Cequel Communications Holdings I, LLC

Q3 2014 Earnings Call Transcript

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Call Participants

EXECUTIVES

Jerald L. Kent
Chairman, Chief Executive Officer

Thomas P. McMillin
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Mary E. Meduski
Executive Vice President, Chief Financial Officer

Peter M. Abel
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JP Morgan Chase & Co

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Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Cequel Communications Earnings Call for the Third Quarter 2014. [Operator Instructions]

As a reminder, this meeting is being recorded. I would now like to introduce Senior Vice President of Corporate Communications, Pete Abel. Mr. Abel?

Peter M. Abel
Senior Vice President of Corporate Communications

Thank you. Good morning, everyone, and welcome to this discussion of the Third Quarter 2014 Results for Cequel Communications Holdings I, LLC, and its subsidiaries which do business as Suddenlink Communications.

Before we get started this morning, we'd like to remind you that certain statements made during this conference call might be considered forward-looking statements within the meaning of the Private Securities Litigation Act of 1995. Those statements are subject to the various risks and uncertainties described in our annual report and in our quarterly report for the period ended September 30, 2014, each of which is posted to our website. These risks and uncertainties could cause actual future results to differ materially from the results expressed or implied by any forward-looking statements made on this call.

The information discussed today will be based on our earnings release for the period ended September 30, 2014. Both our earnings release and quarterly report have been posted to the Investor Relations section of our website at suddenlink.com.

The release compares actual and pro forma financial and operating results for the third quarters and first 9 months of 2014 and '13, and our presenters will focus their comments today on year-over-year pro forma results for the third quarter. The pro forma information they discuss today includes the acquisition of Cable Systems from Northland Communications on January 2, 2014, as if that transaction had been completed on January 1, 2013.

And with that, I'll now turn the call over to our CEO, Jerry Kent. Jerry?

Jerald L. Kent
Chairman, Chief Executive Officer

Thanks, Pete. Good morning, everyone, and thanks for joining us. Our third quarter results demonstrate our continued success in growing our business and delivering strong financial and operating performance. Before I go into the overview of our quarterly results, I wanted to spend a moment addressing the state of our industry and recent decisions we've made to ensure we are acting in the best interest of our customers and adapting to the reality of a changing media landscape.

We're in the midst of a transformative time for our industry. Constant creation and distribution are drastically evolving to keep up with consumer preferences and, consequently, Suddenlink is responding to market demands and ever-changing technologies. We're addressing these structural shifts and are committed to investing in future growth catalysts like our superior broadband service.

Looking ahead, we believe this superior broadband service will continue to be a major revenue driver for us. And for that reason, as announced in our earnings call in August, we launched Operation GigaSpeed. It's a 3.5-year $230 million strategic investment to significantly enhance our Internet services and extend our competitive advantage.

Now at Suddenlink, we have a history of listening to our customers and giving them what they want. We're confident this customer-centric approach positions us for the long term. We also believe slower-moving incumbents who are not willing to innovate and adapt will be left to defend old business models and outdated assumptions. So with that in mind, and as we reflect on where the industry is headed, I'd like to briefly address the decision we made after the close of the third quarter, and that, to terminate carriage of Viacom networks and instead launch a comparable number of other networks.

We ultimately made the decision to terminate with Viacom because of their irrational price increase demands. Over a 4.5-year period, the demand in price increases approached almost 50%, which would eventually have to be passed on to the customer. These increases were demanded by Viacom despite the fact that their major networks have experienced significant ratings declines. We didn't think that was fair to our customers or sustainable for our business. We provided ample opportunity for discussion on the issue.

Several times, in writing, we asked for a best and final offer so we could decide whether or not to continue carrying Viacom programming. With no indication of rational long-term pricing from Viacom, we made the decision to terminate the agreement and move to alternative sources of content. Research revealed that customers wanted us to maintain competitive pricing and that there were other channels they'd like to have on their lineup.

Despite Viacom's continuing efforts to mislead customers and the market in general about the reasons for the decision and the actions they took, our customers' reactions strongly indicate that they understand why we made this important precedent decision. However, Viacom continues to be active in our markets. So we'll continue to do what is necessary to ensure that our customers remain aware of the facts of the situation in the weeks and months ahead.

While we knew this change would result in the loss of some video customers, those losses to date have been less than what we expected. Importantly, most of the customers who disconnected video service because of the loss of Viacom channels chose to keep other non-video services. As a result, we've experienced little change in our total customer relationships.

I will also note the decision to move away from Viacom is not a lessening of our focus on video services. To the contrary, we'll continue to invest in these services and fight for every video customer. We believe in the video business.

Now, moving on to performance in the third quarter. We're pleased to report results that demonstrate our success in increasing our market share, meeting and exceeding our customers' needs, and delivering a strong financial and operating performance.

