



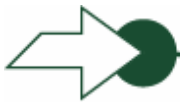
Talk Talk Offers Free Broadband

An opinion by The IP Development Network

The IP Development Network has an in depth understanding of Internet, Telecoms and Media convergence. We provide Strategic Product Analysis & Design services to Service Providers, carriers, equipment manufacturers and investors in the UK market.

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Talk Talk's Free Lunch

But it will be an expensive dinner... By hiding charges within the bundle, Talk Talk is able to add broadband to its products for free, but it missed a trick on usage capping and may pay a price.

The economics of Free Broadband The Carphone Warehouse have done their sums, you can make anything free if you are charging twice as much for something else. The IP Development Network estimates that Talk Talk is generating as much as £6.14 margin over the market average with its existing Talk 3 package due to its premium mobile rates and unused geographic call allowances.

Telephony Spend £s per Month ex VAT

	Talk Talk		Market Revenue
	Revenue	Cost	
Talk 3	16.58	8.50	8.94
Minutes			
Geographic	-	2.80	3.50
International	1.63	1.01	1.27
Mobile	4.17	2.60	3.25
Other	3.23	2.01	2.52
Total Telephone	25.61	16.93	19.47
Talk 3 Margin	8.68		
Talk 3 Premium vs Market	6.14		

This premium is essentially what allows Talk Talk to offer Free Broadband. In the end, they were forced to move as ISPs have been gaining momentum in the CPS market by offering free call packages with a broadband connection. The alternative for Talk Talk was to suffer a squeeze as its core minutes business was devalued by being sold for nothing.

In the new package itself, Talk Talk is charging £17.86 + VAT instead of £16.58 (above), but is including International calls to 24 destinations worth £1.63 in the package so the Free Broadband concept is honest.

Internet Usage is the key variable Product cost is driven by peak usage per subscriber:

Subscribers	250 k	1 m	3 m
All IP Stream (no usage)	8.39	8.38	8.36
Mix IP Stream & LLU (no usage)	8.22	6.90	5.79
All IP Stream (15k)	12.16	11.99	11.48
Mix IP Stream & LLU (15k)	11.85	10.21	7.87
All IP Stream (25k)	13.72	13.41	12.49
Mix IP Stream & LLU (25k)	13.20	10.91	8.13

The key to making money from broadband lies in the ability of an ISP to manage the 10% of users that use 65% of bandwidth. These are not average consumers.





A 40 GB allowance is too much We believe that Talk Talk has given customers too much. A 40 GB allowance is unnecessarily high – most users won't get close to it and Talk Talk will miss out on incremental usage revenue as a result.

We expected a base package offering 1 GB free and then pay as you go. This would have allowed Talk Talk to recover around £6 per customer per month in revenue, at a margin of £3.28, while still keeping with the spirit of Free Broadband. Has Talk Talk gone too far?

Free Broadband with 1 GB cap at 15k usage			
Subscribers	250 k	1 m	3 m
Additional Cost	(8.22)	(6.90)	(5.80)
Usage Margin Recovered	3.28	3.28	3.28
Voice Transport Saving	1.58	1.58	1.58
Impact on Margin	(3.37)	(2.05)	(0.94)

Free Broadband with 40 GB cap at 15k usage			
Subscribers	250 k	1 m	3 m
Additional Cost	(11.85)	(10.21)	(7.87)
Usage Margin Recovered	0.00	0.00	0.00
Voice Transport Saving	1.58	1.58	1.58
Impact on Margin	(10.27)	(8.63)	(6.30)

The table below shows how costs increase significantly with usage, even on densely populated LLU networks.

