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House-to-house in telecom war

Small but feisty, RCN is trying to flank the big telephone, cable and Internet companies

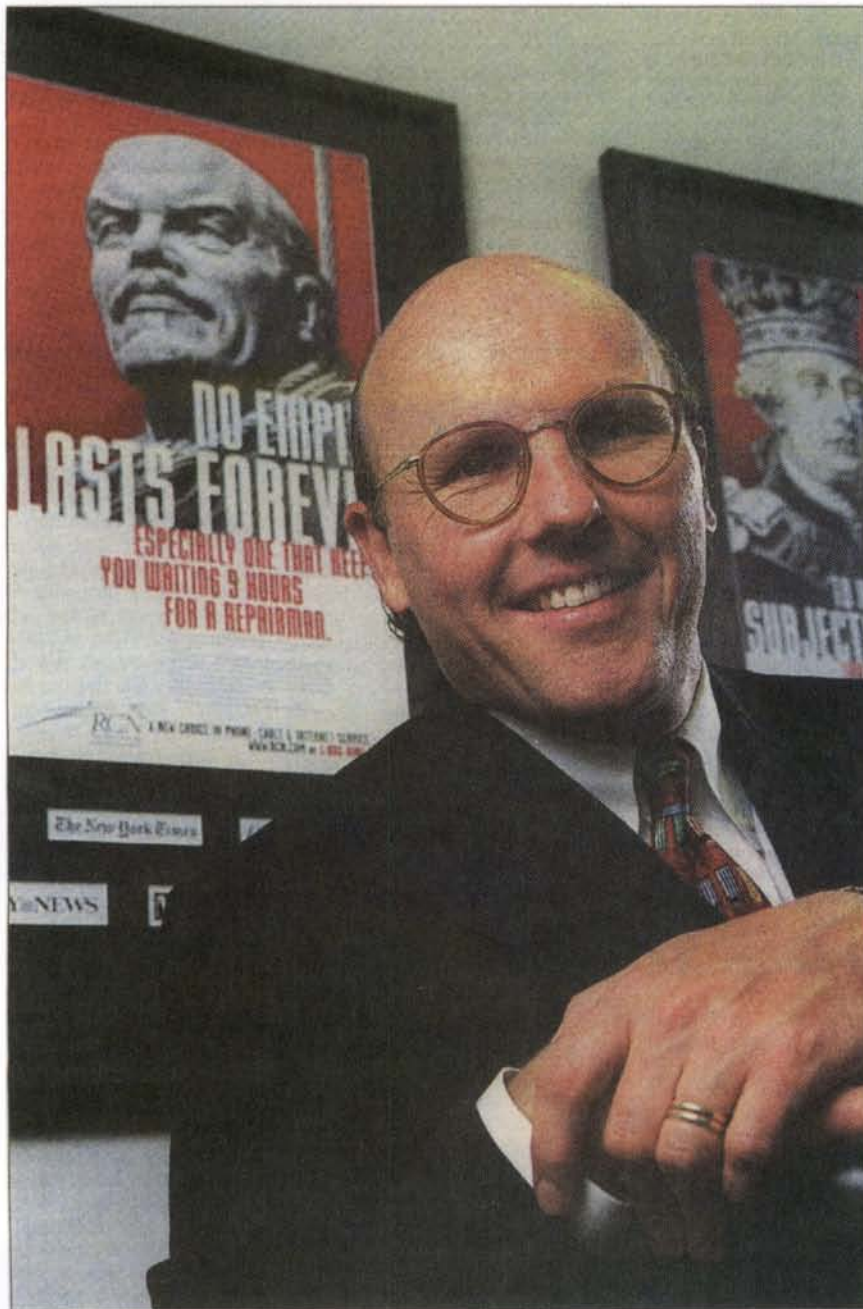


PHOTO BY PATTI SAPONE

RCN Corp. is taking on the biggest telecommunications companies in the business, including Bell Atlantic, Time Warner and Cablevision. Its chairman, David C. McCourt, says, "It's never the big guys who create a sea change in an industry."

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STAR-LEDGER STAFF

The Cold War isn't over for the freedom fighters at RCN Corp.