Let's look first at our customer relationships, which is a measure of the total number of households that subscribe to one or more of our primary services. We gained nearly 25,000 of these relationships during the third quarter. That's our best ever quarterly performance. Furthermore, in the 12 months ending September 30, we added more than 44,000 customer relationships, representing 3.2% growth, and that is another record achievement.

Recall that at the end of 2013, we reported a fourth consecutive year of customer relationship growth with a net gain of 9,000 customer relationships in the trailing 12 months. The fact that we were approaching a fivefold increase in that rate of growth at the end of the third quarter this year demonstrates that the investments we made in strategic offers, direct mail and door-to-door sales are generating meaningful results.

Those investments have also helped us achieve strong growth in PSUs, or primary services units, fueled in large part by accelerated growth in Internet units. In residential video, we gained over 2,000 units during the third quarter of 2014, an improvement of more than 5,000 units over our third quarter of 2013 video results, resulting in the best trailing 12 months video trend we've seen in the last 5 years. On phone, we ended the quarter with more than 548,000 units, representing 8.4% growth in the trailing 12 months.

As a reminder, we're nearing the end of Operation Reliant, the name of our effort to bring all phone operations in-house. In fact, in the next few days, our teams will complete migration of substantially all phone customers to our platform, which is well ahead of schedule. Once completed, Operation Reliant will significantly reduce our annual phone expenses.

Turning to Internet services, in the second half of 2013, we committed to enhancing our Internet-related marketing campaigns and investing in strategic offers. As a result, year-over-year residential Internet unit growth has dramatically improved, reaching 8.4% at September 30, for a net gain of 88,000 units in the trailing 12 months.

A meaningful part of our overall unit growth has included continued gains in high-quality triple play customers. At September 30 this year, we surpassed, for the first time, 400,000 triple play customers, up 9.7% over the year ago period. Among other factors, triple play growth helped us maintain robust ARPU growth even as we gained market share. Third quarter ARPU was $166.64, another record for Suddenlink, and an increase of 9% year-over-year.

We've also achieved continued momentum in our advertising and commercial lines of business. Total commercial revenue in the third quarter was $84.5 million, which is an 11.1% year-over-year increase. That includes 17.3% year-over-year growth in our combined commercial high-speed data, on-net carrier services and telephone revenues. Advertising revenue increased 11.8%, led by an increase in political advertising during this midterm elections year.

Our carrier business also performed -- continues to perform very well with more than 1,535 Fiber-to-the-Tower tenants in billing as of September 30, an increase of more than 22% over the number at the end of the third quarter of 2013. Combined, these various factors contributed to the strong growth in total revenues with third quarter 2014 revenue at nearly $584 million, up 6.6% over the same period last year.

Adjusted EBITDA for the quarter was nearly $217 million before nonrecurring expenses, and approximately $210 million after nonrecurring expenses, representing year-over-year growth rate of 3.9% and 1.6%, respectively. These are solid results, but they are, as we expected, less than our historic EBITDA growth due to the unique strategic investments we made in marketing and sales to support accelerated growth in relationships and units, as described earlier. By design, those investments peaked in the second half of the year, in part to help maximize relationship and new gains during the third quarter, which is a seasonably strong period for us, including the return of college students to campus.

Free cash flow for the third quarter was $37.2 million. While that's down from $59.3 million in the year ago period, this was another expected result attributable to our combined investments in Operation Reliant, which is nearing completion and will significantly reduce our phone operating expenses, and our first round of strategic investments in Operation GigaSpeed, which our CFO, Mary Meduski, will detail during her remarks this morning. Importantly, even after funding Operation GigaSpeed through 2017, we expect to continue generating significant free cash flow.

Now as noted on previous calls, we believe that an important key to our success has been our focus on delivering a superior level of customer service. And for that reason, we're really proud to report that where measured by the independent J.D. Power Surveys, Suddenlink continues to have the most improved customer satisfaction score since 2007, which is the first year we were evaluated by J.D. Power.

Importantly, Suddenlink was 1 of only 2 Internet sales scoring above 700 on the J.D. Power scale, second only to Bright House. That's our highest ranking to date and a testament to the ongoing efforts of our employees to put the customer first in everything we do.

Thanks for your time this morning. I'll turn it -- now I'll turn the call over to Tom McMillin, our Chief Operating Officer, to provide additional perspective on our third quarter operating results. Tom?

Thomas P. McMillin
Executive Vice President, Chief Operating Officer

Thanks, Jerry, and good morning, everyone. I'd like to start this morning by providing more detail on our unit results by category. At September 30, we had approximately 3.8 million residential RGUs, an increase of nearly 144,000 year-over-year. When you include commercial units, we had nearly 3.9 million RGUs, having added 158,000 units over the trailing 12 months, an increase of 4.3%.

