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<b>New Rec: LodgeNet Entertainment (LNET: \$35.46) June 3, 2007</b>
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**Position: Sell**

**Target: \$22**

\$MM	2Q07e	3Q07e	4Q07e	1Q08e	2007e	2008e
<b>Revenue</b>	<b>136.7</b>	<b>145.6</b>	<b>132.2</b>	<b>136.6</b>	<b>489.8</b>	<b>549.8</b>
<b>EBITDA</b>	<b>37.0</b>	<b>40.5</b>	<b>35.3</b>	<b>38.0</b>	<b>135.3</b>	<b>158.3</b>
<b>Y/Y Gro</b>	<b>58%</b>	<b>65%</b>	<b>66%</b>	<b>69%</b>	<b>47%</b>	<b>17%</b>
<b>EV/EBITDA</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>10.3</b>	<b>8.8</b>
<b>Consen EBITDA</b>	<b>38.0</b>	<b>40.8</b>	<b>39.5</b>	<b>40.2</b>	<b>140.5</b>	<b>183.8</b>

**Shares Out: 22.1M**

**Market Cap: \$780M**

**FYE: Dec**

Summary: LodgeNet is the largest provider of hotel video-on-demand (VOD) systems in North America. With its April 2007 acquisition of Liberty Media's On Command subsidiary for \$380M, it now serves 1.88M hotel rooms, or about 52% of North America's 3.6M rooms in mid/large hotel properties. The company is

expected to release its 8-K with pro forma financials within the next three weeks. Most often, we would wait to see the 8-K before recommending selling shares, but in this case the acquired business is nearly identical to LNET, and the company has given pro forma projected net income, cash from operations, capex, and FCF for 2007 and 2008. We think this, along with our discussions with industry experts, provides enough information to understand the challenges facing the company to meet its own and the “street’s” even more aggressive estimates.

In 2006, 72% of total revenue came from fees paid by hotel guests to watch videos in their rooms. Another 24% came from other services provided to guest rooms, including basic cable programming, broadband access, and video games. The remaining 4% came from sales of equipment for high speed internet access (HSIA), and VOD systems/service sold to hospitals, truck stops, and hotels outside of the US and Canada.

LNET owns and maintains all of the VOD equipment in its North American hotel accounts, and pays hotels a commission on video sales. In about 75% of its locations, VOD equipment consists of digital servers and one or more satellite dishes that download new content each month. The remaining sites have VCR equipment with tapes that must be manually changed each month.

Bulls reach their target valuations for LNET using current multiples for cable, awarding LNET a target of \$39, using 8x forward EBITDA, in line with the current valuation of Comcast’s cable operations. But the 8x multiple for Comcast assumes EBITDA growth of 12%-14% through 2010, and DCF models that grow free cash flow in perpetuity, an approach that may be appropriate for the oligopolistic cable market, but which is inappropriate for LNET. LNET lacks most of the good characteristics of a cable company, as we discuss below. Its EBITDA was flat y-y in 2006, and down 2% in 1Q07. After the On Command acquisition laps, we expect EBITDA growth to flatten out again. We think LNET’s long term business model is seriously flawed, and its ability to generate cash flow long term is questionable. As a result, its valuation should not be based on projected long-term cash flows that are unlikely to materialize. We think FCF will be stagnant at \$32M-\$34M per year in 2008-2010 as the company is forced to continue to invest to keep what it can of its installed base. Longer term, the entire business could be threatened.

LNET and On Command long ago saturated the VOD market. Room growth for the combined LNET/On Command increased only 1% per year since 2000. Its share of rooms is dropping as hotels switch to cable-only or competitive systems. LNET’s efforts to increase revenue per room (TV internet, Nintendo, premium sports programming) have failed thus far, with what little growth there

has been is coming from high speed internet access (HSIA) service call centers. Costs are increasing, as content providers and hotels squeeze LNET's gross margins.

Bulls argue that FCF will improve with increased operating leverage from the On Command acquisition and lower capex spending. Our discussions with industry experts suggest that there is little to be squeezed out of operations, especially since LNET will be maintaining two VOD systems. Costs of content are increasing, which will further pressure margins. These sources also tell us that high capex spending will be a continual problem for LNET's business model. Hotels are beginning to demand access to new IPTV technologies, DVR capabilities, and HDTV. Hoteliers tell us they are signing contracts of shorter duration due to the accelerating pace of technological change, suggesting that the capital replacement cycle for LNET is accelerating as well.

Falling EBITDA and expensive installations mean low returns on invested capital. LNET's unit economics seem poor. Indeed, we estimate that the company's ROIC per newly installed room was 7% in 2006, well below the company's WACC of 9.2%. Our ROIC calculation is likely different from the one the company would argue, mainly because we reduce operating earnings by our higher estimate of the company's maintenance capex. Since the room base expanded by only 3,000 rooms y-y in 2006, we allocate only the amount to finance the expansion to "expansion" capex, while the company allocates all spending on new digital rooms to expansion capex, even though most merely replace rooms lost from the base. Thus, from our point of view, nearly all the capex serves just to maintain a level base of rooms.

The company has been experiencing an increasing rate of de-installations, as hotels choose to provide cable only or smaller competitors, and contract durations are shortening. In addition, a master agreement with Hilton (LNET's largest customer, with 21% of total revenue in 2006), and On Command's master agreement with Marriott (38% of On Command revenue in 2006), both end in early 2008, introducing a high level of risk, and the potential for increased de-installations in favor of cable or competitors at these properties.

Competition from cable companies is on the horizon. Comcast is currently testing a hotel VOD service in Chicago called HospitalityONE. Comcast already provides 700,000 hotel rooms with digital cable (and an undisclosed number with HSIA). Adding Comcast VOD that bills movies to the room will give hotel guests a TV experience that more closely approximates the services they have at home, with 3,000 hours of programming. Cable companies may become even more

competitive if they succeed in getting access to first run movies on their VOD systems on the same time frame as LNET.

The company is trying to diversify outside of hotel VOD. In February, it bought an HSIA service call center called StayOnline for \$15M. This business is very competitive, and customers are not very “sticky,” in our view. It has also begun selling VOD systems to hospitals (with McKesson) and truck stops (with IdleAire). However, the equipment can be used with other vendor’s programming, leaving the company vulnerable to losing recurring revenue.