Lenin's statue is hauled away and the Berlin Wall tumbles in company ads that say: "No empire lasts forever." RCN says the empires under siege include Bell Atlantic, Time Warner and Cablevision Systems.

"There is no such thing as a little democracy," says RCN Chairman David McCourt. "I was on my honeymoon when the Berlin Wall was still

up. I went away to Hawaii for two weeks, and when I came back it was gone. It's the same thing with competition. There is no such thing as a little competition."

His executives travel in Hummers, not limos. Guerrilla insurrection is their business as they sell phone, Internet and cable TV service to residential customers of the big guys. That's right: individual consumers. While others target the business crowd, RCN fights house to house.

McCourt's little cable TV and phone service company is grabbing customers from Bell Atlantic and subscribers from Time Warner in New York and Cablevision in Boston. It will soon take on SBC, a big regional phone company, in California. It targets densely populated neighborhoods controlled by the empires.

"It's never the big guys who create a sea change in an industry, nevuh, evuh, evuh," McCourt says, his Boston dialect crushing the end of "never."

During the past six months, RCN has acquired some of the biggest regional Internet service companies on the East Coast. They include: Interport (New York), Erol's Internet (Washington, D.C.), UltraNet Communications (Boston) and JavaNet (Springfield, Mass.). RCN also bought Liberty Cable in New York.

It has formed joint ventures with power utilities such as Boston Edison and Potomac Electric. RCN is using their money and fiber optic lines to expand cable TV service in Boston and Washington. McCourt says he's talking to one more utility, which he won't identify.

A West Coast fiber network is planned from San Diego to San Francisco, Phoenix and Las Vegas. The "new west" game plan could boost the stock price to \$39 in 18 months, according to Merrill Lynch stock analyst Daniel Reingold. The stock closed yesterday at 20%, down 1%.

The Princeton firm was carved from the once-sleepy C-Tec Corp., which spun off three companies last fall. RCN has been reborn under McCourt, an Irish-American version of Che Guevara in a nice suit.

McCourt has been building communications networks for 20 years,



Building an empire

Princeton-based RCN Corp. has grown into an aggressive provider of cable TV, Internet and telephone services.

October 1994: C-Tec acquires 75,000 cable TV customers in Pennsylvania's Lehigh Valley.

January 1995: C-Tec buys 40 percent of Megacable, Mexico's No. 2 cable TV operator, for \$84 million.

August 1996: C-Tec's RCN unit buys Liberty Cable in order to enter the cable TV business in New York.

September 1996: RCN forms two joint ventures: with Boston Edison to sell phone, cable and Internet service in Boston; and with Potomac Electric to sell services in Washington, D.C.

Sept. 30, 1997: C-Tec splits into RCN Corp., Cable Michigan Inc. and Commonwealth Telephone Enterprises Inc.

March 5, 1998: RCN buys UltraNet and Erol's Internet, the biggest online service providers in Boston and Washington, D.C.

April 6: Stock splits 2-for-1.

June 4: RCN announces plan to sell phone, TV and Internet service between San Diego and San Francisco.

July 27: RCN buys JavaNet, a Springfield, Mass., Internet service provider.

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once working out of a small pickup in Boston to help build the Cablevision system. He built Corporate Communications Network and merged it with MFS Communications, which was acquired by WorldCom. He joined forces with MFS' founder, Peter Kiewit Sons Inc., a Nebraska construction firm, to build cable TV and phone networks in the United Kingdom.

The restless New Englander, who

boxes with a sparring partner some mornings at 5 a.m., seems to be tracking five different thoughts at once as he tells a visitor about the phone and video market. He scribbles notes to call so-and-so, pours a gold chain into his hand and repairs the arm chair in his ultra modern office without missing a word.

He's the son of a Massachusetts contractor who worked on road projects at Logan Airport and brought stray dogs with names, like Duke and Duchess, for home supper. Besides his childhood, he is thinking on this hot morning about the Spice Girls fans who tried to buy tickets on April 17 for the group's New York concert.

"The Spice Girls sold out Madison Square Garden in 12 minutes. For two of those 12 minutes, you couldn't get through to the central office switches in Manhattan," McCourt says. "If Bell Atlantic can't handle a Spice Girls concert, how can it handle Internet access when everyone's on? That network has outlived its usefulness."

