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Upgrading Cablevision (CVC) to Outperform: Poor Prospects for Voom Pose Opportunity in RME Spin-Off

Rating Change / Target Price Change / Estimate Change in Bold

Ticker	Rating	CUR	9/9/2004 Closing Price	Target Price	YTD Rel. Perf.	EPS 2003A	EPS 2004E	EPS 2005E	EV/EBITDA 2003A	EV/EBITDA 2004E	EV/EBITDA 2005E	Yield
CVC	**O**	USD	18.29	**24.00**	-22.4%	-1.00	**-1.74**	**-0.67**	11.6	10.1	8.3	0.0%
OLD	M			21.00			-1.81	-0.64				
SPX			1118.38			54.50	63.00	66.50	0.0	0.0	0.0	1.7%

O – Outperform, M – Market-Perform, U – Underperform

U.S. Cable & Satellite Broadcasting

Highlights

- We are upgrading Cablevision to outperform, and raising our target price to $24 for the combined core cable "stub" and the anticipated spin-off of Rainbow Media Enterprises (RME), which is scheduled to occur before the end of this month.
- Perhaps paradoxically, we believe that the likely *failure* of the Voom DBS business to gain traction will be a positive for Cablevision investors, as it will minimize cash drains and lead to a relatively timely closure of the business.
- We forecast that Voom will exhaust its current funding by mid-2006 or before, and that it is unlikely to be successful in acquiring and retaining enough subscribers to make the business self-sustaining. The slim advantages Voom currently enjoys in national high definition (HD) programming will be eroded rapidly, and it suffers significant competitive disadvantages in local broadcast programming, pricing, retail distribution, standard definition programming, and operating cost structure.
- DirecTV's announcement Wednesday of its plans for the launch of four new satellites to deliver more HDTV, both nationally and locally, only underscores the un-sustainability of Voom's HDTV positioning.
- DirecTV's announcement is good news for Cablevision investors, however, as we believe it substantially increases the probability of an asset sale to EchoStar. The pressure is now on EchoStar to find a solution to its own local-HD capacity problem, and the quickest and easiest (partial) fix would be to buy the Voom satellite and spectrum.
- We estimate that the core AMC, IFC and WE cable networks – to be spun off with Voom – are worth $1.4B, or $5-6 per CVC share (net of debt), and that investors will allocate little, if any, value to Voom. The spin-off would therefore be worth roughly $5 per CVC share.
- Pro forma for the spin, we value the CVC cable stub at $19 per share, for a total of $24, representing 31% upside to yesterday's closing price. Even without assigning *any* value to the spin-off entity, we believe the value of the core cable franchise is sufficient to provide a solid floor, and an attractive risk/reward profile for the stock.
- The realization of significant upside to current value may depend on the shuttering and sale of Voom, making this a speculative investment. The risk is that the Dolans, who will control the spin-off entity, will raise additional financing for Voom, sustaining its losses and preventing realization of value for the

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core networks.

Investment Conclusion

Cablevision's risk/reward profile going into its planned spin-off of Rainbow Media Enterprises is too attractive to ignore.

Even if we assume no upside from currently depressed cable valuations, Cablevision's core cable business (including its regional sports networks and Madison Square Garden) is worth $16.50 per share. That means the projected spin-off of RME (networks AMC, IFC, and WE, along with the Voom DBS business) can be had for less than $2.00 per share. Alternatively, assuming a fair valuation for cable that is in line with Cox's go-private take-out offer, the implied value of the spin is actually a negative number.

That's too cheap. Even after newly-raised debt, the core networks (AMC/IFC and WE) alone are worth more than $6 per share. While the DBS Voom business will certainly be a drag on fair value, there are reasons to be optimistic that the overhang may not last long. DirecTV's announcement Wednesday that it plans to launch four new HDTV satellites should put to rest any delusions of competitive advantage for Voom, and at the same time increase Voom's value to EchoStar, which will now be pressured to respond with its own HDTV strategy. Any indication that Voom might be shuttered would immediately unlock the full value of the networks. Any indication that Voom might be *sold* would do the same and then some, since shareholders would recover value for the satellite and orbital licenses as well.

Pro-forma for the spin, we value the stub entity at $19 per share, and the RME spin-off at $5 per CVC share. While we emphasize that the spin equity will be highly speculative – its value will remain subject to the whims of the Dolan family – we believe its risk/reward profile is sufficiently attractive as to warrant a non-negligible valuation. We are therefore upgrading Cablevision (CVC) to outperform, and raising our target price to $24, representing more than a 30% upside to yesterday's closing price.

Details

The much anticipated spin-off of Rainbow Media Enterprises (RME), which includes Cablevision's VOOM DBS service, is scheduled to occur before the end of this month.

RME successfully closed the financing necessary to complete the spin-off in late August, clearing the last major hurdle to the spin. Completion of the spin-off awaits only a declaration of effectiveness of the Form 10 by the SEC, and a final meeting of the Board of Directors to finalize the terms of the spin-off.

A successful spin will leave in its wake a cable stub that we value at $19, or slightly higher than the current Cablevision share price. The spin-off equity can therefore be viewed as a "free option" on the cable networks, which we believe warrant a value of $5 per share.

We believe the Voom business has no sustainable competitive advantage, and will not survive.

Rainbow Media Enterprises – What's Included

Cablevision's upcoming spin-off will leave investors with two separate equities; Cablevision will be much closer to a pure-play cable operation, while Rainbow Media Enterprises (RME) will be a programming/media company with a highly speculative DBS venture.

RME is today a 100% (indirect) subsidiary of CVC. Its spin-off will be accomplished by a tax-free distribution of RME shares to existing CVC shareholders.

