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2018

TITAN

Deep Dive Series

Comcast Corporation

A Toll Road for the Internet

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TICKER: CMCSA

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A Toll Road for the Internet

Meet Comcast

Everyone's talking about FAANG (Facebook, Apple, Amazon, Netflix & Google). What's not talked about enough is the infrastructure that supports these high-flying internet companies. Comcast is a critically important player. While their customer service isn't always perfect, we still pay for it - a testament to this business' underlying strength.

Paradigm / Elevator Summary

Before consumers can stream Netflix, they must pay for internet service provided by a cable company. The cable industry is the "toll road" that all consumers must pay en route to FAANG. There are only a handful of cable operators that control this industry, one of which is Comcast (ticker: CMCSA).

Comcast is poised to capture substantial value from the growing demand for high-speed data and internet services. This industry tailwind and other strong fundamentals make Comcast a wonderful business and, as we believe at Titan, a compelling investment opportunity for the long term.

OPERATIONAL FACTS

Industry	Telecommunications
HQ	Philadelphia, PA
CEO	Brian Roberts

Core products

Cable video, internet services, and other media properties

How this co. makes money

Selling its cable packages directly to end consumers

VALUATION

Price	$37.13
Market Cap	$171 billion
'19E P/E	13.3x
Avg. ROIC	20%

As of 3/11/18. '19E refers to the calendar year period.

What does Comcast do?

Comcast Corp. is a cable and media company. It owns two businesses: Comcast Cable and NBCUniversal. Comcast Cable is the nation's largest video, high-speed internet and phone provider (you may know their main brand XFINITY). NBCUniversal operates several cable networks, TV stations, resorts, and so forth. The most important piece is the cable business, so let's start there.

“The problem with rolling out a new, high-speed internet service the traditional cables-in-the-ground way is that even though many cities already have plenty of fiber optic pipe buried beneath their streets, it’s still hellishly expensive to connect those pipes to customers’ homes.”

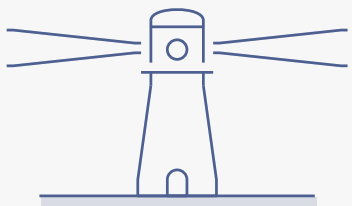
WIRED MAGAZINE

What is “Cable” and why is it so important?

Cable consists of the TV and broadband (internet) services that you likely already use. Cable companies own huge networks of underground wires (literally) that transmit signals from satellite dishes & cell towers to your home and work.

Think of cable companies like a toll road—they control the “highway” through which signals travel to allow you to watch sports on cable TV, stream Netflix, or browse Facebook on your laptop. There are basically only three of these toll roads in the U.S. (Comcast is one of them), and you can’t get around them. Which means that to do any of the above, you must pay them a fee.

A business where customers must structurally use it, with no alternatives, is a great business. Additionally, Comcast has two crucial advantages.



BUSINESS CASE

Comcast's business, driven primarily by its cable assets, has a number of competitive advantages that we believe create a wide moat and make it a high-quality, long-term investment

1 Massive barriers to entry

2 Pricing power from switching costs

3 Broadband internet industry growth

4 Family-operated business

5 Strong returns on capital

Advantage #1: Massive barriers to entry

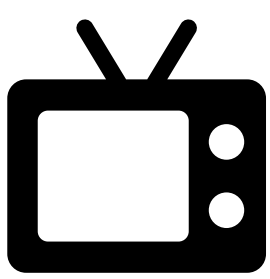
These "toll roads" represent critical infrastructure for the internet, but it is incredibly difficult for new entrants to replicate this infrastructure. Comcast and other cable stalwarts were built decades ago when the television industry was nascent, residential neighborhoods were less developed, and consumer demand for connectivity more than offset the reluctance to the years of local construction required to set up cable networks.

Today's internet companies have tried to make inroads into the cable infrastructure business to reduce reliance on companies like Comcast, but with little success to date. Capital costs are the primary barrier to entry. For example, Google entered the cable industry in 2010 with its Google Fiber project, only to curtail its expansion plans in 2016. Wired said it best:

> "The problem with rolling out a new, high-speed internet service the traditional cables-in-the-ground way is that even though many cities already have plenty of fiber optic pipe buried beneath their streets, it's still hellishly expensive to connect those pipes to customers' homes."

