

Memo 2

To: Pricing Manager, Kansas City

From: Vice President, Marketing

Re: How Low Can We Profitably Go?

Recent reports reveal that Everest has started a new wave of construction in the Kansas City area, after having stopped their expansion one year ago. Their financial health has apparently improved over the past year, allowing them to expand their fiber network beyond their current service areas. Although it's still unclear whether the new expansion is only limited to a few neighborhoods or is part of a broader effort to cover the entire metropolitan area, I'm trying to wrap my head around the worst-case scenario.

As you know, we invested over \$500 million to upgrade our infrastructure in the Kansas City area. This enables us to provide a full line of services, including cable television, broadband Internet and digital telephony. So, if Everest indeed expands throughout the entire area, we should be able to compete with them by offering bundled services as well. Currently, in the neighborhoods that Everest serves, they provide bundled services starting at \$84.95 per month. At present, there are approximately 321,000 households in the entire Kansas City area, and we plan to price in order to maintain a market share of about 65 percent.

In addition to monthly costs associated with the \$500 million (which is being amortized over 20 years at 8.7 percent), agreements with program providers stipulate that we pay them monthly programming fees of \$32.50 per subscriber. On top of all this, our monthly maintenance, service and billing costs are about \$7.60 per subscriber.

I am concerned that if we get into a price war with Everest, pricing in the market may move to unprofitable levels. If things turn for the worse, we need an exit strategy. How low should we be willing to go with our pricing before it makes sense for us to write off our operations in KC?

Please provide your input on this matter as soon as possible. Thanks.