABO.
- Capital spending as a percentage of revenues
  - If they are having a quickly declining video base, less should be spent on CPE and less on "success-based capital" compared to traditional cable companies

Penetration Rates

- I would expect that CABO should be increasing their industry-underperforming penetration rates, even in video
- *Their overlap with DSL and FTTH is less than essentially all other decent-sized MSOs*
  - *Largest competitor is AT&T U-Verse with ~20% overlap*
  - *Less than 3% FTTH (no FiOS)*
- *Given their low penetration rates, despite less competition compared to other cable companies, I suspect one and/or two things:*
  - *Households in their footprint have similar take-rates as U.S. averages, despite being more rural, but they choose DirecTV as the video provider as DirecTV is superior in cost, quality, and channels compared to Cable ONE. DirecTV partners with other DSL ISPs, which shifts the broadband business away from Cable ONE.*
  - *Their footprint (more rural America) has different penetration rates of video and internet in each household; this would imply that their footprint either sees less of a necessity for video and internet, uses mobile-broadband as a primary means of internet access, and/or there is less growth upside as their footprint will not have the same penetration rates as other larger MSOs.*
- *If suspicion #1 is correct, then Cable ONE's strategy of scaling back their investments in video is actually hurting their potential for more broadband customers, as people still want video and see more value in the "bundle" of video and broadband.*

Penetration Rates

- CABO is proud that 44.6% of their total customers in 2015 are HSD-only. However, the HSD-only customer count increased from 235k to 296k (61k y/y) and their total customer count decreased 22k.
- The reason for the large jump is HSD-only customers as a % of total is really attributed to the decline of video customers, from 436k to 350k, a decline of 86k subscribers in one year (-20% in one year alone!)



Slightly concerning given their limited competition, superior speeds, marketing emphasis on them being a “high speed internet company”, and the low cost per mbps of their product.

The Bull-case Story

What do the “longs” see in CABO?

The Bull-case for CABO (Part 1)

- Underfollowed
  - This is quite true, if you look at their conference calls, only three (3) analysts are on the call: MoffettNathanson, JP Morgan, Wells Fargo
- High stock price/low trading volume
  - Average volume around 35.7k shares a day, stock price is ~$450
- Spin-off overhang
  - Spin-off overhang and limited information (only 3 Qtr Calls), less long-term information availability
- Minimal competition
  - 75% of customers in 5 states – MS, ID, OK, TX, and AZ
  - Less than 3% of customers have FTTH with triple play offer (no FiOS)
  - ~25% overbuild (DSL) with CenturyLink, AT&T…20% of homes have AT&T U-Verse [this overbuild percentage is LESS than other MSOs]
- Focus on FCF
  - "changed strategy in 2012 because saw the lack of profitability around telephone and residential video", now focused on HSD and business services
- "Recurring Revenue"
  - 92% of HSD customers renew
- Untapped Pricing Power
  - Lowest cost per mbps for broadband speeds versus other IPs

The Bull-case for CABO (part 2)

- Underleveraged
  - At ~1.4x operating cash flow
- New Buyback Announcement has Investors Excited
  - Announced $250 million buyback July 1, 2015 right after the spin-off, or up to 600,000 shares
  - Levered buyback model (a la Liberty/CHTR-style)
- High Strategic Value for Acquirer
  - CABO's demographics, locations, limited competition, disadvantages versus larger MSOs make it attractive from an acquisition standpoint
- Management and BOD
  - Looking at management, as well as Gayner and Weitz on BOD is attractive for investors

Thoughts on “Bull-case” for CABO

- *Some* of the bull-case has merits
- The high stock price, low trading volume can be attractive as it may deter certain types of investors, as well as “shows” that management is thinking about creating value, not manipulating share price by making it more accessible to the masses
- CABO *is* underfollowed, with only three analysts on the first three quarterly conference calls. More coverage could bring more awareness to the business.
- It has been 10 months since the spin-off, I doubt the “spin-off overhang” is still present. Plenty of time for initial selling, due diligence, etc.
- The “Focus on FCF” is something, I believe, is a byproduct of them having to do something drastic, which was to change their strategy in 2012 to focus on (1) residential broadband and (2) business services customers. I don’t believe this strategy is long-term fruitful versus traditional larger MSOs; rather CABO lacks the scale to negotiate programming costs and it is likely they were seeing a tremendously negative trend in cash flow for video subs that they believed would eventually decimate the stock price, bring negative publicity.
- “Recurring revenue” of 92% renewal for HSD customers is an incorrect statistic. The actual statement is from their 2015 investor presentation for the spin-off, in which the number is “92% in Q4 2014 have intentions to renew, up from 88% in Q4 2013, up from 83% in Q4 2012”