On basic video, we ended the third quarter with more than 1.17 million customers. On digital video, we finished the quarter with approximately 898,000 customers, up more than 36,000 units or 4.2% in the trailing 12 months. Digital penetration of basic video customers continues to increase. And at the end of the third quarter, we're 76.6%, up from 72.2% a year ago.

Along with our annual growth in digital video, with the continued health of our TiVo HD-DVRs, we added nearly 16,700 DVR customers over the last 12 months, an annual growth rate of 4.1%. DVR penetration of digital customers stood at 46.9% at the end of the third quarter. We also added more than 38,000 HD customers in the third quarter and more than 100,000 in the past 12 months, representing 15.4% year-over-year growth, bringing HD penetration of digital customers to 84%. That's up from 75.9% a year ago. Our selling rate of HD to new digital customers in the third quarter was more than 94%.

Total penetration of advanced digital video services, either DVR or HD customers, stood at 84.8% of digital customers at the end of the third quarter. This was up from 77.2% at the end of the third quarter of 2013. We think the third quarter this year with more than 1.1 million residential high-speed Internet customers, up 88,000 or 8.4% in the trailing 12 months. As a result of our accelerated growth, residential data penetration of estimated data homes passed was 37%, up from 34.6% a year ago.

At the end of the third quarter, 86% of our high-speed Internet customers had speeds of 15 meg or higher and 24% of our customers had 30 meg or higher services. Our 37% selling rate of 30 meg or higher services is the third -- in the third quarter was approximately 14% higher than the same quarter a year ago. With Operation GigaSpeed underway, we expect to see more customers getting higher services in the coming months.

A complement to our high-speed Internet service is Suddenlink WiFi@Home. During the most recent quarter, 58% of our new high-speed Internet connects also purchased this service, as we added more than 31,000 Suddenlink WiFi@Home customers. In the trailing 12 months, WiFi@Home grew 37.1%, with a net gain of nearly 93,000 units, bringing our total customers with this service to more than 342,000.

On telephony, we finished the quarter with more than 548,000 customers, up 13,500 units over the second quarter and more than 42,000 or 8.4% compared to the same period last year. As a result, residential telephony penetration reached 20.8% of estimated telephone homes passed.

As Jerry noted, we ended the third quarter with more than 1.4 million residential customer relationships, an increase of some 44,300 in the trailing 12 months. Aiding this accelerated growth in customer relationships is our success in adding non-video customers. During the first 9 months of this year, we added nearly 49,000 non-video customers. And in the trailing 12 months, we added nearly 62,000, a 22% increase over that period.

Our unit success, particularly in broadband and phone, is being driven by our success with our bundled offers and sales channels. At the end of the third quarter, we had nearly 403,000 triple play relationships, an increase of nearly 36,000 in the trailing 12 months. On the commercial side of our business, our 62,500 commercial Internet customers at September 30, resulted from adding more than 6,000 customers in the trailing 12 months, representing 11% growth.

Over the same period, we added 8,200 commercial home customers, ending the third quarter with more than 38,000 for a year-over-year growth rate of some 27%. Overall, we have had great success adding commercial relationships, up 7.5% during the trailing 12 months, with commercial bundled relationships up nearly 19% over the same period.

As Jerry mentioned, we also continued to see record-setting gains in our carrier service group. We have now successfully completed and initiated billing for more than 1,500 Fiber-to-the-Tower tenants and have many more tower tenants on signed contracts in the process of being installed.

Our carrier sales team continues to aggressively pursue the sale of fiber optic connections to wireless and wireline carriers to serve cell towers and large enterprise end customers. And investments made to enable carrier revenue growth have also enhanced Suddenlink's network for the benefit of both our residential and commercial customers. I'd now like to single out a couple of other initiatives briefly before closing.

As Jerry noted, in the next few days, we will finish migrating existing telephone customers to our own platform. We will complete some additional Operation Reliant work over the coming months and wrap up the project early next year. I'm pleased to report that our teams have executed this great transition seamlessly for our customers. This project was no small task and included moving approximately 700,000 phone lines across more than 300 rate centers in a dozen states. To do that, our teams invested thousands of man hours, a huge percentage of them outside the normal workday and overnight. I'm very proud of the many Suddenlink team members who've helped make this transition a great success for our customers and our company.

In recent reports, I've mentioned the success of our new e-commerce efforts. Our investment in online sales continues to pay off. Sales in the third quarter this year were 66% higher than in the third quarter of 2013, and the channel is the leading contributor to year-over-year relationship connect growth. E-commerce is now the third-largest sales channel for the company.