While bulls look at the On Command deal as an opportunity for LNET to increase its leverage over hotel customers, we have heard an alternative explanation for the deal. An industry source tells us that Liberty Media, which was looking to offload On Command as part of its restructuring effort, used its new 38% stake in DirecTV (supplier of TV programming to LNET and On Command) to force the deal. Our source says that Liberty proposed the deal, and threatened to cut a preferential programming deal with On Command, which would allow it to undercut LNET’s prices if LNET refused. Faced with this choice, our source says, LNET agreed to the deal in a matter of days at a price that left it highly leveraged and deeply wed to the stagnant and increasingly threatened hotel VOD industry.

Insiders may concur with our analysis, since they have been actively selling shares since the On Command deal closed. Insiders have sold shares worth \$10.2M since early April. A senior vice president has taken a demotion, and a director has resigned two years before the end of his term, removing the obligation of each to report share sales.

“Street” analysts argue that shares should trade at an 8x forward EBITDA basis, in line with Comcast. The Comcast valuation reflects DCF models which depend on the long-term ability of the companies to grow EBITDA and to generate long term growth of free cash flow from a sticky subscriber base. As we have discussed, LNET’s business does not have these benign characteristics.

We think that LNET’s business model will generate neither long term EBITDA growth, nor long term FCF growth. Furthermore, LNET’s client base is far from “sticky.” We note that LNET paid only 6.7x current EBITDA for peer On Command even in a “strategic” acquisition, where multiples should be high. We think LNET’s EBITDA growth will disappoint, and will be well below that of cable companies. The “street” estimates \$141M EBITDA in 2007 and \$184M in 2008. Bulls estimate FCF of \$20M in 2007 and \$60M in 2008 with a full year of On Command. At the “street” share price target of \$39, the yield on 2008 consensus FCF is 7%.

We project EBITDA of \$135M in 2007 and \$158M in 2008. We expect FCF of \$13M in 2007 and \$32M in 2008. We apply a 7x multiple to our 2008 EBITDA estimate to arrive at an EV for the company of \$1.1B (\$488M in equity/\$625M in debt) and our target price of \$22. At our target, the yield on 2008 FCF is 7%, in line with the “street’s” valuation metric.

#### Background:

LodgeNet, based in Sioux Falls, SD, is the largest provider of VOD systems to hotels in North America. The company was founded in 1980 as Satellite Movie Company, a provider of satellite TV services to hotels. It began providing pay-per-view movies in 1996, and VOD in 2002. With its April 2007 acquisition of On Command from Liberty Media (\$332M in cash, \$48M in stock), LNET now serves about 1.88M rooms, or 52% of the North American mid/large hotel market. Other much smaller players in the market include KoolConnect, NXTV, Guest-Tek, and Cox’ Hospitality Network (primarily in Las Vegas with a server-based system similar to LNET’s).

The majority of LNET’s revenue in 2006 (72%) came from fees paid by hotel guests to watch movies in their rooms. Industry sources tell us that 40%-50% of this revenue comes from sales of adult content (polite for porn). The company also offers first run movies that are at the tail-end of their theatrical run but have not yet hit pay-per-view. Videos cost the hotel guest about \$10-\$14, depending on the hotel property. Some hotels offer 24 hours unlimited viewing of “adult content” for \$29.99.

LNET owns and services the satellite dishes and servers it installs in hotels to deliver videos on demand to guest rooms. The combined LNET/On Command has so far converted 75% of its installed base from analog VCR tape-based systems to digital servers. Notably, few of these systems are capable of delivering high definition (HD) content, or IPTV capabilities (e.g., pause/rewind of movies and live TV) that guests are coming to expect since many have these features at home.

The video business operates under a revenue-share business model. LNET pays the movie studios a royalty based on revenue generated by guest purchases, and pays the hotels a commission on video revenue. Commissions on hotel video revenues are about 16%-20%, but can be much higher at very large volume properties (e.g., Las Vegas). Contracts with hotels have been 5-7 years in length.

Video revenue has been stagnant, with just 2% growth in 2005 and 3% in 2006. This is despite efforts to capture more of the hotel guest’s dollar with

Nintendo video games, TV internet, and expanded program offerings. LNET also provides hotels with free-to-guest (FTG) TV programming via satellite, and call center service for guest internet access. These services, paid for by hotels on a per room basis, generated about 24% of sales in 2006 and grew 6% . The remaining 4% of sales is from equipment sales.

LNET Revenue Segmentation (2004-2006)

\$MM	2004a	2005a	2006a
Video Revenue	197.3	201.7	208.3
Other Interactive Rev (FTG, internet)	62.2	65.7	69.3
Other Revenue	7.9	8.0	10.8
Total Revenue	267.3	275.4	288.4

Y-Y change	2004a	2005a	2006a
Video Revenue	4%	2%	3%
Other Interactive Rev (FTG, internet)	14%	6%	6%
Other Revenue	23%	2%	34%
Total Revenue	7%	3%	5%

% Total Revenue	2004a	2005a	2006a
Video Revenue	74%	73%	72%
Other Interactive Rev (FTG, internet)	23%	24%	24%
Other Revenue	3%	3%	4%
Total Revenue	100%	100%	100%

Since LNET controls only the VOD delivery infrastructure within the hotel, it must rely on multiple parties to make its model work. It needs satellite TV companies (now DirecTV) for TV content, the studios for movie content, broadband providers to sell internet access to the hotels it services, and the hotels themselves for access to the guests. This interconnected web makes it difficult for LNET to control its destiny, as a couple of events from the past illustrate.

Originally, TCI Communications provided the company's satellite TV programming. In December 1999, TCI was purchased by Liberty Media, owner of LNET's largest competitor, On Command. Apparently not wishing to aid and abet the enemy, in January 2000, LNET switched to DirecTV for its satellite programming. As we shall see, this lack of control of delivery infrastructure (in this case delivering TV content) outside of the hotel building is a problem that has vexed LNET throughout its history.

In 1996, LNET formed ResNet Communications, a subsidiary targeting the apartment market with private satellite cable service that planned to also offer VOD and internet service. The goal was to leverage the hotel technology to the much larger apartment market, but the service could not compete with cable.

LNET threw in the towel just two years later when it merged its ResNet business into a new joint venture company. The JV quickly failed, and LNET began writing down this investment in 1999. This was just the first of many failed efforts by LNET to break out of its limited hotel VOD market.

Today, LNET is still searching for ways to break out of the stagnant VOD business. In February 2007, LNET acquired StayOnline, a reseller of high speed internet access (HSIA) equipment and call center service support. It paid \$15.6M in cash for a company that generated \$12M in revenue in 2006. Most of this revenue thus far is from equipment sales and service. In February and March 2007, StayOnline generated \$2.5M in revenue, of which \$800,000 was from recurring help desk service fees.