Thoughts on “Bull-case” for CABO

- I’m torn in believing that CABO has “untapped pricing power”. Why:
  - CABO raised broadband pricing 10% in February 2015, for the first time in nearly 5 years, as simply a catch up
  - They believed they were able to do this because they reinvested in channel bonding, going digital, splitting nodes which freed up bandwidth for the high speed data. CABO increased speeds (doubled at the time) and felt they had an argument to raise prices 10% after doubling internet speeds.
  - CABO has no plans to raise pricing in 2016
  - Their markets are more rural, where the general demographic is less internet-dependent (look at their penetration numbers) and have less median household income levels versus median U.S.
  - Most of their markets are where there are more “blue collar” people, farmers, shipping channels, casinos, government employees (Naval yards, VA hospitals, teachers) with the exception of Micron, St. Luke's Hospital, Hewlett-Packard, Albertson’s, DirecTV in Boise, ID.
  - CABO has a very low cost per mbps, but this may simply imply they believe they cannot extract the pricing - in today’s age, broadband is almost a necessity (see FCC’s Lifeline program, “It’s Your Data”, Set-Top-Box push, and so on – all regulations to bring better pricing to broadband, or availability due to the inherent importance of the product)
- The buyback, *at this point*, is a huge marketing ploy
  - Announced $250 million share repurchase program at the spin in July 1, 2015
  - Investors appeal to this, especially in the cable space, as they know the story/history of John Malone and his “levered equity return” preference and track record
  - Through the first three quarters – CABO has repurchased a dismal $16.4 million of shares, even at what management called “very attractive prices”. This is about 0.5% of the total shares outstanding, almost a non-event.

Thoughts on "Bull-case" for CABO

- CABO has strategic value for an acquirer
  - In my opinion, this would be the sole reason to own CABO
  - CABO has the least amount of overbuild of the larger/medium sized MSOs, at around 25% DSL and <3% FTTH overlap
  - Compare this to Charter Communications: 34% overbuild with AT&T, 4% FiOS
  - Compare this to Time Warner Cable: 44% AT&T and FiOS and other DSL, some overbuild with Google Fiber
  - The location of these markets, all outside the top 100 DMA's, are less desirable for Google Fiber to enter, as well as less appealing for increased overbuild (however, overbuild by another cable company may make sense, as larger MSO could offer similar pricing but better packages and overall superior product line)
  - A larger MSO could come in, use their video programming rate card, and larger business scale (advertising, larger business client potential) to have quite a bit of synergies + more upside as video and voice are very much underpenetrated compared to other MSOs, and based on their overbuild percentage
- Excluding the Graham Family (Donald Graham owns 17.6%), the BOD and executives own only 1.1%
  - Wally Weitz doesn't own any in his Value Fund
  - Tom Gayner and Markel Corp. only owns about $2.5 million of CABO

Management/ Board of Directors

Fairly strong management *but* weak ownership

Stock Ownership

- The Graham Family (Donald Graham) owns 17.6% of CABO
- Daniel Mosley (trustee for a number of trusts) owns 8.7%
- Discouragingly, the directors and executives own ~1.1% of CableOne (CABO), including Gayner and Weitz
- Wally Weitz doesn't own any CABO for his investment funds (red flag)
- Tom Gayner/ Markel only owns 5,200 shares of CABO as of Markel Corp.'s most recent 13F (ends Dec. 2015), for a total around ~$2.5 million (red flag)

Name	Amount and Nature of Beneficial Ownership	Percent
Principal Stockholders:		
Donald E. Graham[7] 1300 North 17th Street Arlington, VA 22209	1,013,938	17.6%
Daniel L. Mosley[8] 825 Eighth Avenue New York, NY 10019	501,834	8.7%
BlackRock, Inc.[9] 55 East 52nd Street New York, NY 10055	345,597	6.0%
T. Rowe Price Associates, Inc.[10] 100 E. Pratt Street Baltimore, MD 21202	330,222	5.7%
The Vanguard Group[11] 100 Vanguard Blvd. Malvern, PA 19355	312,721	5.4%

