

1. REVISED CABLE AND SATELLITE IBAC ESTIMATES

1.1. INSTRUCTIONS

In 2002 NECG, which has since been acquired by CRA International, prepared reports for FOXTEL on an appropriate pricing methodology for access to digital cable and satellite set-top units. One part of the cost pool shared with access seekers was an estimate of the unrecovered analogue installed base costs (the IBAC). NECG prepared a model which estimated the IBAC. NECG's IBAC estimation relied upon inputs and assumptions obtained from a model prepared by PriceWaterhouseCoopers (PWC).

The inputs into the NECG IBAC estimation have since changed, following an independent review by PWC of O&M line items that feed into the PWC Model.

CRA has been asked to complete two tasks:

- First, update the NECG model with the reviewed O&M inputs and then provide an estimate of the IBAC for cable and for satellite for the period to 30 June 2004, using the same methodology and assumptions as previously used by NECG.
- Second, to sensitivity test the cable and satellite IBAC to changes in the brand marketing percentage. The underlying PWC Model relied upon by NECG to estimate the IBAC assumed that 68% of FOXTEL's marketing expenditure was on non-brand marketing and 32% was on brand marketing. We have been asked to prepare a table which shows what the IBAC would be for the following sensitivities presented in Table 1.

Table 1: Sensitivities

Brand marketing (%)	Non brand marketing (%)
15%	85%
40%	60%
50%	50%
60%	40%

In the 2002 NECG report, it was noted that a very conservative approach to calculating the IBAC was adopted, which resulted in an IBAC of \$271 million for the period to 2003/04. This compared to the full IBAC which exceeded \$858 million. For the current exercise, CRA has been requested to update the conservative IBAC estimate only. In addition, CRA has only been requested to update the IBAC for the period to 30 June 2004. We have not been requested to update IBAC estimates beyond this period – and this is reflected in our results summary (see Table 7 below). To the extent that the updated inputs are higher than the original inputs used for the 2002 NECG report, the IBAC for the period beyond 30 June 2004 would be higher.

1.2. MATERIAL RELIED UPON FOR REVISED CABLE IBAC ESTIMATE

The revised Cable IBAC estimates rely upon revised data contained in the Excel workbook entitled "DOC 3 - Agreed Upon Procedures Report on Cable IBAC Cost Schedules dated 13 July 2005" (DOC 3). This workbook contains the O&M line items that have been reviewed by PWC.

We have been instructed that the relevant tab in DOC 3 is entitled "IBAC Summary Cable". Relevant line items from this tab are reproduced as Table 2.

Table 2: IBAC Summary Cable tab, \$000s

	Ref	95/96	96/97	97/98	98/99	99/00	00/01	01/02	02/03	03/04
Engineering	A									
Installation	B									
Less Installation Revenue	B									
Net Installation Costs	B									
MDU Backboning	C									
Disconnections	D									
Service Calls (Net)	E									
Marketing	F									
Sales	F									
Publicity & Promotions	F									
Corporate Other	G									
Call Centre	G									
Other Common Costs (ie. Corporate Other + Call Centre)	G									
Cable STUs	H									
Smart Card Costs	I									
Logistics Department	J									
Foreign Exchange and Parts	K									

Masked for Confidentiality

In addition to data in this tab, we rely upon data contained in the underlying tab labelled "Installation – ref B" tab, which feeds into the "IBAC Summary Cable" tab. Relevant line items sourced from this tab are reproduced as Table 3. The sum of line items in Table 3 equals the "Installation" line item contained in Table 2.

Table 3: Installation Costs, \$000

	Jun-96	Jun-97	Jun-98	Jun-99	Jun-00	Jun-01	Jun-02	Jun-03	Jun-04
Total Installation costs per P&L	Masked for Confidentiality								
Imputed cost of standard installs									

1.3. MATERIAL RELIED UPON FOR REVISED SATELLITE IBAC ESTIMATE

The revised Cable and Satellite IBAC estimates rely upon revised data contained in the Excel workbook entitled "DOC 4 - Agreed Upon Procedures Report on Satellite IBAC Cost Schedules dated 13 July 2005" (DOC 4). This workbook contains the O&M line items that have been reviewed by PWC.

We have been instructed that the relevant tab in DOC 4 to be relied upon is entitled "IBAC Summary Satellite". This tab is reproduced as Table 4.

Table 4: IBAC Summary Satellite tab, \$000s

Subscribers	Ref	98/99	99/00	00/01	01/02	02/03	03/04
No. of Subscribers - Satellite closing	A	Masked for Confidentiality					
No. of Subscribers - Cable closing	A						
No. of Subscribers - Total closing	A						
Revenues	Ref						
Satellite Subscription Revenue	B						
Advertising Revenue	B						
Austar Sub Licence	B						
Programme Sales	B						
Other Revenue							
Costs	Ref						
Satellite STUs	C						
Smart Card Costs	D						
Logistics Department	E						
Installation	F						
MDU Backboning / Conversion Costs	G						
Service Calls & Other Activities	H						
Engineering	I						

Sales & marketing allocated to STUs	J
Foreign Exchange and Parts	K
Other common costs	L

Masked for Confidentiality

In addition to data in this tab, we rely upon data contained in the underlying tabs labelled "Sales&Marketing - Ref J" and "Common Costs - Ref L", which feed into the "IBAC Summary Cable" tab. These tabs are reproduced as Table 5 and Table 6, respectively.

Table 5: Sales and Marketing costs, \$000

	98/99	99/00	00/01	01/02	02/03	03/04
Marketing per GL (excluding magazine)						
Less: Marketing Retention						
Marketing						
Sales per GL						
Less: MDU Backboning Conversion						
Sales less backboning						

Masked for Confidentiality

Table 6: Common Costs, \$000

	98/99	99/00	00/01	01/02	02/03	03/04
Corp Overheads (incl IT)						
Depreciation (non-STU)						
Billing and Call Centre Costs						

Masked for Confidentiality

1.4. RESULTS

Table 7 presents the revised estimates for the Cable and Satellite IBAC, for the Base Case – i.e. assuming 68% of FOXTTEL's marketing expenditure is on non-brand marketing and 32% is on brand marketing – as well as for those sensitivities presented in Table 1. For ease of comparison, the table also contains the original NECG Cable IBAC estimate.

Table 7: Summary of Cable and Satellite IBAC Results for period to 30 June 2004, \$000

	Brand	Non brand	Cable IBAC	Satellite IBAC
Original NECG estimate	32%	68%	271,394	114,660
Base Case	32%	68%	287,607	105,576
Sensitivity Test 1	15%	85%	301,273	107,802
Sensitivity Test 2	40%	60%	281,062	104,528
Sensitivity Test 3	50%	50%	272,838	103,218
Sensitivity Test 4	60%	40%	264,567	101,908