The “street” is expecting LNET to generate revenue of \$494M in 2007 and \$567M in 2008. EBITDA is expected to be \$141M in 2007 and \$184M in 2008. We think LNET will meaningfully miss both revenue and EBITDA estimates in 2008, and project revenue of \$550M in 2008 and EBITDA of \$158M. The miss is driven by lower top line expectations, but also by lower EBITDA margins. We think EBITDA margins, which have been declining for the past four years, will fail to rebound in 2008 to 2006 levels as the “street” hopes, because LNET faces increasing competition from expanding consumer electronics options and cable.

“Street” and OWS Estimates

\$MM	2006a	"Street" 2007e	"Street" 2008e	OWS 2007e	OWS 2008e
Revenue	\$288.2	\$494.3	\$566.9	\$489.8	\$549.8
EBITDA	\$92.0	\$140.5	\$183.8	\$135.3	\$158.3
Y-Y chng	0%	53%	31%	47%	13%
EBITDA Margin	32%	28%	32%	28%	29%

Note that “street” depreciation and amortization expenses for 2008 are \$120M, well below the \$145M guidance provided by the company in December when it announced the acquisition. Our discussions with the company indicate there has been no formal reduction in this guidance. Should the company announce lower D&A expense as a result of acquisition accounting when it files its pro formas (expected during the third week in June), EPS number will increase. However, this will do nothing to improve EBITDA and FCF, the metrics that are most important in valuing the company.

Discussion:

1. Market fully saturated, with the combined LNET/On Command showing 1% annual room growth since 2000 despite 4% growth in the number of hotel rooms

While bulls are excited about the increased leverage LNET/On Command will supposedly have in the marketplace, we wonder about the value of this leverage in a market that is stagnant and may soon begin to shrink. The combined room count for LNET/On Command is only 6% greater than the room count of the two companies in 2000, as shown on the table below. LNET and On Command merely switched share positions during that six-year period, with the total rooms covered by the two players increasing by less than 1% per year. As we will discuss later in this report, most of the room shift came from Hilton. The hotel company cancelled a Master Agreement with On Command in 2000 and immediately signed one with LNET.

LNET and On Command Room Share and Growth 2000-2006

	2000	Share	2006	Share	2000-2006 CAGR
LNET rooms served	806,112	44%	1,052,025	56%	4.5%
On Command rooms served	977,000	56%	832,000	44%	(2.6%)
Total	1,783,112	100%	1,884,025	100%	0.9%

Source: LNET SEC filings

Interestingly, according to LNET's SEC filings, the total number of hotel rooms in the US has increased during that period by about 4% per year, from 3.9M to 4.9M. Thus, it appears that LNET/On Command's presence in hotel rooms has been declining, from 46% of total rooms in 2000 to 38% today.

Our discussions with industry experts suggest there are a number of reasons for the share losses being experienced by LNET/On Command:

Competing Electronics: Nearly everyone with whom we spoke in the industry mentioned the ubiquitous presence of consumer electronics as a factor diminishing VOD purchases. Business travelers bring their laptops with downloaded movies, kids bring personal DVD players, Game Boys, and video ipods. There are simply many other options for hotel time today.

Expanded Cable: Some hoteliers are dropping services like VOD in favor of expanded cable programming. The mantra in the industry is the hotel should be at least as good as the home, and expanded cable channels (e.g., HBO) and HDTV is what hotel guests now favor over VOD. Most hotel managers are indifferent to the revenue lost by not having a VOD system. VOD, in their view, is an amenity, not a revenue generator. When its value as an amenity declines, hotels will drop the service.

Cable VOD: A relatively new threat to LNET is the expansion of cable VOD systems into the hotel environment. Now that cable companies like Comcast have nearly fully-deployed their VOD capabilities nationwide, they are looking for more ways to use it. Comcast is trialing a hotel VOD system (HospitalityONE) in Chicago that allows hotel guests to download movies from the Comcast cable system for \$12 per movie. Comcast interfaces with the hotel property management system to allow billing of downloaded movies at guest checkout. Revenues are collected by the hotel, and Comcast pays the hotel a commission. The Comcast offering will closely approximate what hotel guests already have at home, making it a potentially very desirable option for hotels looking to mimic the home experience.

Cable operators are also trying to strike deals with movie studios to offer movies on VOD concurrent with the release of DVDs, and even with theatrical release. If viewing a movie concurrent with theatrical release, users at home or in a hotel would pay about \$20 for a major first run movie (versus the current \$3.99 for a movie 120 days after theatrical release). This would eliminate the competitive advantage LNET has had over cable with its access to movies before they are released for cable.

Comcast has already struck such a deal with IFC Entertainment, whereby selected independent films are being released thorough VOD on the same day they are released in theaters.

Other competitors: Smaller competitors (NXTV, KoolConnect, Guest-Tek) are winning some high-end accounts with their IPTV-based systems. These systems are high customizable, and have IP technology that allows for freeze/rewind of programs, as well as HDTV.

## 2. Revenue per room is stagnant, EBITDA per room declining

With no way to grow rooms served, LNET put its effort into expanding revenue per room by increasing services available to hotel guests. The company has offered Nintendo games, TV internet access, and expanded video offerings. However, guests failed to respond with increased purchases. Video revenue per room has been flat for the past three years. What growth there has been has come from other interactive services (high-speed internet access (HSIA) support services, free-to-guest (FTG) basic cable programming) that are paid by the hotel.

### LNET Per Room Income Statement

\$ per room	2005a	2006a	1Q06a	1Q07a
Avg Guest Pay Rev (mostly videos)	17.00	17.27	17.11	17.13
Other Interactive Service Rev (HSIA, FTG)	5.53	5.75	5.55	6.27
Avg Monthly Rev	22.53	23.02	22.66	23.40
Guest Pay Direct Costs	10.01	10.50	10.20	11.13
Guest Pay Gross Profit	12.52	12.52	12.46	12.27
Guest Pay Op Exp	2.96	2.92	2.92	2.82
G&A Exp	2.14	2.41	2.29	2.58
EBITDA	7.42	7.19	7.25	6.87
Deprec/Amort	5.89	5.51	5.62	5.32
Interest Expense	2.47	2.14	2.17	2.05
Maintenance Capex*	3.58	3.91	3.63	3.05
Cash/ Room (EBITDA-Int Exp-Maint Capex)	1.37	1.14	1.45	1.77
Gross Margin	55.5%	54.4%	55.0%	52.4%
EBITDA Margin	32.8%	31.2%	32.0%	29.4%

Source: LNET filings

While revenue has been growing slowly, costs have been increasing, and EBITDA margins per room have fallen from 32.8% in 2005 to 31.2% in 2006 and 29.4% in 1Q07. The declines are mostly due to lower gross margins from increased content costs (both royalties to studios and basic TV programming fees) and increased commissions to hotels. G&A expenses also increased as the company hired consultants, presumably to try to figure out how to fix its business.