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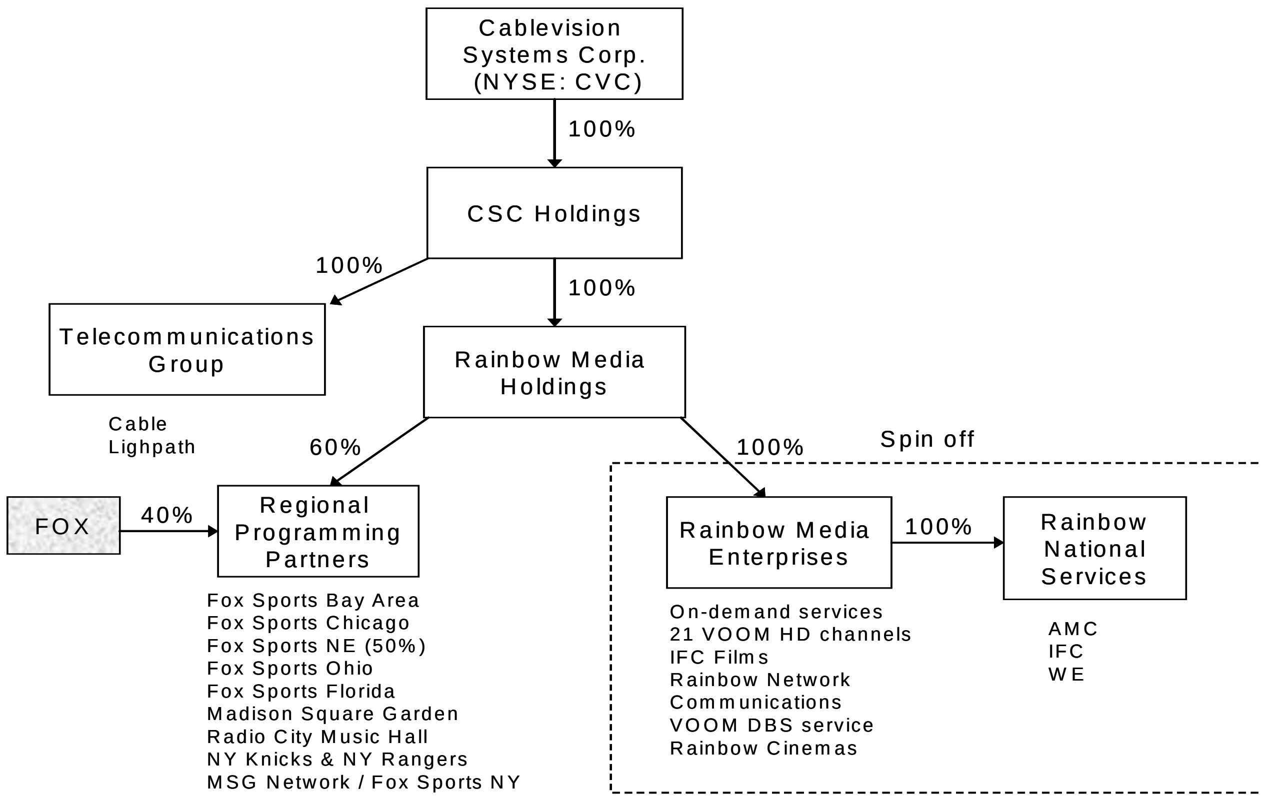
Exhibit 1
Cablevision Structure Diagram



The RME's spin-off will include the following assets:

- Rainbow programming: AMC, IFC and WE cable networks; on-demand services (MagRack, World Picks etc.); the Voom HD channels; the IFC film production and distribution business, and Rainbow Network Communications.
- Rainbow DBS (Voom).
- Rainbow Cinemas: 53 motion picture theaters in the New York metro area (excluding the venerable Ziegfeld Theater in mid-town Manhattan).

Spin-off Funding and Liquidity

Based on starting financing, and cash generated from operations, we believe the spin-off will be fully funded through mid-2006.

RME will start off with approximately $670M in cash on its balance sheet. Only $8.4M of this is legacy cash on hand; the balance is the net proceeds from a series of financing transactions completed last month by Rainbow National Services (RNS). RNS is a 100% subsidiary of RME, and owns 100% of AMC, IFC and WE. The debt issued by RNS consists of bank facilities of $950M (a fully drawn $600M term loan and an undrawn $350M revolving credit facility), $300M senior notes, and $500M senior subordinated notes (see Exhibit 2).

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Exhibit 2
Rainbow National Services Financing (closed August 20, 2004)

Term loan (maturing March 2012)	600.0
Revolving credit facility (undrawn) (maturing Sep 2011)	350.0
8 3/4% senior notes due 2012	300.0
10 3/8% senior subordinated notes due 2014	500.0
Total principal	1,750.0
Cash proceeds before costs	1,400.0
Financing costs	33.6
Net proceeds	1,366.4
Distributed to Rainbow Media Holdings to repay old facility	704.9
Net cash available at RME	661.5

Source: Company Filings, Bernstein Analysis

Proceeds from the financing were distributed by RNS to RME. RME paid $705M of this to Rainbow Media Holdings, which used it to repay the existing Rainbow credit facility. The remaining $661M will be used by RME primarily to invest in Rainbow DBS.

Operating Cash Flows Provide Balance of Financing

In addition to the proceeds from the RNS financing, the three core cable networks owned by RNS (AMC, IFC and WE) generate over $200M in EBITDA each year, which could be used to fund Voom.

Exhibit 3
Rainbow National Services (Core Networks) Free Cash Flow Forecast

($ thousand)	2004	2005	2006	2007	2008
AMC, IFC and WE					
EBITDA	253,044	288,090	322,211	356,807	392,509
Capex	(7,681)	(10,762)	(11,970)	(12,885)	(13,580)
Interest (RNS debt)	(37,144)	(107,645)	(113,345)	(117,395)	(120,995)
Net cash available (required)	208,219	169,683	196,896	226,527	257,934

Note: Tax payments are not shown as it is assumed that RME will file a consolidated tax return, and initial operating losses will shelter future income within the forecast period
Source: Bernstein Estimates and Analysis

The spin-off of the core cable networks catches them in the midst of a strong growth cycle. Anchor network AMC is enjoying its strongest Nielsen ratings ever, and is still benefiting from the relatively recent addition of advertising in 2002. WE and IFC are both strengthening as well, and have shown continued expansion in household distribution.

Although we expect RNS to generate almost $300M in EBITDA in 2005, we estimate that after capex and payment of interest on debt, RNS will net $160M of cash flow. We forecast that cash flow from RNS will grow to $258M in 2008.

