BANYAN CAPITAL MANAGEMENT

October 18, 2022

Through the third quarter, Banyan's equity composite fell 21.9% compared to the S&P 500's year-to-date decline of 23.9%. Over the last twelve months (i.e., Q3 2021 through Q3 2022), Banyan's equity composite fell 17.3% compared to the S&P 500's decline of 15.5%. The primary cause of our poor performance was Charter Communications (CHTR).

We first bought Charter in early 2017 for $308.66 per share. The stock took off in 2019 after sitting idle for two years and reached a high of $821.01 in September 2021. Charter was then our largest position, but its time at the top was short. The stock traded for $303.35 at the end of Q3 2022. To our chagrin, we averaged up as the stock fell. Our average cost per share is now $370.88.

By September 2021, Mr. Market had clearly taken a liking to Charter. It is easy to see why. From 2017 through 2021, Charter added 6.2 million internet subscribers but lost 1.2 million video subscribers. As shown in the table below, this shift in product mix was lucrative, which was the crux of our original thesis. Cash operating income almost doubled to $12.3 billion over the period.

(in Millions of Dollars)	2017	2018	2019	2020	2021
Residential Revenue	$ 33,288	$ 34,643	$ 36,194	$ 37,759	$ 40,322
Commercial Revenue	$ 5,896	$ 6,193	$ 6,424	$ 6,432	$ 6,743
Other Revenue	$ 2,397	$ 2,798	$ 3,146	$ 3,906	$ 4,617
Total Revenue	**$ 41,581**	**$ 43,634**	**$ 45,764**	**$ 48,097**	**$ 51,682**
Opex, excluding Depr. & Amort.	$ 26,887	$ 28,095	$ 29,327	$ 29,988	$ 31,811
Operating Income before Depr. & Amort. (OIBDA)	**$ 14,694**	**$ 15,539**	**$ 16,437**	**$ 18,109**	**$ 19,871**
Net Capex	$ 7,861	$ 9,595	$ 7,140	$ 7,492	$ 7,555
Cash Operating Income	**$ 6,833**	**$ 5,944**	**$ 9,297**	**$ 10,617**	**$ 12,316**
Free Cash Flow	**$ 4,093**	**$ 2,172**	**$ 4,608**	**$ 7,070**	**$ 8,684**
Return on Tangible Capital Employed	**24%**	**20%**	**30%**	**33%**	**39%**

Charter's management used its growing free cash flow to repurchase 44.5% of Charter's shares outstanding from September 2016 through Q2 2022. They paid $461.86 per share on average. We like repurchases if the stock is undervalued. Then, repurchases create value for remaining owners. Only time will tell whether Charter's repurchases created value.

Regardless of whether its repurchases created value or not, Charter has fewer shares outstanding today than it did in 2017, and its earnings power has grown considerably. Therefore, Charter's valuation is much lower now despite an almost unchanged stock price. As shown below, Charter's "free cash flow yield" was 14.8% at the end of Q3 2022; it was 4.4% at the end of 2017.[1]

[1] Free Cash Flow Yield = Trailing Twelve Months Free Cash Flow ÷ Diluted Equity Value

(In Millions, except Stock Price)	Q4 2017	Q3 2022
Diluted Shares Outstanding	275.65	183.32
Stock Price	$ 335.96	$ 303.35
Diluted Equity Value	$ 92,608	$ 55,611
TTM Free Cash Flow	$ 4,093	$ 8,220
Free Cash Flow Yield	**4.4%**	**14.8%** [2]

Mr. Market's enthusiasm for Charter has obviously waned. The reason is straightforward. Charter and its cable peers have experienced a meaningful slowdown in internet subscriber growth this year. In fact, Charter *lost* 21,000 internet subscribers in Q2 2022. This was an unpardonable sin in the eyes of Mr. Market, and Charter's current valuation reflects it.

We are more forgiving. Competition in the internet market is a factor, without question, but it is not the only factor at play. We doubt it is even the most important factor. Demand for internet was pulled forward by the pandemic, government subsidies for internet have changed or been reduced, and people are moving less, which is when most new subscribers are acquired.