### 3. ROIC per room below WACC. Unit economics a problem.

We calculate the ROIC per newly installed room by annualizing the EBITDA per room, subtracting maintenance capex (discussed in more detail below) and applying a 38% tax rate to get after tax operating earnings. While LNET pays virtually no taxes, we think it should not get credit for this benefit when evaluating its return on capital, since we are comparing its return to that of tax paying businesses (e.g., cable). We divide after tax operating income by the cost of installing a new digital room. This yields an ROIC per new room in 2006 of 6.9%.

#### ROIC Per Room 2005/2996 and 1Q06/1Q07

	2005a	2006a	1Q06a	1Q07a
Annual EBITDA per room	\$89.05	\$86.32	\$87.00	\$82.44
Maintenance Capex*	42.97	46.95	43.52	36.63
Pretax operating earnings	46.08	39.37	43.48	45.81
Taxes	17.51	14.96	16.52	17.41
After tax operating earnings	28.57	24.41	26.96	28.40
Installation cost/new room	\$340	\$354	\$348	\$366
ROIC Per New Room	8.4%	6.9%	7.7%	7.8%

\*OWS estimate. See discussion below.

We estimate the company's cost of equity at 11.8% (risk free rate + (beta\*market premium) = 5.37% + (1.2\*5%)), and its cost of debt at 6.37% (LIBOR + 1%). The WACC with its current structure of 56% equity and 44% debt is 9.2%. By our calculation, therefore, the ROIC per room of 7%-8% is lower than the company's WACC. ROIC may decline further if the lower cash flow per room and higher installation costs seen in 1Q07 continue.

The maintenance capex we use above is higher than that presented by the company. This reduces after tax earnings and drives ROIC lower than the level the company would like investors to believe. We consider LNET's maintenance capex to be any capital investment that does not expand the total number of rooms. In 2006, the net increase in rooms was only 3,008, even though the company installed about 66,000 new digital rooms. The company attributes all of the capex for these 66,000 rooms to expansion, even though 63,000 installations were merely to replace lost rooms to maintain the base, not to expand the base. We think it is inappropriate to allocate these "churn" rooms to expansion capex, when the spending really only "maintains" the current level of rooms. Thus, in our view, expansion capex in 2006 was only \$1.1M (3,000 rooms x \$354 per new room) versus the company's \$22.3M estimate.

#### LNET and OWS Estimates of Expansion and Maintenance Capex

(\$MM)	LNET 2004	LNET 2005	LNET 2006	OWS 2004	OWS 2005	OWS 2006
Expansion Capex	27.6	24.2	22.3	18.3	9.2	1.1
Maintenance Capex	27.3	27.6	26.0	36.7	42.6	47.2
Total Capex	54.9	51.9	48.3	54.9	51.9	48.3

Source: Company presentation, OWS estimates

With such high levels of maintenance capex, it is difficult to see how the company can significantly reduce capex spending even when the conversion to digital is complete.

Finally, we note that the company has argued that digital rooms generate more revenue and cash flow than its old tape-based rooms. At a presentation in March 2007, it said that the annual cash flow of a digital room is \$133 per year. Perhaps this represents an ideal digital room, rather than the overall digital base. There was an average of 681,224 digital rooms in 2006. If each generated \$133 in cash flow, digital rooms would have generated \$90.6M in cash flow in 2006. But the entire cash flow from operations for LNET was \$68M. Are we to infer that the remaining tape-based rooms (about 25% of the base) are actually losing money?

#### 4. FCF growth will be limited

With little revenue growth, continued high capex expense, and high interest expense its \$625M in debt, we see little opportunity for LNET to expand FCF once the acquisition laps in 2Q08. As shown in the table below, we think there will be no meaningful growth in FCF in 2008-2010. The FCF yield on our \$33M 2008 estimate at our target of \$22 is 7%.

OWS LNET FCF 2005a-2010e

	2005a	2006a	2007e	2008e	2009e	2010e
Net Income	(7.0)	1.8	-30.8	-25.2	-16.5	-11.0
Deprec/Amort	69.9	66.3	130.8	145.0	137.0	129.0
Share Based Comp	--	1.7	1.6	1.6	1.6	1.6
Capex	(51.9)	(48.3)	(87.2)	(88.0)	(86.9)	(85.7)
FCF	11.0	21.5	14.5	33.4	35.2	33.9

Bullish “street” analysts are looking for \$60M-\$61M in FCF in 2008, driven by higher EBITDA estimates. This would give the company a FCF yield of 7% at their target price of \$39. It is worth noting that one analyst (whose bank was involved in selling the debt used to fund the On Command acquisition) projects 2008 FCF well below ours, at \$5.9M. The lower projection versus ours is driven by lower EBITDA estimates (\$146M), and higher capex (\$94M).

Interestingly, bullish estimates are well above the company’s 2008 FCF projection of \$43M when it announced the On Command deal. Our discussions with the company suggest there have been no meaningful changes to the estimates. The difference may be explained by the “street’s” expectation of a \$17M increase in working capital following the On Command acquisition. But we think it would be incorrect to include this one time working capital increase when evaluating the company’s FCF.

## 5. Shortening contract lengths signal increasing pressure to reinvest

LNET reports that the average term of its contracts is 5-7 years, and that at the end of 2006, the average remaining contract term was 39 months. This would suggest an average contract length of 6.5 years. However, its 10-K also says that “Approximately 19% of current Guest Pay rooms are subject to renewal prior to 2008,” which would suggest a 5.3 year average contract term. We have heard from industry sources that LNET is letting hotels remain on a month-to-month contract, which may explain the difference between these two metrics.

Some of these month-to-month contracts may be part of the 25% remaining tape-based rooms at low revenue properties that the company has decided not to upgrade. But if contracts are not being re-signed because hotels are exploring alternatives or jockeying for more technology as part of the deal, an increasing amount of revenue could be at risk.