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This cash would be available to fund Rainbow DBS, subject to specific limitations: the terms of the financing limit the amount that RNS can invest in Rainbow DBS to $150M annually (plus any unused amount from previous years) up to a total of $600M. The terms also limit distributions to $50M annually, and $200M in total, for other general purposes such as funding for the developing networks or the VOOM HD channels (Exhibit 4).

Exhibit 4
Rainbow National Services Credit Facilities: Permitted Distributions and Investments

- Proceeds from notes issuance and term loan borrowings
- Up to $150M annually and $600M in the aggregate to be used by RME to fund Rainbow DBS
- Up to $50M annually and $200M in aggregate to be used by RME for other purposes
- Subject to compliance with leverage ratio, up to $300M proceeds from permitted future debt offerings

All distributions subject to compliance with covenants and minimum liquidity balance

Source: Company Filings

Other developing businesses within RME, including Mag Rack and other on-demand channels, and the 21 Voom HD channels (discussed below) will also require funding. The cash drain of Mag Rack and other developing networks, however, should moderate as they continue to gain distribution.

In total, then, it appears that Rainbow DBS will be funded by the $661M of net proceeds from the initial RNS financing, as well as $150M per year distributed from RNS.

In our base case for Rainbow DBS, this will be sufficient to fund the business through mid-2006.

We believe that when the business runs out of cash – or, when it becomes clear that it soon will – the decision to close the Voom business will be inescapable.

Projecting a DBS Burn Rate

Paradoxically, the worse Voom does at acquiring subscribers, the less cash will be needed to fund the business. Because costs are incurred to acquire a subscriber up front (a combination of equipment costs, retailer commissions and installation costs) and revenues are not earned until later on, the more subscribers are acquired, the more cash needs to be spent.

In our base case, we assume Voom achieves 3% market share by 2008, or approximately 2.8 million subscribers. (For reference, DirecTV achieved this milestone in late 1997 after just over three years in service, but in a much more accommodating market. In late 1997, multichannel penetration of U.S. households was only 73%, versus 80% today, and a typical cable operator offered only 40-or-so analog channels as competition.)

We have also examined high growth and low growth scenarios. In our "high sub growth" case, we assume that Voom reaches 5% penetration of the multichannel market by 2008, and adoption increases at a faster rate. In our "low sub growth" case, we assume VOOM eventually reaches 2.5% penetration of the U.S. market, but not till 2011.

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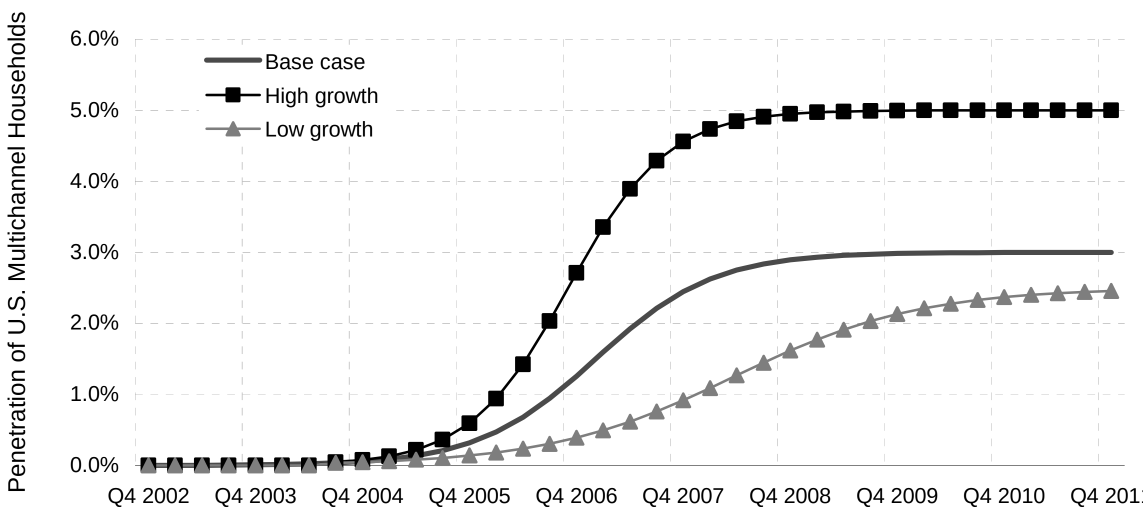
Exhibit 5
Penetration Curves: Base Case, High and Low Sub Growth Cases



Source: Bernstein Estimates and Analysis

For further reference, we note that more than 5 million HD TV sets are projected to be sold in 2004 alone. Compared to this potential market, our 200K base case subscriber estimate for Voom at the end of 2005 (1.3% of the potential HD households) does not seem unreasonably aggressive. (As noted previously, faster growth would consume more cash.)

Other Key Assumptions in our Voom Burn Rate Model

Our model of Voom's burn rate is based on a combination of company guidance, DBS industry benchmarks, and good-old fashioned speculation. Key assumptions include:

- Subscription revenues: We have assumed initial package pricing in line with Voom's current offers ($49.90 for the basic package, up to $79.90 for everything). Future price increases are modeled at 3% annually, slightly lower than the industry average, since VOOM is currently slightly more expensive than comparable service offerings, and therefore can be expected to have less room for future price increases.
- Subscriber Acquisition Cost (SAC): We have assumed SAC of $900 per subscriber, initially partially offset by equipment sales and rental revenue (below). This assumes 2.0 set-top boxes per subscriber, an elliptical dish, installation, and $300 HD set-top boxes declining at 5% annually.
- Equipment sales and rental revenue**:** We have assumed initial equipment charges in line with Voom's current offers. Voom equipment currently costs $300 to buy for the first box and $250 for additional boxes. Rental charges for leasing customers are $9.50 per month for the first box, $14.50 per month for additional boxes. We assume that initially 80% of new subscribers choose the lease option. However, we believe that in the long run it is not sustainable for Voom to continue to charge for boxes up front, where there is no equivalent cost to sign up for any of the other multichannel services (both DirecTV and

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EchoStar offer free equipment, and cable has a lease model). We therefore phase out equipment sales revenue over the next two years, and reduce the proportion of customers choosing the lease option to 25%.