And finally, as Jerry mentioned, we launched Operation GigaSpeed in August, work is well underway and our initial activities are focused on increasing our flagship Internet service download speeds from 15 meg to 50 meg, resulting in substantially all of our customers enjoying market-leading Internet speeds of 50 meg or greater in the coming months. At the same time, we'll also launch new 75 meg and 150 meg or 250 meg services as we move towards our ultimate 1 gigabit launches for virtually all customers during the next several years.

Thank you for your time today. I'd now like to turn things over to our CFO, Mary Meduski, for a closer look at our financial results during the quarter. Mary?

Mary E. Meduski
Executive Vice President, Chief Financial Officer

Thanks, Tom. Today, I will discuss financial results for Cequel Communications Holdings I and subsidiaries for the third quarter of 2014, adding to what Jerry and Tom have already provided. I'll also discuss our balance sheet and liquidity position.

As of September 30, the face amount of our debt outstanding was approximately $5.16 billion, which was comprised of $1.5 billion of 6.375% senior notes at Cequel Communications Holdings I; $1.25 billion of 5.125% senior notes at Cequel Communications Holdings I; $2.38 billion of senior secured term loans at Cequel Communications, LLC; and $28.4 million of capital leases and other obligations at Cequel Communications, LLC.

The preceding reference to $1.25 billion over the 5.125% senior notes includes $500 million of senior notes due in 2021 that were issued on September 9 at a price of $97.25. These notes have the same terms as the existing 5.125% senior notes due 2021. As announced, the proceeds from this offering were used along with cash on hand to make a $600 million distribution to holders of equity interests in Cequel Corporation and to pay related fees and expenses.

At September 30, we had approximately $136 million of cash on hand and approximately $481.3 million available under our $500 million revolving credit facility, after taking into account $18.7 million of outstanding letters of credit. Our secured bank leverage at September 30, as calculated under our credit agreement, was 2.6x, which was in compliance with our bank covenant with significant cushion.

As of September 30, our total leverage, as calculated under our senior notes, was 5.71x. At September 30, we had no interest rate hedges in place and the weighted average cost of our debt was 4.74%. The proportion of fixed rate notional debt was 54%.

Now for a few comments on our third quarter financial results. As mentioned, total third quarter 2014 revenue was $583.6 million, representing growth of 6.6%, or approximately $36.4 million over the third quarter 2013. ARPU was $166.64, an increase of 9%.

Our revenue -- our increase in total revenue for the third quarter of 2014 versus the third quarter of 2013 was largely attributable to increases in residential high-speed Internet, telephone and advanced digital video service revenue, growth of revenue from our Commercial business, including carrier services and growth in advertising revenue.

Video service revenue increased 2% due primarily to video rate increases, higher broadcast retransmission revenue and customer growth in our digital and advanced video services. Offsetting this growth in part was the impact of basic video customer losses in the trailing 12 months, digital customers purchasing fewer digital tiers of service on average and decreased premium and pay-per-view revenue.

High-speed Internet service revenue rose 16.2%, due primarily to increases in residential high-speed Internet customers, growth in home networking revenue, the impact of residential rate increases, the shift of customers to higher-speed Internet products, growth in our commercial high-speed data services and growth in carrier services, including Fiber-to-the-Tower and optical Internet and transport revenue.

Telephone service revenue grew 1% as the increase in residential telephone customers and growth in our commercial telephone services were offset by impact -- the impact of bundled discounts to residential customers. Advertising revenue increased 11.8%, due largely to higher political advertising spending.

Our commercial lines of business embedded in the video high-speed Internet, telephone service and other video -- and other revenue described earlier, are comprised of commercial and bulk video, commercial high-speed data, commercial telephone and on- and off-net carrier services. Representing approximately 14.5% of total company revenue in the third quarter of 2014, commercial revenue of $84.5 million grew 11.1% versus the third quarter of 2013. Commercial high-speed data, on-net carrier services and telephone revenue grew 17.3% year-over-year on a combined basis.

Operating cost and expense increased 9.7% in the third quarter of 2014 versus the third quarter of 2013, primarily due to higher programming expense, including broadcast retransmission consent costs, increased marketing, labor and employee-related costs and $6.9 million of nonrecurring operating expense related primarily to Operation Reliant.

Programming and retransmission consent expense grew principally as result of higher contractual rates charged by our programming and broadcast spenders; new channel distribution, including sports programming, such as the ESPN-backed SEC and Longhorn Networks and an increased number of digital customers. Labor and labor-related expense increased due to the impact of annual salary increases and additional headcount, notably in direct sales, and the increased marketing expense that supported our offer strategies aimed at growing our customer base.

Before the impact of nonrecurring expense, Adjusted EBITDA for the third quarter 2014 was $216.9 million, an increase of 3.9% compared to the same quarter last year. This resulted in an Adjusted EBITDA margin of 37.2% for the third quarter of '14 versus 38.2% in the third quarter of 2013.