Industry experts with whom we have spoken say that hotels use the contract renegotiation process as an opportunity to get new equipment, and are increasingly reluctant to enter long term contracts, since they perceive the pace of technology change is increasing. One hotel manager with whom we spoke (not an LNET customer) had signed a five year contract three years ago, and laments the long term because it is blocking him from upgrading his VOD movies to HDTV. He told us that at the time he signed, he did not anticipate that the hotel would upgrade its TVs to HD. Now his VOD system has fallen behind the capabilities of the in-room technology.

## 6. De-installations increasing

De-installations of LNET systems were running at 1%-3% of the installed room base until 2005, when de-installs accelerated to 3.7% of the installed room base. The pace picked up even more in 2006, when 6.3% of the room base de-installed. Some of this (about 15,000 rooms) was lost to On Command when it won the Red Roof Inn account from LNET. Another 3,000-4,000 rooms were lost when a long-term stay account discontinued service. Even excluding these accounts, however, 4.4% of the base de-installed, versus 3.7% in 2005.

### De-installations at LNET (rooms)

	1Q05	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	4Q06	1Q07
De-installed rms	7,283	10,754	9,002	9,366	8,041	17,144	21,306	16,494	11,626
% installed base*	3%	4%	4%	4%	3%	7%	8%	7%	5%
Y-Y change	--	--	--	--	10%	59%	137%	76%	45%

\*Annualized

Source: Company filings

LNET has argued that many of these de-installs are due to its decision not to maintain and upgrade accounts at less profitable hotel properties. If this is indeed the case, we wonder why there has not been more improvement in the average per room revenue.

We also note that 54% of the rooms de-installed in 1Q07 were digital, continuing a trend seen since 2Q06. While it makes sense that more de-installs will be digital now that 75% of the base is digital, this statistic does not mesh with management's comments that higher de-install rates are due to its decision to close low revenue accounts. We wonder what the story is behind these lost digital rooms.

#### De-installs of LNET Digital Rooms

	1Q06	2Q06	3Q06	4Q06	1Q07
Gross Digital Room Installations	29,369	31,583	28,615	29,124	32,326
Net Digital room installations	29,091	28,377	24,240	22,569	26,017
Digital De-installs	278	3,206	4,375	6,555	6,309
% Total De-installs	3%	19%	21%	40%	54%

Sources: LNET filings and press releases

## 7. Digital upgrades doing little to enhance revenue, EBITDA

Management has promoted its investment in digital upgrades of existing rooms as an opportunity to increase revenue, saying that digital rooms generated 50% more revenue than tape-based rooms in 2005. Yet with 75% of the installed base converted to digital, video revenues per room remain stagnant. This is because the company converted higher revenue properties before lower revenue ones, and the remaining low revenue rooms are dragging down average room revenue.

In 3Q06, the company disclosed guest pay revenue per digital room, allowing us to back into the implied revenue per tape-based room. Revenue per digital room increased only 2% year over year, while revenue per tape-based room fell 13%. LNET has logically left the lowest revenue producing rooms for last in its move to digital. While this makes sense, we think bulls should worry that there is not much bang for the buck left from converting the remaining rooms to digital, as they will likely only pull down the average revenue of the digital rooms. Moreover, LNET cannot give up on these installations entirely, since they generated about 19% of revenue in 3Q06. And finally, as we have shown above, slowing conversion to digital will likely do little to lower capex spending.

#### Average Revenue Per Month Digital vs. Tape-based Room

\$ Per Room	3Q05	3Q06
Guest pay revenue per DIGITAL room	\$27.50	\$28.08
Y-Y change	n/a	2%
Implied Guest pay rev per non-digital rm	\$18.42	\$15.98
Y-Y change	n/a	-13%
Total Guest pay revenue per room	\$23.88	\$24.55
Y-Y change	n/a	3%

Source: LNET filings

The higher digital room revenue has not stopped EBITDA/room from slipping, largely due to higher direct costs (royalties to movie studios, commissions to hotels). Industry sources tell us that this is because the movie studios and TV programming providers are successfully charging more for HDTV content, thus negating much of the revenue benefit LNET gets from converting a room to digital. The larger hotels that would have been the first LNET switched to digital may also have been able to negotiate better commissions in anticipation of the higher revenue per room.

#### 8. Hospital/truck stop opportunity limited

Prior to its acquisition of On Command, the company had made much of its expansion into VOD for hospitals and truck stops. Now, guidance that puts hospital revenue up 100% to \$4.6M is but 1% of projected total revenue. Truck stop revenue was about \$700K in 2006, so will also not be much of a factor in 2007.

While much less a part of the LNET story now, the fact the company was making a concerted effort to penetrate these markets is instructive. LNET struck a deal with McKesson for the hospital market, and with IdleAire for the truck stop market. Under both deals, it sells the equipment to the hospital or truck stop, and collects a recurring service and program content fee. Thus, its revenue opportunity is even more diluted than in the hotel VOD market, since it has distribution partners to contend with, and only service and content fee to collect. We think it is interesting that the company has abandoned its system ownership model in these markets, perhaps signaling that it does not see the returns on investment that it saw in hotels.

At least one small competitor is following a model where the hotel purchases the equipment and pays a service and content fee. However, with systems running at \$100,000 or more, and technology rapidly evolving, we think it will be hard for most hotels to stomach the idea of such a large technology

investment, particularly if cable VOD for hotels is available with none of the capital investment.

## 9. Hilton and Marriott relationships

LNET's largest customer is Hilton, representing 20.8% of revenue in 2006. The company signed a master agreement with Hilton in 2000 (which it won away from On Command) giving it the exclusive right to provide VOD services to Hilton-owned properties, and to be the "exclusive recommended provider of choice" at its managed and franchised properties. This master agreement expires in March 2008.

LNET paid up for the right to sell to Hilton properties. In addition to \$9M in "contract acquisition costs" paid over five years (2002-2006), the company also issued Hilton warrants to purchase up to 2.1M shares of LNET stock at \$20.44, and paid Hilton \$1M for a six month master agreement extension. Hilton exercised a total of 535,000 shares under the warrant, which is now expired. Interestingly, its last exercise of 196,570 shares in December 2006 was cashless—it exercised and immediately sold.

The Hilton relationship has been quite significant for LNET. As shown below, revenue from Hilton grew \$10M per year in 2005 and 2006, and represented more than 100% of the company's incremental revenue in those years. Thus, were it not for winning Hilton business away from On Command under the Master Agreement, LNET's revenue would have been down y-y in 2005 and up just 1% in 2006.