- Installation revenues**:** Voom currently charges $199 for installation of the first box, and $50 for each additional box. Given that all other services offer free installation (in some cases after a rebate), we believe that VOOM will eventually have to discontinue this in order to be competitive. We therefore only model revenues from installation for the next 12 months.
- Churn rate: Voom has experienced extremely high churn rate in its first year. The company reports that 30% of subscribers have churned off through the end of August. We estimate that the current quarter churn rate could be as high as 10% per month. We have modeled churn to fall to 1.6% (in line with DirecTV and EchoStar) over the next four years.
- No new satellites: Perhaps most critically, we assume no incremental capital investment for new satellite construction. Including launch costs and launch insurance, a new satellite could be expected to cost upwards of $250M. Adding even one new satellite would therefore quickly push the business into cash deficit in all scenarios, requiring additional financing. Investors should note, however, that Cablevision's recent purchase of DBS spectrum from the FCC carries with it the condition of timely satellite construction and launch.

Additional key assumptions are detailed in the exhibit below.

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Exhibit 6
Rainbow DBS Model: Subscriber and Revenue Assumptions

Customers		
End Penetration (of US Multichannel, 2008, base case)		3%
Churn Rate (target, by 2008)		1.6%
Revenue		
Subscription Revenue		
Basic Offer	$	49.90
Average Premiums, PPV, etc.	$	30.00
Total ARPU	$	79.90
Annual Rate of Increase		3.0%
Equipment Rental Revenue		
First box, per month	$	9.50
Additional boxes, per month	$	14.50
Starting % HHs renting equipment		80.0%
Target % HHs renting equipment after 2 years		25.0%
Equipment Sales Revenue (first 2 years only)		
First box	$	300.00
Additional boxes	$	250.00
Starting % HHs buying equipment		20.0%
Target % HHs buying equipment after 2 years		75.0%
Installation Revenue (first year only)		
Per install	$	199.00

Source: Bernstein Estimates and Analysis

Exhibit 7
Rainbow DBS Model: Cost Assumptions

Cost		
Customer Acquisition Cost		
Retailer Subsidy	$	100.00
STBs/HH		2.0
STB Cost (long run)	$	300.00
Annual increase (decrease)		-5%
Installation cost	$	200.00
Total SAC	$	900.00
Programming Cost (other than 1st year)		
Programming Cost - basic offer		39.0%
Programming Cost - premiums		55.0%
Weighted Average Programming Cost		45.0%
Monthly Variable Expense (e.g. CS)	$	6.00
Fixed other operating expense (e.g. ground station)		15,000
SG&A		
Advertising & Marketing (Annually thru year 3)		40,000
Advertising & Marketing (Annually -ongoing)		20,000
Fixed Overheads		20,000
Fixed number of Employees (starting)		50
Average loaded cost per employee	$	100,000
Variable SG&A (% of sales)		15.0%
Capital Investment		
Capital to Launch + Ground Stations + Launch Insurance		250,000
Annual Maintenance Capital		10%
Working Capital Requirements (% of Sales)		5%
Depreciation asset life (PP&E)		8.6
Depreciation asset life (STBs)		4.0
Tax Rate		35.0%

Source: Bernstein Estimates and Analysis

Base Case Results: Cash Runs Out in 2006, Even Without New Satellites

In our base case (3% penetration of multichannel households by 2008) Voom achieves positive EBITDA and cash flow breakeven in early 2008. Cumulative cash flow break-even does not come until five years later, in 2013, yielding a negative IRR and NPV for the entire project.

Our model projects that the Voom DBS business alone – *excluding* the 21 proprietary HD networks – will require $295M in net funding in 2004 (the Form 10 provides 2004 guidance of $447M, *including* the 21 networks) and $340M in 2005. Cumulative cash outflows peak at approximately $2.1B in 2008 in our base case (including the estimated $380M spent to date).

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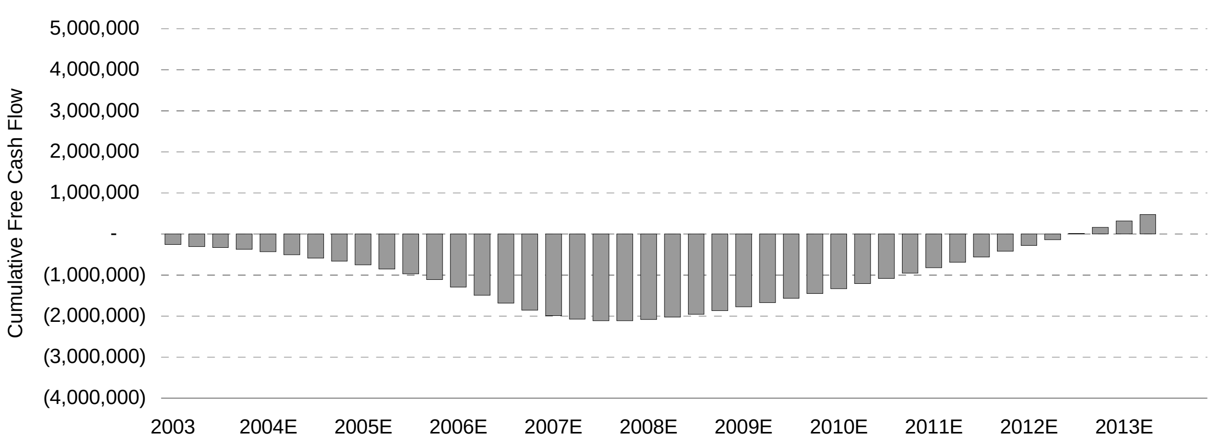
Exhibit 8
Rainbow DBS Model Summary – Base Case