While we continue to generate significant Adjusted EBITDA and maintain a strong margin, our third quarter 2014 results were impacted by both increased programming expense and the planned strategic investments we made in marketing and sales, including strategic offers, direct mail and door-to-door sales.

We incurred $6.9 million of nonrecurring expense, largely to migrate telephone customers to our internal platform as part of Operation Reliant. Since inception in early 2013 and through September 30, 2014, we've incurred $11.1 million of nonrecurring operating expense for Operation Reliant. We now expect to complete the project inside our previous guidance of $30 million. After the impact of nonrecurring expense, Adjusted EBITDA for the third quarter of 2014 was $210.1 million, an increase of 1.6% compared to the same quarter last year.

Capital expenditures for the three months ended September 30, 2014, were $114.9 million compared to $89.7 million in the three months ended September 30, 2013, inclusive of our capital expenditures for Operations Reliant and GigaSpeed, which I will elaborate on.

For Operation Reliant, we have $3.4 million of capital expenditures during the third quarter of '14 and $14.6 million since inception. We continue to expect total capital expenditures for this effort to be approximately $20 million. We also continue to expect significant operating cost savings beginning in 2015 and a payback of less than 3 years on this $50 million investment.

For Operation GigaSpeed, we incurred $18.4 million of capital expenditures in the third quarter of 2014. Our guidance for the full 3.5-year program remains at $230 million.

For the full year 2014, we expect total capital expenditures inclusive of Operations Reliant and GigaSpeed, to be approximately $410 million to $420 million, consistent with our prior guidance. As mentioned on our second quarter earnings call, we would expect capital expenditures as a percent of revenue to be in the high-teens this year and next, dropping to the mid-teens in 2016 and declining thereafter.

Free cash flow for the third quarter of 2014 was $37.2 million compared to $59.3 million for the same period in 2013. As Jerry mentioned, this year-over-year decrease in free cash flow was due primarily to increased capital expenditures for Operations Reliant and GigaSpeed as well as increased cash, interest expense, offset in part by improved operating results. Despite the increased capital expenditures for Operation GigaSpeed, we do expect to continue to generate significant free cash flow.

Finally, a few words on our tax position. The operating activities of Cequel Communications Holdings I are included in the consolidated tax filings of our parent company, Cequel Corporation. As of December 31, 2013, Cequel Communications Holdings I and Cequel Corporation have approximately $650 million and $1 billion, respectively, in net operating loss carry-forwards for a total of $1.65 billion in NOLs. Given these NOLs and the tax basis of approximately $3.65 billion, we are not expected to be a significant income taxpayer until after 2019.

I will now conclude my remarks and turn the call back over to the operator to facilitate questions. I would like to remind everyone that this is a public call, and we would generally refrain from discussing information other than what is disclosed in our earnings release and quarterly report. Operator?

Question and Answer Session

Operator

[Operator Instructions] Our first question is from Mike Pace of JPMorgan.

Michael V. Pace
JP Morgan Chase & Co

A question on programming expenses. So I think in the past, you've said that you expect programming costs in maybe the high single-digit growth rate on a dollar basis and low double digits on a per sub-basis, and please correct me if I got that wrong. But I guess if we think about the net impact of not having Viacom and the addition of those channels, I'm wondering, can you help us understand maybe what that net impact is going forward, either on a dollar basis or around that growth figure? And does it really move the needle?

Jerald L. Kent
Chairman, Chief Executive Officer

All right. Thanks, Mike. Let me answer that kind of generally first and then I'll get more specific. But first of all, dropping Viacom programming really was a necessary decision. It's in the best interest of our business and, importantly, our customers.

Viacom was demanding a nearly 50% increase over the next 4.5 years and this was for programming which the vast majority of their channels which, from our research, have showed significant declines in ratings.

Plain and simple. Let me just call it what it is. It's price gouging. We made every reasonable effort to reach agreement, including asking for a best and final offer to determine whether we would continue to carry Viacom programming. And we did this in writing 3 times, yet never received an offer in response.

So we moved on. Now Viacom is putting out misleading statements, and are active in our markets. But we're taking and we'll take all necessary actions to protect our business and our customers.

Viacom is trying to protect, frankly, an outdated business model. We've been very vocal about the fact that we believe the old model of runaway programming costs is not sustainable and that necessary decisions will be made to take account of a rapidly changing video marketplace. And our decision to replace Viacom is a move away from that outdated business model. And Mike, you did get it right. We have talked about double-digit type programming cost per customer going up.

To specifically answer your question, this will help mitigate our programming cost pressures in the near term. But in the long term, we'll continue to see programming cost rise significantly beyond inflation and probably really not much different than what we've seen in the past.

But we'll continue to evolve and make the necessary decisions to protect our customers and our business. Now the customer reactions and results in our business today confirmed that the decision to replace Viacom, frankly, was the right business decision.