LNET Revenue from Hilton-related Properties (2003a-2006a)

\$MM	2003a	2004a	2005a	2006a
Rev From Hilton	\$31.3	\$39.7	\$49.9	\$59.9
Y-Y chng	n/a	27%	26%	20%
% Total Incremental Revenue	n/a	52%	109%	81%

Source: LNET filings

On Command's largest customer is Marriott, representing 35% of revenue in 2006. On Command signed a master agreement with Marriott in March 2001 that expires in 2008. Thus, with the combination of LNET/On Command, about 30% of the entity's business will be at risk in early 2008.

Will these hotel companies re-up with LNET? Industry contacts with whom we have spoken suggest they will not, instead letting each property make an individual decision about how, and, indeed, if it wants to deliver VOD to its rooms. These sources note that it is the higher end, better revenue generating properties in

the LNET portfolio that allow it to cover the costs of the lower end, lower revenue properties. Our sources suggest that if the better Hilton and Marriott franchises migrate away from LNET to cable or other providers, LNET would be left with the worst performers in each portfolio.

We note that there have been sporadic protests against the large chains, criticizing them for providing pornography in their hotel rooms. We think that, at least in some markets, hotel operators may choose to forgo the limited revenue they get from LNET's porn offerings and opt for cable (with porn blocked) instead.

#### 10. On Command acquisition may have been done under duress

With all the problems faced by the hotel VOD business, why would LNET choose to make such a big bet in acquiring On Command, a competitor from whom it had been winning share (albeit in a stagnant market) for years? Certainly the imminent expiration of the Hilton and Marriott contracts may have been a factor, since the two companies would not want to go head-to-head in a re-bid. But we have heard that the impetus for the deal came from Liberty Media, which was looking to unload the asset as part of its overall restructuring effort. In December 2006, Liberty became a 38% holder of DirecTV, the provider of satellite TV programming to both LNET and On Command.

Our source tells us that Liberty came to LNET in December with an ultimatum: Take On Command off our hands for a premium price, or we will use our new investment in DirecTV to cut On Command a preferential TV programming deal that will allow it to undercut you in the marketplace. Faced with this choice, according to our source, LNET cut the deal in just a matter of days at a price that left it highly leveraged and even more deeply wed to the stagnant and increasingly threatened hotel VOD industry.

Our source also says that LNET may be left holding the bag for a very poor deal On Command signed with Red Roof Inns. As discussed above, LNET lost 15,000 Red Roof rooms to On Command in 2006, but our source tells us that On Command rolled out its systems very slowly because it realized how poor the economics of the deal were. We wonder, will LNET have to honor the On Command/Red Roof contract?

#### 11. Las Vegas Sands, other international business

LNET recently signed a deal with Las Vegas Sands (LVS) to sell its VOD system, which it will install in the 3,000 room Venetian Macao, scheduled to open in August 2007. While LNET will see equipment and management/service

revenue from the deal, it will not get a recurring programming revenue stream. This deal is similar to LNET's other ex-North America deals (just \$700K-\$800K per year in 2004-2006).

We view the ex-US opportunity as limited for LNET, since it does not bring to the table the local language content deals that drove its penetration of the US market.

## 12. Insider selling

Since the LNET/On Command deal was closed in April, insiders have sold 303,850 shares valued at \$10.2M. This compares to just 35,050 shares sold during the same period a year ago. The largest sellers during this period were the SVP of Product and Technology Development, the Senior VP of Programming, and the CEO.

Industry sources have heard that LNET executives are taking demotions in order to avoid disclosing their sales. While this may be just industry backbiting, we do know that the Senior VP of Sales & Hotel Relations (2002-2007) now has the title of VP, Field Sales, and informed the SEC on May 14 that he is no longer a Section 16 Officer. According to the company's latest proxy, he held 113,058 shares.

In addition, an LNET director resigned from the board less than three weeks after the On Command deal closed, although his term did not expire until 2009. This director held about 100,000 shares.

## 13. Valuation

Bulls compare their target valuations to current multiples for cable, suggesting that are valuing LNET like a cable company, awarding it a target valuation of 8x forward EBITDA, or \$39, in line with current valuations for Comcast's cable operations. But the 8x multiples for Comcast is based on EBITDA growth of 12%-14% through 2010, and a DCF models that grows free cash flow in perpetuity, an approach that may be appropriate for the oligopolistic cable market, but which is inappropriate for LNET. We think LNET's long term business model is seriously flawed, and therefore its ability to generate cash flow long term is questionable. As a result, its valuation should not be based on projected long-term cash flows that are unlikely to materialize.

We expect EBITDA growth to slow to 7% y-y in 2Q08 once the On Command acquisitions laps, and expect no growth in 2009 and 2010 as the

company loses hotel rooms and revenue per room remains stagnant. We think FCF will be stagnant at \$32M-\$34M per year in 2008-2010 as the company is forced to continue to invest in its installed base to keep whatever business it can.

We apply a 7x multiple to our 2008 EBITDA estimate of \$158M to arrive at our share price target of \$22. This multiple represents a slight premium to the 6.7x multiple LNET paid for On Command.

We think FCF will be stagnant at \$32M-\$34M per year in 2008-2010 as the company is forced to continue to invest in its installed base to keep whatever business it can. The FCF yield at our target price of \$22 is 7%, in line with the FCF yield the “street” expects on its 2008 FCF target of \$60M and target price of \$39.

#### 14. Financials

Following the On Command acquisition on April 4, 2007, LNET has about \$16M in cash and \$625M in debt. At the end of 1Q07, the company had an accumulated deficit of \$303M, a figure the company acknowledges is likely to worsen due to the costs associated with the integration of On Command. The company has a shareholders’ deficit balance of (\$54M). We think the balance sheet is likely to deteriorate further as the company continues to invest in an installed base that will generate increasingly lower returns. We will review the financials when the company reports pro forma for the acquisition.