($ million)	2003	Q1 2004	Q2 2004E	Q3 2004E	Q4 2004E	2004E	2005E	2006E	2007E	2008E
Income Statement Items										
Revenue	0	1	3	13	19	36	242	792	1,982	2,982
Operating Expenses (ex D&A)	46	29	57	63	78	227	542	1,449	2,559	2,797
EBITDA	(46)	(28)	(54)	(50)	(59)	(192)	(300)	(657)	(577)	185
% sales	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*-29%*	*6%*
Depreciation & Amortization	7	8	8	9	9	33	45	68	110	142
Operating Profit	(53)	(36)	(62)	(59)	(68)	(225)	(345)	(724)	(687)	42
% sales	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*1%*
Cash Flow Items										
Cash from Operations		(16)	(32)	(49)	(55)	(152)	(263)	(484)	(395)	142
Capex		(7)	(15)	(12)	(18)	(53)	(78)	(157)	(189)	(95)
Free Cash Flow		(23)	(137)	(61)	(73)	(295)	(341)	(640)	(584)	47
Change in IS Items										
Revenue							580.4%	227.1%	150.3%	50.4%
EBITDA							NM	NM	NM	NM
Free cash flow							NM	NM	NM	NM
Subscriber Detail										
Subscribers (thousand)	1	6	25	32	50	50	284	1,159	2,308	2,790
Growth %							*472.7%*	*307.8%*	*99.1%*	*20.8%*
Gross Adds		7	24	15	27	73	304	1,068	1,550	1,009
Growth %							*317.7%*	*250.9%*	*45.1%*	*-34.9%*
Net Adds		6	19	7	18	49	235	875	1,149	481
Churn		30.0%	10.9%	9.5%	7.5%	14.5%	4.6%	2.6%	1.9%	1.7%
ARPU		$ 1.44	$ 47.03	$ 87.70	$ 87.85	$ 56.00	$ 88.71	$ 90.73	$ 93.14	$ 95.74
SAC (total)		$ 1,275	$ 1,247	$ 937	$ 857	$ 1,079	$ 857	$ 837	$ 802	$ 748

Exhibit 9
Rainbow DBS Model Base Case: Cumulative Free Cash Flow



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In this base case scenario, then, the proceeds of the initial financing, together with distributions from RNS – and assuming no capital investment for additional satellites – will be sufficient to fund the business through early-to-mid-2006.

Exhibit 10
Rainbow DBS Funding – Base Case

($ million)	2004	2005	2006	2007	2008
Cash balance carried forward	670	610	420	(71)	(505)
Distributions from RNS	75	150	150	150	75
Cash required by VOOM	(134)	(341)	(640)	(584)	47
Cash balance at year end	610	420	(71)	(505)	(383)

Note: Cash balance is pro forma as of June 30, 2004. Analysis includes VOOM cash burn from that date

Source: Bernstein Estimates and Analysis

(Investors should note that our burn rate analysis is focused on the cash available to sustain the DBS Voom business only. An additional significant cash drain comes from the 21 proprietary HD networks, which are not included in our Voom model, but which are expected to consume an additional $101M in 2004 according to Cablevision's most recent Form 10 filing. The cash that can be distributed from RNS to fund these networks is counted by RME as "cash for other purposes," and is limited to $50M annually [see Exhibit 4]. A comprehensive revenue and EBITDA forecast for all of RME is included in Exhibit 18 at the end of this report.)

High and Low Growth Cases Still Don't Look Viable

In the "high sub growth" case, cumulative cash outflows peak at over $2.7B in 2007, but future potential earnings are much greater because of much high subscriber additions. However, in this scenario, cash would run out sooner – at the end of 2005/beginning of 2006. Despite the faster ramp, the business would still claim only 500K subscribers by that time, and we believe additional funding would therefore be very difficult to acquire. Once again, this scenario includes no capital investment for new satellites.

Exhibit 11
Rainbow DBS Funding – Rapid Growth Case

($ million)	2004	2005	2006	2007	2008
Cash balance carried forward	670	598	303	(697)	(1,176)
Distributions from RNS	75	150	150	150	75
Cash required by VOOM	(146)	(446)	(1,150)	(629)	500
Cash balance at year end	598	303	(697)	(1,176)	(600)

Note: Cash balance is pro forma as of June 30, 2004. Analysis includes VOOM cash burn from that date

Source: Bernstein Estimates and Analysis

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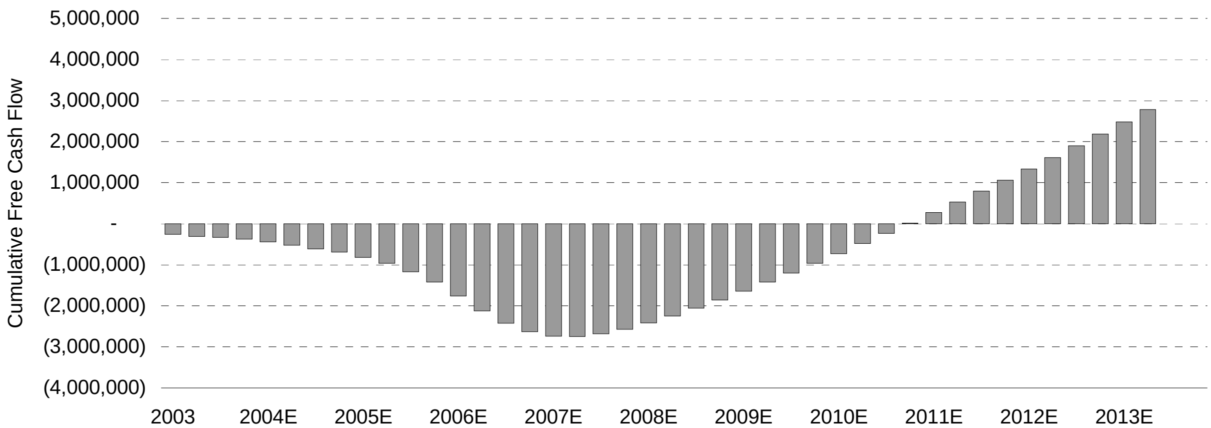
Exhibit 12
Rainbow DBS Model "High Sub Growth" Case: Cumulative Free Cash Flow



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In our "low sub growth" case, initial cash requirements are more modest (peaking at $2B cumulatively in 2009), with lower subscriber gains. In this scenario, available cash would sustain the business until 2007, but the business would never achieves sufficient scale to reach cumulative cash flow break-even.