We expected to lose some video customers but, at this point, we're performing better than what we mapped out in our expectations. In addition, most of the customers who made changes in video had been downgrades and not full disconnects.

In other words, Mike, they're keeping other services. And as a result, we haven't seen any real significant change in the number of customer relationships. And I can tell you that the decision to replace Viacom has not had an adverse impact on our business. Actually, quite to the contrary, the results have confirmed that we made the right business decision.

Now going forward, I want to be absolutely clear about something. We have confidence in our video business. We're not de-emphasizing video. We will continue to make investments in our business to grow our video, broadband and phone businesses, and we will fight for every customer, including video customers, and we'll take all actions to protect our business and our customers.

Michael V. Pace
JP Morgan Chase & Co

Can you also help us out and share with us maybe what key programming agreements that you have renegotiated successfully over the last 12 months or so? And what key contracts are up maybe through 2015, whether the local broadcasters or the bigger cable networks?

Jerald L. Kent
Chairman, Chief Executive Officer

Yes, yes. In the last year, we've -- I think we had close to 50% of our programming costs that were coming due. And we did reach agreement with Turner, ESPN, Discovery and CBS, just to name a few. Going forward, we don't have any significant major programming agreement due for at least over a year.

Now we do have a number -- pretty sizable number of retransmission consent agreements coming due at year end. But in terms of other major cable programming, as I said, we don't have a major room for -- about it -- actually, a little over a year. And I just want to point out that we've been -- when our programming partners are reasonable, we can reach agreement with them. It's only if we feel that the price is out of whack for the value where we run into issues.

Michael V. Pace
JP Morgan Chase & Co

And then, just, Jerry, just one more. You talked about structural shifts earlier in your prepared remarks and I'm wondering, were you focused more on just the distributors carrying a different set of programming as maybe some of your competitors have suggested? Or are you really talking about the delivery of content whether it's over the top or via mobile, and any additional color there?

Jerald L. Kent
Chairman, Chief Executive Officer

Yes, I'm talking about the whole changing video landscape. We're seeing content migrating more to the Internet. We're seeing emerging competitors, including DISH and others who have announced potential competing Internet video service. We're seeing our programming partners go direct to our customers, with HBO going direct. And Showtime and CBS now actually going direct, and I'm sure there are others who have that in their business plan.

And I'm also talking about the issue of the pro-ground rate programming cost. We've been very vocal about it. It's just not sustainable and we've said that unless something changes, that we're going to have to make necessary decisions to protect our customers and our business. And the Viacom decision is one of those necessary decisions. I hope we don't have to do another one in the future. But if we are faced with price value relationships that are out of whack, we're not going to be afraid to make those necessary decisions.

Operator

Next question is from Jason Kim of Goldman Sachs.

Jason K. Kim
Goldman Sachs Group Inc.

Now that you've done the dividend transaction, can you just update us on the M&A opportunities that you see out there over the next year or 2 for the company? And I guess another way to ask that question is, was the dividend payment a reflection of the opportunities that you saw out there being smaller than you have previously thought? Or are we reading too much into the timing of the transaction and it was just the shareholders being opportunistic?

Jerald L. Kent
Chairman, Chief Executive Officer

Yes, that would be reading too much into it. It was an opportunistic time. We have record low interest rates. The bonds were very attractively priced. We're very happy. We're able to return about 1/3 of the original equity from our investors who came in 2 years ago. It really has nothing to do with the M&A landscape. We continue to be looking for opportunistic acquisitions.

We're not going to do something irrational. We're not going to grow just for growth's sake. But if we can find the right strategic acquisitions, we're very open to them. In addition, I will point out that our partners, Canadian Pension Plan Investment Board, it manages over $200 billion, and BC Partners, who is a very sizable international private equity firm, have told us that they are interested for the right acquisitions of putting more equity to work with us. So I wouldn't read into the dividend. We do have the capability and the, frankly, the firepower to go after acquisitions if they make sense.

Mary E. Meduski
Executive Vice President, Chief Financial Officer

And Jason, I would add one more point to Jerry's remarks, which is that we paid the distribution and achieved the leverage of 5.7x. As you can imagine, there was much more capital available for this type of activity should we desire, but we are always cognizant about the total leverage of the company and know that we are able to delever in the range of 0.75 turn on an annual basis. And so that will help you see the increased flexibility that will build over the coming year.

Jason K. Kim
Goldman Sachs Group Inc.

Great. And then, FCC Chairman Wheeler has made some comments recently regarding sort of a hybrid model to regulate the broadband business. And now I was just curious, Jerry, to hear your thoughts about some of those ideas that have been coming out lately.