Name	Amount and Nature of Beneficial Ownership	Percent
Directors and Named Executive Officers:		
Thomas O. Might[1]	22,047	*
Stephen A. Fox[2]	5,686	*
Julia M. Laulis[3]	5,491	*
Naomi M. Bergman[4]	430	*
Brad D. Brian[4]	430	*
Thomas S. Gayner[5]	5,773	*
Deborah J. Kissire[6]	473	*
Alan G. Spoon[4]	430	*
Wallace R. Weitz[6]	473	*
Katharine B. Weymouth[4]	12,651	*
All directors and executive officers as a group, eliminating duplications (14 individuals)	62,001	1.1%

Board of Directors

- BOD is mostly compensated through stock awards, base retainer of $150,000
- Full of "high quality" and intelligent individuals, basically an All-Star lineup
- Two well recognized value investors: Tom Gayner (President, CIO of Markel Corp.) and Wally Weitz (founded Weitz Investments, has connections to Warren Buffett)
- An attorney at Munger, Tolles & Olson LLP (founded by Charlie Munger, Vice-Chairman of Berkshire Hathaway)
- President of Bright House Networks since 2007 (being acquired by Charter Communications in April 2016)
- Former executives of Graham Holdings and Washington Post Media

Director Compensation

Director[1]	Stock Awards[2], [3]	All Other Compensation[4]	Total
Naomi M. Bergman	$ 177,457	$ 442	$ 177,899
Brad D. Brian	$ 177,457	$ 442	$ 177,899
Thomas S. Gayner	$ 195,286	$ 442	$ 195,728
Deborah J. Kissire	$ 195,286	$ 442	$ 195,728
Alan G. Spoon	$ 177,457	$ 442	$ 177,899
Wallace R. Weitz	$ 195,286	$ 442	$ 195,728
Katharine B. Weymouth	$ 177,457	$ 442	$ 177,899

Board of directors

Naomi M. Bergman
Director
- President of Bright House Networks since 2007
- Serves on the FCC Technical Advisory Committee

Brad D. Brian
Director
- Trial lawyer at Munger, Tolles & Olson LLP
- Represented numerous *Fortune 500* corporations

Thomas S. Gayner
Director
- President & CIO of Markel Corporation since May 2010
- Serves on Graham Holdings and Colfax Corp Boards

Alan G. Spoon
Director
- CEO of The Washington Post Company from 1993– 2000
- Serves on Danaher Corp and IAC Boards

Wallace R. Weitz
Director
- Founded Weitz Investment Management, Inc. in 1983
- Served as a Trustee of the Weitz Funds since 1986

Katharine B. Weymouth
Director
- CEO of Washington Post Media from 2008 – 2014
- Serves on Graham Holdings Board

Summary

Personally – Wouldn’t Own; ***But*** Likely M&A Candidate

Summary:

- Cable ONE targets mid-high growth rates over time, coming from: 2-3% increased penetration, 2-3% sub growth, and 2-3% pricing
- I am more skeptical of their strategy, as I believe they may be at a disadvantage currently to their competition, despite having competitive broadband pricing and far superior broadband speeds
  - Penetration rates of cable in their footprint
  - Cash flow to Footprint
  - Capital spending is similar to larger MSOs despite having a lower video subscriber base as percentage of total PSUs
  - Lack of investment in their video product
- Their footprint is truly rural America, with lower HH incomes, typically lower house values, and a potential customer base that is more price sensitive (thus the lack of historical price increases, the feel of a justification of why they should be able to raise prices – i.e. “we double the speeds of internet”)
- Their footprint should be ripe for the taking, as current cable companies are making headway to taking share from satellite providers; yet, CABO has lower penetration in each large market they are in.
- Business is priced at a premium to more well-run cable companies, likely due to the sexiness of their strategy and value investor-speak; however, I still believe they will and should be acquired by a larger cable company in the next 1-2 years.

Feedback/Comments are Appreciated.

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