Exhibit 13
Rainbow DBS Funding – Slow Growth Case

($ million)	2004	2005	2006	2007	2008
Cash balance carried forward	670	617	493	302	21
Distributions from RNS	75	150	150	150	75
Cash required by VOOM	(128)	(274)	(341)	(431)	(382)
Cash balance at year end	617	493	302	21	(286)

Note: Cash balance is pro forma as of June 30, 2004. Analysis includes VOOM cash burn from that date

Source: Bernstein Estimates and Analysis

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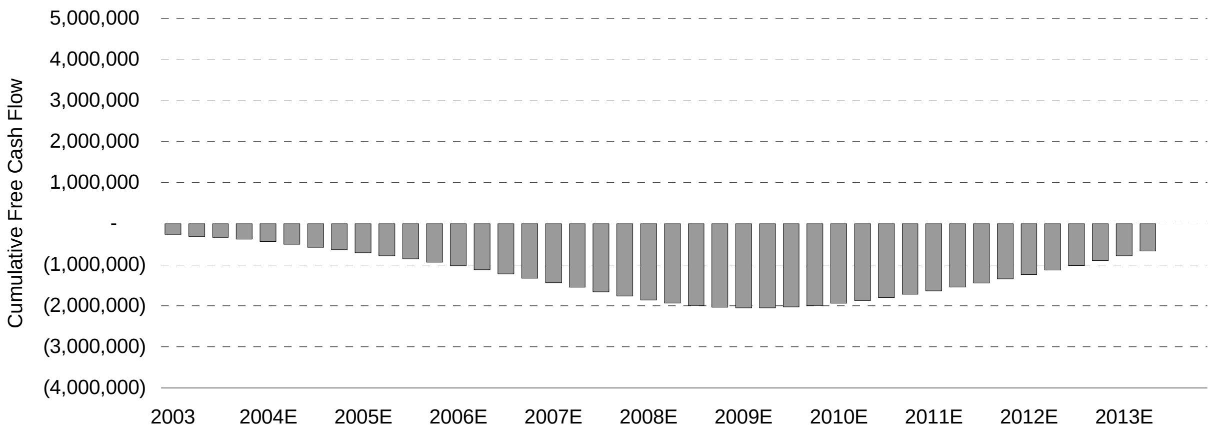
Exhibit 14
Rainbow DBS Model "Slow Growth" Case: Cumulative Free Cash Flow



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Plugging the Funding Gap?

In any of the above scenarios, the proceeds of the RNS financing and allowed distributions from RNS will not be enough to fund Rainbow DBS through to cash flow breakeven. In our base case, RME would need to raise additional funding before the end of 2006. We believe it will be very difficult for RME to obtain the additional funding necessary, and that the likely outcome when this becomes clear will be closure of the business.

Apart from the proceeds from the RNS financing, and cash from RNS' operations, RME could attempt to tap the capital markets again for additional funding for Voom. We do not believe that additional debt at RNS is likely to be a realistic source of additional funding in the near term. As a multiple of 2005 EBITDA, RNS is already levered over 6x, leaving limited room for more debt. Granted, as EBITDA grows, funding capacity should increase, but EBITDA growth will slow down as the networks reach full distribution, and the tailwind from newly-added advertising revenue starts to run out.

With no other source of cash flow than RNS, it is unlikely that any other parts of RME could support additional debt.

The most plausible avenue for RME to raise capital is by selling additional shares once the spin-off is completed. This would be dilutive to early RME shareholders if the shares have to be sold at a discount in order to attract investor demand, or if the cash proceeds were invested in VOOM DBS with no concurrent gain in overall valuation. However, we are skeptical that RME could generate enough demand for a material share offering in the next few years at any price, given the lack of investor enthusiasm for the VOOM DBS business.

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The Most Likely Scenario is a Voom Closure

In any case, we believe the most likely outcome for the Voom business is its early demise. And this would actually be the best possible outcome for CVC/RME shareholders.

Voom's positioning as a high definition service is problematic. Today, the HD market is plagued by lack of content much more than by a lack of distribution; VOOM's competitors already carry most of the quality HD programming available. The incremental HD channels that Voom provides – many of which are just up-resolution movies from the AMC library – are of questionable value. Making matters worse, the production costs for the 21 Voom HD channels can also only be amortized over Voom's small base of subscribers, making them hugely uneconomic to run without getting additional distribution. But broadening distribution would undermine VOOM's value proposition further. Meanwhile, Voom's core standard definition lineup is inadequate to make VOOM a credible replacement for cable, DirecTV or EchoStar's DISH service.

DirecTV's announcement yesterday of its plans for the launch of four new satellites to deliver HDTV only underscores the un-sustainability of Voom's HDTV positioning. In addition to dramatically expanding the number of DirecTV national HDTV channels, the new satellites will provide ample capacity to serve the nation with HD locals; with the launch of Spaceway 1and 2 in 2005, DirecTV has said they will provide local HD channels to 100 markets (more than 80% of U.S. HHs) by mid-year.

DirecTV's announcement is good news for Cablevision investors, however, as we believe it substantially increases the probability of a sale to EchoStar. The pressure is now on EchoStar to find a solution to its own capacity problem, and the quickest and easiest fix would be to buy the Voom satellite and spectrum.

A Weak Product Offering

The weakness of Voom's offering is apparent in its lack of success to date.

The Voom offering has now been in the market for over 10 months; in that time, the company has managed to acquire and retain only 28,600 subscribers (as of the end of August, as disclosed in their most recently amended Form 10). Notably, this means they've added less than 4,000 new subscribers in the past two months. In contrast, Cablevision's cable unit had 83K subscribers taking its package of high definition channels (which incidentally is free with the service) as of the end of 2Q, even though it's potential reach is only 4 million homes passed (versus Voom's 80-100M).

The Voom DBS service has been trialing different packages, price points and promotions since its launch in October 2003. However, despite the possibility of additional tinkering with product offerings, we do not believe VOOM will be able to offer a service that is competitive with is cable and DBS competitors, either now or in the long term.

We expect Voom's lack of competitiveness will eventually become apparent even to the Dolans, and that they will conclude that persisting with the venture is pointless.

Valuing the Spin-off

Rainbow Media Enterprises has two business units that are material to valuation; the three mature cable networks (AMC, IFC and WE) and Rainbow DBS. For valuation purposes, we will ignore the remaining businesses, and assume that they contribute nothing to overall value.