Jerald L. Kent
Chairman, Chief Executive Officer

Well, first, let me just address the whole reclassification issue. I have been to D.C. a few times talking to some people about the situation. And I think what's interesting is there's a common recognition that there really is no problem out there. We do not have distributors. Now we have content providers blocking the Internet, which I find interesting. They talk about slow lanes and fast lanes, where Viacom is blocking our Internet customers to their website. At that's a complete roadblock. So besides that -- besides the edge provider problem, if there's a common acknowledgment, distributors, there's not a problem in the marketplace.

But there has been a lot of activity, a lot of public comments. The number of public comments filed on this issue at the FCC was twice the previous number of comments on any item, and that was the Janet Jackson wardrobe malfunction. But so, there's a lot of perceived interest in this. I think it was a lot of gen-up [ph] of the public who don't really understand the issue, but they feel public pressure just because of the focus on the net neutrality issue.

I would hope that sanity would prevail. That we, as an industry, as I understand it -- an analyst told me that the telecommunications infrastructure industry, as a whole, in the last several years, has made more investments than any other industry out there, period. And if we want to cut off investment, then reclassification to Title 2 which creates first of all it will go is -- it'll be in court immediately. It will create all kinds of uncertainty. And I don't know how you can prepare and there would still be significant uncertainty. And something like that, somebody like us with Project Imagine, we invested $350 million over and above our normal capital expenditures. With Operation GigaSpeed, we are investing another $230 million. So we're over and above our CapEx. We're investing $0.5 billion just to improve our Internet speeds and to provide, frankly, what hardly anybody else in the country is doing, which is ubiquitous, 1 gigabit speed offering to our customers. Others, I see AT&T investing in GigaPower and I see CenturyLink and making announcements. There's Google Fiber. I know Cox is talking about GigaSpeed. There's other investments being made.

If we want to cut off that investment, I think the reclassification of Title 2 is one way to do it, and we as a company, have been generating new jobs every year. And even through the financial crisis, we may continue to make investments, and we'll do that as long as we have regulatory certainty. And I'm concerned that if there is significant change in the environment, it's not only going to create uncertainty, but it's going to harm the great technical revolution that's occurring.

And in the United States, last time, they have the second largest number of Internet customers in the world, second to China, and last I checked it, they had a few more people than us, were making investments, and it's very successful. And then when I talked to people in the Hill, they agree. There's been a very successful cycle of investment with the light regulatory touch.

So there -- I know there are proposals around about making interconnection Title 2 and keeping the residential Title 1, or just going to Title 2, where there's a lot of proposals out there. And I think, my only concern would be that I hope there's sanity that the regulators understand the environment is positive. We are making those investments, and we just want an environment that incents us to continue, and then not only will our industry be better off, the American consumer will.

Operator

Next question is from Davis Hebert of Wells Fargo.

Davis Hebert
Wells Fargo Securities, LLC

Another MSO that dropped Viacom was Cable One and we've had a couple of quarters of results from them. Do you feel like they're a good proxy for how your video sub base will react? Or do you think there's a different demographic profile there?

Jerald L. Kent
Chairman, Chief Executive Officer

That's a really good question, David. I don't think they're a proxy at all. I think Cable One has publicly commented that -- and I think they publicly commented. I know for a fact that their actions would suggest that they're deemphasizing the video business and they're not making the investments in their video business that others are. So no, I don't think they're a good proxy at all.

We don't see -- I'm familiar with their reporting, and we don't see anything in that hemisphere, let alone, close to them, in terms of our customer reaction. So just, again, we believe in the video business. We're not giving up on the video business. We're going to continue to make those investments, and we think that we can continue to have a viable and successful video business going forward. And that is not a proxy for us.

Davis Hebert
Wells Fargo Securities, LLC

Okay, and that's helpful. You mentioned retransmission consent and just relative value of programming and you have some agreements coming out at the end of the year. Where does that fit into your profile of relative value. Because the networks, as you probably are aware, are taking another pound of flesh from the affiliates, which implies they may come after you guys for higher and higher increases? Just wondering how you're thinking about that over the longer term.

Mary E. Meduski
Executive Vice President, Chief Financial Officer

Right. Well, retransmission consent costs have been -- have grown significantly third quarter of 2014 versus third quarter 2013, along with the rest of the programming landscape. We have a large number of retrans agreements coming due at the end of the year and we are expecting to have a significant increase there. And that is all factored into our overall view of what our programming expense growth will look like. We provide that color, including RTC. So we do have a large number of retrans agreements. We do expect the cost there to rise and we are in the process of negotiating them now.

Davis Hebert
Wells Fargo Securities, LLC

Okay, helpful. And you mentioned political advertising earlier. I know it's a small part of your overall revenue profile. Just curious in this election season if you felt like cable maybe have a better share because most of it seems to go to local broadcast TV. So just curious how that look for you this season.