Current Balance Sheet Items (March 31, 2007, unless otherwise noted)

Debt	\$625M*
Equity	(\$54M)
Tangible Book	(\$54M)
Current Market Value	\$780M
Cash	\$16M
Current EV	\$1.389B
DSO	45

\*Post On Command acquisition on April 4, 2007

Income Statement and Cash Flow Items (2006a-2010e)

\$MM	2006a	2007e	2008e	2009e	2010e
EBIT	26.9	4.5	13.3	21.6	26.8
EBITDA	92.0	135.3	158.3	158.6	155.8
Surplus CF (NI+DA-capex)	21.3	14.5	33.4	35.2	33.9
Capex	(48.3)	(87.2)	(88.0)	(86.9)	(85.7)

### EV/EBITDA Analysis

\$MM	2007e	2008e	2009e
Current EV/EBITDA	10.3	8.8	8.8
OWS Target EV/EBITDA	8.2	6.9	6.9
Current EV/(EBITDA-capex)	6.2	5.5	5.6
OWS Target EV/(EBITDA-capex)	5.0	4.3	4.4

Guest Pay Rev/Room/Month	2006a	2007e	2008e	2009e	2010e	1Q07a	2Q07e	3Q07e	4Q07e	1Q08e	2Q08e	3Q08e	4Q08e	1Q09e	2Q09e	3Q09e	4Q09e	1Q10e	2Q10e	3Q10e	4Q10e
Avg Guest Pay Rms (000)	1,005	1,634	1,832	1,800	1,768	1,008	1,840	1,841	1,843	1,843	1,839	1,832	1,824	1,816	1,808	1,800	1,792	1,784	1,776	1,768	1,760
Video Revenue/Rm/Month	\$17.26	\$17.20	\$17.15	\$17.07	\$16.99	\$17.13	\$17.00	\$18.40	\$16.30	\$17.04	\$16.92	\$18.31	\$16.22	\$16.96	\$16.83	\$18.22	\$16.14	\$16.87	\$16.75	\$18.13	\$16.06
Other Revenue/Rm/Month	\$5.69	\$6.69	\$6.94	\$7.12	\$7.31	\$6.27	\$6.77	\$6.94	\$6.60	\$6.75	\$7.03	\$7.17	\$6.77	\$6.92	\$7.21	\$7.35	\$6.94	\$7.10	\$7.39	\$7.55	\$7.12
Tot Guest Pay Rev/Rm/Month	\$22.95	\$23.89	\$24.09	\$24.20	\$24.29	\$23.40	\$23.77	\$25.34	\$22.90	\$23.79	\$23.94	\$25.48	\$22.99	\$23.88	\$24.04	\$25.57	\$23.08	\$23.97	\$24.14	\$25.67	\$23.18

Y-Y change	2006a	2007e	2008e	2009e	2010e	1Q07a	2Q07e	3Q07e	4Q07e	1Q08e	2Q08e	3Q08e	4Q08e	1Q09e	2Q09e	3Q09e	4Q09e	1Q10e	2Q10e	3Q10e	4Q10e
Avg Guest Pay Rms	1%	63%	12%	-2%	-2%	0%	83%	83%	84%	83%	0%	0%	-1%	-1%	-2%	-2%	-2%	-2%	-2%	-2%	-2%
Video Revenue/Rm/Month	2%	0%	0%	0%	0%	0%	0%	-1%	-1%	-1%	-1%	0%	0%	0%	-1%	0%	-1%	-1%	-1%	-1%	0%
Other Revenue/Rm/Month	3%	18%	4%	3%	3%	13%	16%	16%	18%	8%	4%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%
Tot Guest Pay Rev/Rm/Month	2%	4%	1%	0%	0%	3%	4%	3%	4%	2%	1%	1%	0%	0%	0%	0%	0%	0%	0%	0%	0%

\$ millions	2006a	2007e	2008e	2009e	2010e	1Q07a	2Q07e	3Q07e	4Q07e	1Q08e	2Q08e	3Q08e	4Q08e	1Q09e	2Q09e	3Q09e	4Q09e	1Q10e	2Q10e	3Q10e	4Q10e
Video Revenue	208.3	337.4	376.9	368.8	360.5	51.8	93.8	101.6	90.1	94.2	93.3	100.6	88.7	92.4	91.3	98.4	86.8	90.3	89.2	96.1	84.8
Other Guest Pay Revenue	68.6	131.1	152.5	153.8	155.0	19.0	37.3	38.3	36.5	37.3	38.8	39.4	37.0	37.7	39.1	39.7	37.3	38.0	39.4	40.0	37.6
Total Guest Pay	277.4	468.0	529.4	522.6	515.4	70.3	131.2	140.0	126.6	131.5	132.1	140.0	125.8	130.1	130.4	138.1	124.1	128.3	128.6	136.2	122.4
Core HSIA equip/service	4.1	3.9	4.0	4.0	4.0	0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
StayOnline equip/service	0.0	9.5	10.4	10.4	10.4	1.7	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Healthcare revenue	2.3	3.8	2.0	2.0	2.0	0.8	1.0	1.0	1.0	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Other Equipment	4.4	4.6	4.0	4.0	4.0	1.6	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Total Other	10.8	21.8	20.4	20.4	20.4	5.0	5.6	5.6	5.6	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1
Total Revenue	288.2	489.8	549.8	543.0	535.8	75.3	136.7	145.6	132.2	136.6	137.2	145.1	130.9	135.2	135.5	143.2	129.2	133.4	133.7	141.3	127.5
Direct Cost, Guest	126.6	222.1	251.5	248.2	244.8	33.2	62.3	66.5	60.1	62.5	62.7	66.5	59.7	61.8	61.9	65.6	58.9	60.9	61.1	64.7	58.1
Direct Cost, Other	5.3	13.4	12.2	12.2	12.2	3.4	3.3	3.4	3.4	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Guest Pay Operations	35.2	60.2	68.8	67.9	67.0	8.5	17.1	18.2	16.5	17.1	17.2	18.2	16.4	16.9	16.9	18.0	16.1	16.7	16.7	17.7	15.9
Gen./Admin.	29.0	58.8	59.0	56.0	56.0	7.8	17.0	17.0	17.0	16.0	15.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0
EBITDA	92.0	135.3	158.3	158.6	155.8	22.5	37.0	40.5	35.3	38.0	39.2	43.4	37.7	39.4	39.5	42.6	37.0	38.7	38.8	41.8	36.4
Deprec./Amort.	66.3	130.8	145.0	137.0	129.0	16.1	38.8	38.3	37.8	37.0	36.5	36.0	35.5	35.0	34.5	34.0	33.5	33.0	32.5	32.0	31.5
Total Operating Expense	261.3	485.4	536.5	521.4	509.1	68.9	138.4	143.3	134.7	135.6	134.5	137.8	128.7	130.8	130.4	134.6	125.6	127.7	127.4	131.4	122.6
Operating Income	26.9	4.5	13.3	21.6	26.8	6.4	(1.7)	2.3	(2.5)	1.0	2.7	7.4	2.2	4.4	5.0	8.6	3.5	5.7	6.3	9.8	4.9
Interest Expense	(25.7)	(34.8)	(37.8)	(37.4)	(37.0)	(6.2)	(9.5)	(9.5)	(9.5)	(9.5)	(9.5)	(9.4)	(9.4)	(9.4)	(9.4)	(9.3)	(9.3)	(9.3)	(9.3)	(9.2)	(9.2)
Other	1.1	0.6	0.6	0.6	0.6	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Net Income Before Taxes	2.3	(29.7)	(23.9)	(15.2)	(9.6)	0.4	(11.1)	(7.1)	(11.8)	(8.3)	(6.6)	(1.9)	(7.0)	(4.8)	(4.2)	(0.6)	(5.6)	(3.4)	(2.8)	0.7	(4.2)
Taxes	0.3	1.1	1.3	1.3	1.3	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Net Income After Taxes	2.0	(30.8)	(25.2)	(16.5)	(11.0)	0.3	(11.4)	(7.4)	(12.2)	(8.7)	(6.9)	(2.3)	(7.4)	(5.1)	(4.5)	(0.9)	(5.9)	(3.7)	(3.1)	0.4	(4.5)
EPS	0.11	(1.38)	(1.10)	(0.69)	(0.45)	0.01	(0.52)	(0.33)	(0.54)	(0.38)	(0.30)	(0.10)	(0.32)	(0.22)	(0.19)	(0.04)	(0.25)	(0.15)	(0.13)	0.02	(0.18)
S/O	18.5	21.5	23.0	23.2	23.4	19.0	22.1	22.3	22.5	22.7	22.9	23.1	23.3	23.5	23.7	23.9	24.1	24.3	24.5	24.7	24.9