A post-pandemic hangover is more easily cured than a terminal competitive disease. To us, Charter seems to be suffering more from the former than the latter. According to Charter's management, "voluntary churn," or subscribers choosing to switch to alternative internet providers, was at an all-time low as late as September 14, 2022.[3] This suggests a healthy business, not a terminal illness.

With that said, Charter's competition is not to be dismissed. It is real, formidable, and on the rise. Competition for at-home internet takes two forms, wireline and wireless:

1. **Wireline** | Only 40% of Charter's footprint has a fiber internet competitor today.[4] This is changing where traditional telephone companies (or "telcos"), mainly AT&T, replace their copper wires with fiber. These "overbuilt" markets go from monopolistic to oligopolistic.

2. **Wireless** | Advances in wireless technology make it a viable substitute for in-home internet. T-Mobile is the leader here offering speeds of 300 megabits per second for $55 per month. The technology has reliability and capacity issues, but it is a viable option for many people.

Despite heightened competition, we like Charter's position. It remains the low-cost provider of a modern necessity with insatiable demand – fast and reliable internet. In 2021, for example, Charter earned a good profit while charging residential internet subscribers $63.74 per month on average

[2] For Q3 2022 calculations, we used the stock price at the close of Q3 2022 but financial data from Q2 2022 because it was the latest financial data available. Charter does not report Q3 2022 financials until October 28, 2022. For Q4 2017 calculations, we used the stock price at the close of Q4 2017 along with financial data from Q4 2017.

[3] *See* Goldman Sachs Communacopia + Technology Conference, Tom Rutledge, Charter CEO (September 14, 2022), *available at*: https://event.webcasts.com/starthere.jsp?ei=1566350&tp_key=621f9f0116&tp_special=8.

[4] *See* Bank of America Media, Communications & Entertainment Conference, Jessica Fischer, Charter CFO (September 7, 2022), *available at*: https://bofa.veracast.com/webcasts/bofa/mediacomment2022/id8p4tqg.cfm.

with 80% of subscribers taking speeds of 300 megabits or more per second. In addition, Charter can offer internet speeds of 10 gigabits per second with minor network upgrades.[5]

Charter also has a powerful defensive weapon – mobile. Charter and Comcast sell mobile services using Verizon's network under a perpetual deal struck in 2011.[6] The two offer internet subscribers unlimited talk, text, and data for $30 per month per line with two lines or more. That is much cheaper than telcos' mobile offerings. Granted, mobile is not a very profitable business for Charter or Comcast, but it is a useful retention tool aimed at protecting the profitable core, internet.

Lastly, wireline "overbuilding" is likely to fall short of expectations. The wireline business is not a high return business to begin with. Charter, for instance, earned less than 40% on tangible capital employed in 2021, its most profitable year, despite dominant market share and utility-like economies of scale. Not to mention the lower valuations throughout the industry. "Overbuilding," which is hard to justify under ideal conditions, appears deeply uneconomical today.

Hence our continued confidence in Charter. The stock has behaved unexpectedly, but the business has performed better than we originally hoped. That, in addition to stock repurchases, has resulted in an undemanding valuation. To paraphrase Warren Buffett, it is easier to ***build permanent wealth*** by stepping over low hurdles than by slaying dragons. Mr. Market has set the hurdle for Charter exceedingly low. We like our odds that Charter can clear it, perhaps by a wide margin.

Sincerely,

Drew Estes
Partner & Portfolio Manager

Alek Nabulsi
Partner

---

[5] *See* 10G Technology, DOCSIS 4.0 Technology, CableLabs, *available at*: https://www.cablelabs.com/technologies/docsis-4-0-technology#:~:text=DOCSIS%204.0%20technology%20supports%20up,symmetric%20services%20over%20HFC%20networks.

[6] *See* Daniel Frankel, *Report: Comcast's 2011 MVNO deal with Verizon full of pricing and packing hurdles*, Fierce Video (July 31, 2015), *available at*: https://www.fiercevideo.com/cable/report-comcast-s-2011-mvno-deal-verizon-full-pricing-and-packing-hurdles.