Bell Atlantic concedes some fans might have heard busy signals, but it says the network hardly belongs in a museum. The company says it has ways of managing high-volume traffic to ensure that other customers can get through.

"They are absolutely wrong about our network, because we are bringing it into the modern age and managing the migration of our existing network to that new environment," says Mark Wegleitner, vice president of new services technology for Bell Atlantic.

"While the circuit-switched network is perceived as obsolete, it is carrying a significant amount of traffic for our valued customers."

Bell Atlantic is spending more than \$5 billion a year to upgrade its network with fiber-optic lines and it has hired Lucent Technologies to build a new data network on the East Coast.

Bell Atlantic is a \$30 billion corporation that spends more on switches than RCN has in sales. The Mercer County firm might hit \$241 million in sales this year. The big payoff will be four years from now, when it's expected to reach \$1.8 billion in sales, according to Prudential Securities analyst Guy Woodlief.

Shares of RCN are not for investors who are risk-averse. The company and its C-Tec predecessor lost money the last two years, and RCN executives concede they probably won't turn a profit for seven to 10 years. RCN might have a pre-tax loss of \$43 million this year, Merrill Lynch says. The company also has nearly \$1 billion in debt.

It could turn a profit tomorrow if it stopped building the network, McCourt says. "But what good is that?" he says. "The 100-year-old network was designed to give you ears around the world. The new network is designed to give you eyes around the world. If we have to worry about earnings today, then we won't be able to build this new network."

McCourt has another old network to worry about — his. RCN has 77,000 cable TV customers — some of the

most affluent in the nation — in Hunterdon, Somerset, Mercer and Morris counties. Their 15-year-old cable system gets only 64 channels while new customers in Boston and Washington see 110.

It will take one to three years to modernize the RCN cable network in New Jersey, says spokesman James Maiella. "It was state-of-the-art when it was built, and it had more channels than most of the systems in place then," he said.

The old C-Tec was never known for providing great service, either. "I couldn't agree more," McCourt says. "But we won't accept anything less than being the best in the country. We're not there, but we will be."

RCN is reselling Bell Atlantic's phone service in the state, and it's asking regulators for approval to create its own phone network. It already offers long-distance service and shares network construction costs with carriers such as WorldCom and Level 3 Communications. McCourt is a longtime business partner of Level 3 President James Crowe, who is the former chairman of MFS.

Level 3, which sells Internet-based telephone service, owns 36.9 percent of RCN. McCourt owns less than 5 percent, and the public owns the rest. McCourt sits on Level 3's board. He resigned from WorldCom's board a few months ago.

RCN has nearly 710,000 service connections. Each connection means one category of service — cable, long-distance, local phone or Internet — sold to consumers. RCN is bundling services so it can maximize revenue from the fiber network.

The company could become an acquisition target several years out, according to Prudential. The stock is likely to remain volatile, and should

be considered only by "aggressive investors," the New York investment firm says.

RCN and its partner, Boston Edison, waged a major battle in Massachusetts against Cablevision, a large Woodbury, Long Island, cable TV operator. The two partners are using Boston Edison's fiber-optic lines in the eastern part of the commonwealth to sell video and telephone service to Cablevision customers. A unit of Cablevision and The Star-Ledger jointly own the 24-hour news channel, News 12 New Jersey.

RCN-Boston Edison began offering customers more channels at a lower price than Cablevision. Time Warner lowered its cable rates in Manhattan after RCN began targeting middle-class customers in New York.

C-Tec Corp. split itself last September into three publicly traded companies. The spin-offs are RCN Corp., Cable Michigan Inc., consisting of C-Tec's Michigan cable operations, and Commonwealth Telephone Enterprises Inc.

Spinning into three companies helped former C-Tec shareholders, whose stock is worth about three times its price as of last October. RCN had a 2-for-1 stock split in April. The company also raised \$250 million through a debt sale this year. McCourt will use the money to continue building his network of glass.

"The average network has 26 homes per mile of phone plant. We're going into areas that have 200 homes per mile of plant," says McCourt, who hopes to sell each customer enough services to reach \$1,000 a year per customer. "If you have 200 customers per mile of plant, that's like having one big, high-rise building on its side. The key is to go into areas that are dense."