GB / user	2	4	6	8	9	15	32
IP Stream	9.73	11.07	12.42	13.72	15.03	18.89	28.34
250k base	9.66	10.89	12.08	13.20	14.29	17.46	24.40
1m base	8.92	9.68	10.33	10.91	11.41	12.62	14.92
3m base	7.40	7.69	7.92	8.13	8.33	8.92	10.35

Talk Talk's content gamble Talk Talk can charge additional revenues for new applications that it develops (eg. IPTV movie for £2.50) in lieu of charging for the bandwidth itself (7 GB data transfer).

The risk is that the user will get their content from somewhere else on the internet and as a result Talk Talk doesn't get paid for the service, although still bearing the cost. Because it has set its caps too high, Talk Talk will be obliged to deliver the content (at a cost of 50p to £3 depending on user density), without being able to monetise it. If the initial cap much lower Talk Talk could have been sure of getting paid.

Pressure to develop service layer This is going to put pressure on Talk Talk to develop the applications that use the network – more capital expenditure required – in order to generate incremental revenues and recover margins. Doing so will also avoid a reliance on aggressive traffic management.

A history of traffic management Talk Talk has a history of aggressive policies towards customers who run bandwidth hungry peer to peer applications. Their existing Terms and Conditions (clause 4.5) gives Talk Talk sole discretion over what levels are unacceptable and the traffic management that can be deployed to limit customer usage at peak times.





Backhauling on-net saves costs We estimate that the average monthly cost savings per user of bringing the traffic back on-net and routing "internal calls" directly will save £1.58

Voice Transport Saving £s per Month

Geographic	0.67
International	0.08
Mobile	0.16
Other	0.24
On-Net Call Termination	0.43
Total Saving	1.58

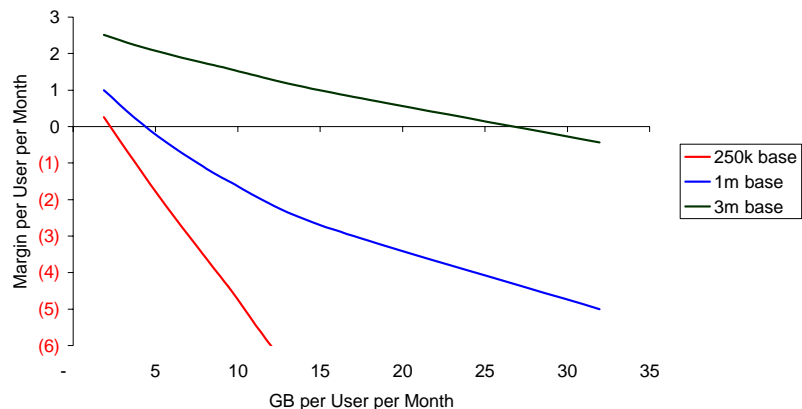
The usage cost kills the model We have revised our initial estimates in version 2 of this analysis because the earlier version assumed that the cap would be minimal and not 40 GB.

Talk Talk Margin Outlook at 15k usage

Subscribers	250 k	1 m	3 m
Total Package Costs	25.26	25.26	25.26
Total Voice Costs	(15.35)	(15.35)	(15.35)
Total Broadband Costs	(11.85)	(10.21)	(7.87)
Total Margin	(1.94)	(0.30)	2.04

Talk Talk's exposure to usage growth is shown in the chart below

Affect of Bandwidth Growth on Talk Talk Margin



What should competitors do? ISPs have been offering Free Calls for over a year. They need to portray broadband as the valuable service, voice as the giveaway whereas Talk Talk are approaching from the opposite side. The addition of mobile and other call margins will allow ISPs to reduce the overall cost of their broadband led packages to compete with Talk Talk.

Other CPS carriers are most at risk from the Talk Talk move as it will quickly become impossible to buy Broadband or Line Rental without also getting a minutes bundle. Having a Line Rental product is a must and CPS carriers must seek to add more to that core service.

The more valuable the lead service, the higher premiums can be charged for under-the-radar ancillary products within a bundle. This is good news for NTL, Sky and BT who have the lead on content services which are much easy to define as "valuable" in the consumer's eyes.