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We value AMC, IFC and WE using a 12.5x multiple of 2005 combined EBITDA (please refer to our colleague Tom Wolzien's note, "*Media: Revaluing Cable Nets (Down) & TV Nets (Up) As Distribution Maturity Comes Into View*", September 2, 2004 for a discussion of cable network valuation metrics). Using our 2005 EBITDA estimate of $288M for the three networks, we arrive at an enterprise value of $3.6B. After subtracting debt and preferreds, we estimate that the networks are worth $6 per CVC share.

Exhibit 15
Valuation: AMC, IFC and WE

($ million)	
AMC, IFC and WE 2005 EBITDA	288.1
Multiple	12.5x
Enterprise value	3,601.1
RNS debt outstanding	1,400.0
AMC redeemable preferred stock	350.0
Equity value	1,851.1
CVC diluted shares outstanding (million)	294.7
Implied value per CVC share	$ 6.28

Source: Bernstein estimates and analysis

This method of valuing the networks is extremely conservative, in that it implicitly allocates no value whatsoever to IFC, which we estimate currently has near zero or negative EBITDA. Note that we also do not account for the $670M in cash currently on RNS' balance sheet, as we assume this will be used by the DBS business in short order.

All else being equal then, the three networks would be worth over $6 per CVC share. The question is whether investors will consider Voom a net addition, or a net subtraction from this value.

Valuing the Voom DBS Business

On balance, we believe that the spin-off will trade with Voom being allocated a positive value, largely based on its liquidation value.

Unfortunately, while DirecTV's capacity announcement this week increases the probability of a sale, it reduces the probable price, as it realistically leaves EchoStar as the only bidder. (As we have noted in the past, negotiating under duress with Charlie Ergen – when he is the only potential bidder – is not an enviable task). Conservatively, we believe that Voom's satellite and spectrum (Ka- and Ku-band, and MVDDS) might fetch $250M in a sale – less than half what Cablevision has invested to date. The VOOM subscriber base at the time of any transaction would have additional value to either of EchoStar or DirecTV, and could provide additional upside in a sale.

A liquidation of Voom that realizes $250M would yield $0.85 per CVC share.

In the case that the Dolans do not decide to shutter the Voom business, we believe the most likely scenario is that the business will limp along acquiring few subscribers, and therefore consuming little cash (see our "low sub growth" scenario above). While the business might not be worth $250M in this case, it would at least not be a major detractor from the value of the Rainbow networks.

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Valuing the Core Cable Stub

A successful spin of RME will release Cablevision's core cable assets from the overhang from VOOM, and should give better clarity on the remaining assets. Both should provide a boost for the market valuation for the core cable stub.

The biggest chunk of the stub will be the New York metro cable business. If we were to use Cox Enterprises' takeout offer for the Cox minority as a benchmark (which at the $32 offer price implies a 9.0x multiple on Cox's forward 12 months EBITDA), we would arrive at a $20 valuation for the Cablevision stub. (Note that this cable valuation is after assuming relatively conservative valuations for non-cable assets remaining in the stub, including the MSG Group and the Regional Sports Networks. We ascribe a particularly conservative 10x forward EBITDA valuation to the RSNs, which despite strong current cash flow have been impaired by the pending loss of carriage rights to professional teams in Chicago). Based on yesterday's closing price of $18.29, this would mean the option value of the spin is currently accorded a negative value (Exhibit 16).

Exhibit 16
Cablevision Stub: Sum of the Parts Valuation

($ billion)		
Cable Operations	11.9	*9.0x forward 12 months EBITDA*
Non-Cable Operations		
Fox Sports Net Florida, Ohio, Chicago and Bay Area	0.6	*10x forward 12 months EBITDA*
Madison Square Garden	0.2	*13x forward 12 months EBITDA*
Lightpath	0.3	*5x forward 12 months EBITDA*
Total	1.2	
Publicly Traded Investments	1.8	*Book value (marked to market)*
Non-Traded Equity Investments		
Fox Sports Net New England	0.0	*15x forward 12 months EBITDA*
AMC PIK Preferred Security	0.4	
Total Non-Cable Assets	3.4	
Total Enterprise Value	15.3	
Net Debt	9.4	
Preferred Stock	0.1	
Total Equity Value	5.8	
Shares Outstanding	295	million
Implied Value per Share	$ 19.72	

Note: Balance sheet items as of 6/30/04. Debt balance is pro forma for $705M debt repayment. Includes Cablevision's pro rata share of asset or equity value on
Source: Bernstein Estimates and Analysis

Alternatively, if we were to apply Comcast's current trading multiple of 8.0x FTM EBITDA (cable-only) to Cablevision – that is, if we were to assume no appreciation in cable multiples over the next year – then the stub would warrant a value of $16.34 per CVC share. Adding just our conservative valuation of AMC, IFC and WE ($6 per CVC share) brings the value to $22.34, a 22% premium to last night's closing price.

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We have adopted an intermediate valuation of $19 as the basis of our stub valuation.

Conclusion: VOOM Unlikely to Gain Traction

It may seem paradoxical to upgrade a stock based on the hopes of a swift business failure. But given its pricing, product and distribution disadvantages, we believe that Voom will continue to have difficulty attracting new subscribers. In addition, its churn rate is likely to stay high. As the amount of HD programming available from other providers (especially local channels) increases, this will eliminate any perceived product advantage Voom has in HD.

Without a clear path to success, and without strong prospects for additional funding, we continue to believe Voom is likely to live a short life. And when Voom goes, the asset values of the rest of the Cablevision portfolio will return to more normal levels.

Valuation Methodology

We value Cablevision as the total of the RME spin-off and the core cable stub. We value each part on a sum of the parts basis. The enterprise value of the cable division (Telecom Group) is based on a composite of a 9.0x forward 12 month EBITDA, in accordance with Cox Enterprises' takeout offer for Cox as a benchmark, and the 7.8x forward 12 month multiple currently being awarded Comcast. Programming assets, including those to be contributed to the new spin-off, are valued on a mixture of 12.5x Forward-Twelve-Months (FTM) EBITDA multiples for mature networks, and per subscriber valuations for developing networks. MSG is valued at 13x FTM EBITDA. The Regional Sports Networks, which will remain in the core cable stub, are valued at 10x FTM EBITDA, a conservative valuation reflecting the impairment to the Chicago RSN from the pending loss of carriage rights to its professional teams. VOOM is ascribed no material value in our target price. Publicly traded investments are valued at market value.