Thomas P. McMillin
Executive Vice President, Chief Operating Officer

Yes, we -- this is -- we'll set a record in terms of our national political rev dollars this year so it does feel like we've certainly gotten our fair share or more than our fair share of those dollars.

Jerald L. Kent
Chairman, Chief Executive Officer

And that's before the runoff in Louisiana where we still have a significant presence. So I'm not sure we've seen the last dollar yet.

Thomas P. McMillin
Executive Vice President, Chief Operating Officer

Yes, right.

Davis Hebert
Wells Fargo Securities, LLC

True, true. And then, lastly, on HBO. I appreciate your commentary there. I just wanted to -- if you could just confirm what the margin profile of the HBO product looks like for you. Is it fairly low?

Mary E. Meduski
Executive Vice President, Chief Financial Officer

Yes.

Jerald L. Kent
Chairman, Chief Executive Officer

It's very low.

Davis Hebert
Wells Fargo Securities, LLC

Okay.

Jerald L. Kent
Chairman, Chief Executive Officer

It’s microscopic.

Davis Hebert
Wells Fargo Securities, LLC

That's what I figured. Just wanted to make sure and confirm that.

Mary E. Meduski
Executive Vice President, Chief Financial Officer

And premiums don't play a big role in our overall product strategy for that reason, primarily.

Operator

Your next question is from David Phipps of Citigroup.

David Phipps
Citigroup Inc

I just wanted to follow up on some of the inflection points on where we might see continued acceleration on the telephony switchover so you had huge adds this quarter. And then, as we roll through GigaSpeed, when are we hitting the planing outpoint for GigaSpeed? Is that in the next couple of quarters? Or how do we think about that?

Mary E. Meduski
Executive Vice President, Chief Financial Officer

GigaSpeed is -- yes, now, GigaSpeed is $215 million project over the next 3.5 years. And so we have said that we'll spend some $35 million in 2014 and that you should think about the next couple of years ratably for the difference. So that -- it's a reasonable assumption that it will be spread equally among the quarters in the future.

David Phipps
Citigroup Inc

And when you introduced the new products and are taking them away, is it -- how are you picking up share in your markets? Or are you getting new house formations within your markets?

Thomas P. McMillin
Executive Vice President, Chief Operating Officer

It's mainly been share over the last several years, but we are seeing an uptick now in new household formations, particularly in our southern markets, Texas, most notably. So that is taking some more investment now through line extensions, new home construction.

But it is generally been share and I would imagine, as we position ourselves to have, in the near term, a 50 meg flagship product in our markets, we'll continue to gain share and Operation GigaSpeed has that 50 meg doubling to 100 meg, and then ultimately, 200 meg is our flagship service. And we expect as a market leader, from an Internet product standpoint, we'll continue to gain share. We, today, have 37% share and we believe that, that is not our fair share of the Internet business.

Mary E. Meduski
Executive Vice President, Chief Financial Officer

We've also been driving our sell-in of higher tiers of HSI service. We've done a very nice job of that over the last years and we would continue to look for that trend, adding more valuable Internet customers with each incremental add.

Jerald L. Kent
Chairman, Chief Executive Officer

Tom, what's the migration with Tier 1, 2 versus...

Thomas P. McMillin
Executive Vice President, Chief Operating Officer

Yes. On sell-in, greater than 30% of our customers are now taking above -- speeds above our flagship level of service.

David Phipps
Citigroup Inc

Okay. And you mentioned some of the video people when they're getting out of video and an opportunity to upsell them. When they look at their packages, is it somewhat of a, "This is the amount of money I'm going to spend so I will spend more on faster broadband if I disconnect video." Is that a fair -- what some of your customers are doing? So you actually could make more money because broadband is a higher margin than video. Or is it that they are selecting to stay just the same broadband speed after they downgrade on the video product?

Jerald L. Kent
Chairman, Chief Executive Officer

It's really too early to tell. I mean, I love to be able to tell you exactly, but it's just too early. Most of what we're talking about on the migration to higher tiers of speed occurred before October 1. Now we still are gaining broadband. We gained broadband in October and we're still investing and we're still taking market share. But it's too early to tell whether what the impact, if any, someone downgrades, whether that will incent them to take higher speeds. Now it's a lower bill so one would think that it would be positive -- having positive impact, but I just can't tell you definitively at this point.

Operator

I'm showing no further questions at this time. Management, do you have any further remarks?

Jerald L. Kent
Chairman, Chief Executive Officer

No. I just want to thank everyone for their time and interest in Cequel Communications. We really do appreciate it, and we look forward to continuing to make the investments in taking care of our customers, and thanks for your time.

Thomas P. McMillin
Executive Vice President, Chief Operating Officer

Thank you.

Mary E. Meduski
Executive Vice President, Chief Financial Officer

Thank you.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect. Have a wonderful day.