The vast network of underground wires that cable companies have built, both in cities and into customers' homes, is nearly impossible to replicate. Imagine having to get all the local government approvals required to dig ditches and undergo years of construction in each city, then physically digging underground across the entirety of the US (incredibly expensive), laying down miles of cable wire from cable headends (master facilities) to each residential household.

Comcast's underground network has been built and maintained for decades. This network provides a wide "moat" around its castle of a cable business which should ward off threats to its wired network for years to come.



Advantage #2: Pricing power from switching costs

Changing your cable/internet provider is a pain in the butt. If you've ever had to set up cable/internet services in your home, you know what this feels like.

It takes days if not weeks just to schedule an installation. If you're not happy with the service or if the company tries to raise your cable prices, there is usually only one other cable company you can switch to, and after you factor in new installation costs, it usually ends up costing more than it would to just stick with your existing provider.

These factors create very high switching costs, making it painful to change cable companies. That's great for Comcast—it means it can raise prices fairly easily without customers leaving.

As Warren Buffett would say, the business has pricing power.

> "The single most important decision in evaluating a business is pricing power. If you've got the power to raise prices without losing business to a competitor, you've got a very good business. And if you have to have a prayer session before raising the price by 10 percent, then you've got a terrible business."

Comcast has generally raised its prices by 3–4%+ each year for the last 30+ years with remarkably stable customer churn. This low churn proves the stickiness and lack of substitutes for Comcast's services.

Advantage #3: Broadband internet industry growth

The broadband industry has excellent growth prospects as consumers demand more data and internet bandwidth. Although ~80% of US homes are already connected to broadband, there are still 10–15 million homes left for the cable companies to go after in coming years.

This should allow Comcast to grow its broadband subscriber base by 6–7% per year. Factor in some price increases and you've got a 10%+ revenue growth business. Importantly, this growth will be driven by an excellent management team with a long legacy in the business and a proven track record.

Advantage #4: Family-operated business

Comcast is a family-run business, with the Roberts family owning a 33% controlling stake and multiple generations having served as company executives.

Ralph Roberts founded Comcast in 1963. and his son Brian currently serves as CEO. The duo has had a terrific history of shrewd operating experience and smart acquisitions at Comcast. We're confident that Brian Roberts will continue to create value for shareholders for the foreseeable future. They know this industry inside and out.

Advantage #5: Strong returns on capital

When you own a stock, you are a business owner. The most important metric a business owner looks for is return on invested capital (ROIC). It combines two important things. Return, or the profit a company makes. And capital, how much money is needed to get those profits.

Example: Imagine if I told you if you could invest in a pizza shop and you could make $1000 profit. Your next question should be: how much capital is needed to achieve that profit?

"Oh... just $50,000." Your return on capital is 2%. Not so great. Over the last few years, Comcast and the other large cable companies (such as Charter) have showed an ROIC of 20%+ on average. If their moats remain intact, these ROICs should continue to hold strong going forward.

WHAT ARE THE RISKS?	As an investor, it's essential to have a perspective on why your investment thesis could be wrong. There are a few risks to think about with Comcast.
TV subscriber growth	TV subscriber growth could deteriorate faster than the market anticipates as over-the-top services like Netflix take more market share.
Rising costs	Comcast could be forced to pay more for the TV/video content it distributes to homes and be unable to pass those costs onto consumers.
Capital expenditures	Capital expenditures, which Comcast spends on things like cables for its underground networks, could rise to meet greater consumer demand for its internet services, which would weaken free cash flow.
Regulations	Regulations could limit Comcast's ability to raise prices for its broadband services—though this seems unlikely under the Trump administration, which is actually deregulating the sector.

Putting it all together

At Titan, our goal is to invest your money in high-quality companies that we believe can provide strong risk-adjusted returns over the long run.

Comcast is a business that checks nearly all of the boxes that we look for at Titan, outweighing the risks we've identified. We believe it has a clear moat, pricing power, high switching costs, strong growth, high returns on capital, and an experienced leadership team.

Do you believe Facebook, Google, and Netflix will continue to be used by consumers? Comcast is the gatekeeper.

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