Risks

- As we have noted in the past, no amount of analysis can provide an answer about what the Dolan family will choose to do with Voom. For this reason, an investment in Cablevision based on the expectation of closing Voom must be viewed as speculative. The Dolan family exercises complete operating discretion, and continuation or closure or the Voom business will be a Dolan family decision.
- The DBS venture continues to burn cash at an alarming rate. Until the planned spin-off is completed, management can give no absolute assurances that there will be no further exposure to the venture for Cablevision's core cable investors.
- Our investment thesis for the cable group continues to be underpinned by our view that the competitive pricing environment will less aggressive than consensus expectations, as none of the RBOCs, DBS operators, or cable MSOs can economically justify aggressive pricing strategies on the basis of market share gain, market elasticity, or retention of other products in the bundle. Notwithstanding our analysis of rational pricing strategies, however, players may adopt irrational pricing behavior. Alternatively, *expectations* of a more challenging pricing environment may continue to weigh on the stocks for some time.

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Exhibit 17
VOOM, DirecTV and DISH Product Offerings

Provider	**VOOM**	**VOOM**	**DirecTV**	**DISH**
Package	VOOM Package	Va Va VOOM Package	DirecTV Total Choice with locals	America's Top 60 with locals
Up front cost	Lease: $199 installed, $9.50/mth equipment fee. Buy: $499 installed.	Same	None	None
Cost per month	$49.90	$89.90	$39.99	$29.99
Channels	21 VOOM HD channels; all non-premium HD channels; over 50 cable channels; 18 digital music channels; local off-air broadcast channels	VOOM package plus four PlusPaks	130 channels including 31 music channels + local channels	60 channels + local channels
Other	Premium movie multiplexes (PlusPaks) $19.90/mth (each 9 channels, 2-3 in HD)		HD tier $9.99/mth (6 mths free promotion)	HD tier $9.99/mth (6 mths free promotion)

Source: Corporate reports

Exhibit 18
Rainbow Media Enterprises: Summary Income Statement

($ million)	2003	Q1 2004	Q2 2004	Q3 2004E	Q4 2004E	2004E	2005E	2006E	2007E	2008E
Income Statement Items										
Revenue		155	167	191	208	721	1,026	1,686	3,023	4,159
Operating Expenses (ex D&A)		149	187	200	220	755	1,122	2,078	3,253	3,552
EBITDA		6	(20)	(8)	(12)	(34)	(95)	(392)	(230)	607
% sales		*4.0%*	*-12.0%*	*-4.4%*	*-5.8%*	*-4.7%*	*-9.3%*	*-23.3%*	*-7.6%*	*14.6%*
Depreciation & Amortization		32	32	32	34	130	142	166	210	244
Operating Profit		(26)	(52)	(40)	(46)	(164)	(237)	(558)	(441)	363
% sales		*-16.5%*	*-31.2%*	*-21.1%*	*-22.1%*	*-22.7%*	*-23.1%*	*-33.1%*	*-14.6%*	*8.7%*
Net interest expense		(6)	(7)	(11)	(38)	(61)	(159)	(172)	(184)	(198)
Tax credit (expense)		2	1	18	29	50	139	256	219	(58)
Net income		(37)	(58)	(34)	(54)	(183)	(258)	(475)	(406)	107

Source: Bernstein Estimates and Analysis

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Exhibit 19

Rainbow Media Enterprises: Revenue and EBITDA by Segment

($ million)	2003E	Q1 2004	Q2 2004	Q3 2004E	Q4 2004E	2004E	2005E	2006E	2007E	2008E
Revenue by Segment										
Rainbow programming	449	131	140	151	160	581	671	759	861	960
AMC, IFC + WE	442	126	130	140	147	543	606	664	723	784
Other programming assets	7	5	10	11	13	39	65	95	138	175
Rainbow DBS	0	1	3	13	19	36	242	792	1,982	2,982
Rainbow cinemas	84	17	19	21	22	80	79	78	77	77
Corporate and intersegment	19	5	5	6	7	24	35	57	102	141
Total	552	155	167	191	208	721	1,026	1,686	3,023	4,159
EBITDA by Segment										
Rainbow programming	102	33	32	39	44	148	190	244	315	380
AMC, IFC + WE	180	61	58	65	70	253	288	322	357	394
Other programming assets	(78)	(27)	(26)	(26)	(26)	(105)	(98)	(78)	(43)	(13)
Rainbow DBS	(46)	(28)	(54)	(50)	(59)	(192)	(300)	(657)	(577)	185
Rainbow cinemas	6	(0)	0	1	2	3	6	5	5	5
Corporate and intersegment	3	2	1	2	2	6	9	15	27	37
Total	65	6	(20)	(8)	(12)	(34)	(95)	(392)	(230)	607

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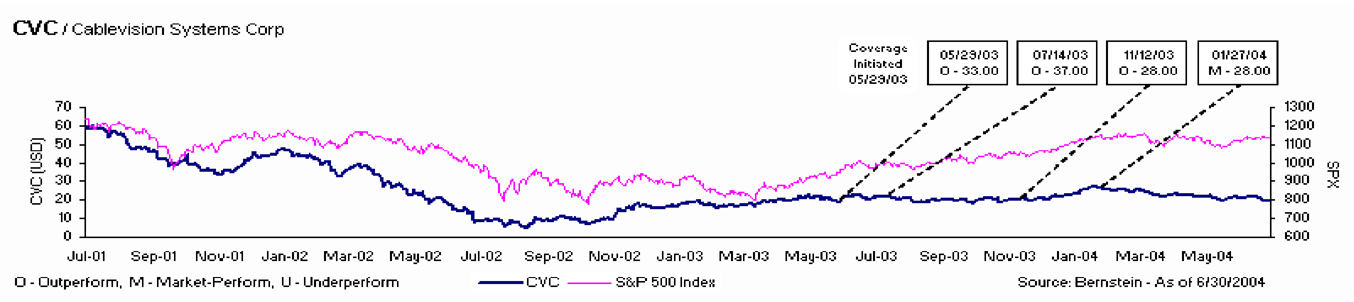

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