Y-Y chng	2006a	2007e	2008e	2009e	2010e	1Q07a	2Q07e	3Q07e	4Q07e	1Q08e	2Q08e	3Q08e	4Q08e	1Q09e	2Q09e	3Q09e	4Q09e	1Q10e	2Q10e	3Q10e	4Q10e
Video Revenue	3%	62%	12%	-2%	-2%	0%	83%	82%	83%	82%	-1%	-1%	-2%	-2%	-2%	-2%	-2%	-2%	-2%	-2%	-2%
Other Guest Pay Revenue	4%	91%	16%	1%	1%	19%	111%	112%	116%	97%	4%	3%	1%	1%	1%	1%	1%	1%	1%	1%	1%
Total Guest Pay Revenue	4%	69%	13%	-1%	-1%	3%	90%	89%	91%	87%	1%	0%	-1%	-1%	-1%	-1%	-1%	-1%	-1%	-1%	-1%
Core HSIA equip/service	n/a	-5%	3%	0%	0%	0%	0%	-17%	0%	11%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
StayOnline equip/service	n/a	n/a	10%	0%	0%	n/a	n/a	n/a	n/a	53%	2%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Healthcare revenue	n/a	66%	-48%	0%	0%	326%	25%	25%	96%	-38%	-50%	-50%	-50%	0%	0%	0%	0%	0%	0%	0%	0%
Other equipment	n/a	5%	-13%	0%	0%	79%	9%	54%	-48%	-38%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Total Other	34%	102%	-6%	0%	0%	152%	104%	111%	64%	2%	-8%	-9%	-9%	0%	0%	0%	0%	0%	0%	0%	0%
Total Revenue	5%	70%	12%	-1%	-1%	7%	90%	90%	90%	81%	0%	0%	-1%	-1%	-1%	-1%	-1%	-1%	-1%	-1%	-1%
Direct Cost, Guest	6%	75%	13%	-1%	-1%	8%	101%	91%	99%	88%	1%	0%	-1%	-1%	-1%	-1%	-1%	-1%	-1%	-1%	-1%
Direct Cost, Other	31%	152%	-9%	0%	0%	269%	162%	160%	82%	-9%	-8%	-9%	-9%	0%	0%	0%	0%	0%	0%	0%	0%
Guest Pay Operations	0%	71%	14%	-1%	-1%	-3%	88%	104%	94%	100%	1%	0%	-1%	-1%	-1%	-1%	-1%	-1%	-1%	-1%	-1%
Gen./Admin.	14%	103%	0%	-5%	0%	13%	138%	140%	115%	105%	-12%	-18%	-18%	-13%	-7%	0%	0%	0%	0%	0%	0%
EBITDA	0%	47%	17%	0%	-2%	-2%	58%	65%	66%	69%	6%	7%	7%	4%	1%	-2%	-2%	-2%	-2%	-2%	-2%
Deprec./Amort.	-5%	97%	11%	-6%	-6%	-5%	130%	138%	130%	130%	-6%	-6%	-6%	-5%	-5%	-6%	-6%	-6%	-6%	-6%	-6%
Total Operating Expense	3%	86%	11%	-3%	-2%	7%	113%	110%	111%	97%	-3%	-4%	-4%	-4%	-3%	-2%	-2%	-2%	-2%	-2%	-2%
Operating Income	19%	-83%	198%	63%	24%	7%	-125%	-73%	-143%	-84%	-258%	224%	-189%	343%	86%	17%	60%	29%	26%	14%	37%
Interest Expense	-12%	35%	9%	-1%	-1%	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Other	300%	-43%	0%	0%	0%	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Net Income Before Taxes	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Taxes	n/a	276%	21%	0%	0%	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Net Income After Taxes	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

% Total	2006a	2007e	2008e	2009e	2010e	1Q07a	2Q07e	3Q07e	4Q07e	1Q08e	2Q08e	3Q08e	4Q08e	1Q09e	2Q09e	3Q09e	4Q09e	1Q10e	2Q10e	3Q10e	4Q10e
Video Revenue	72.3%	68.9%	68.6%	67.9%	67.3%	69%	69%	70%	68%	69%	68%	69%	68%	68%	67%	69%	67%	68%	67%	68%	67%
Other Guest Pay Revenue	23.8%	26.8%	27.7%	28.3%	28.9%	25%	27%	26%	28%	27%	28%	27%	28%	28%	29%	28%	29%	28%	29%	28%	29%
Total Guest Pay Revenue	96.3%	95.6%	96.3%	96.2%	96.2%	93%	96%	96%	96%	96%	96%	96%	96%	96%	96%	96%	96%	96%	96%	96%	96%
Core HSIA equip/service	1.4%	0.8%	0.7%	0.7%	0.7%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%
StayOnline equip/service	0.0%	1.9%	1.9%	1.9%	1.9%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%
Healthcare revenue	0.8%	0.8%	0.4%	0.4%	0.4%	1%	1%	1%	1%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Other equipment	1.5%	0.9%	0.7%	0.7%	0.7%	2%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%
Total Other	3.7%	4.4%	3.7%	3.8%	3.8%	7%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%
Total Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Direct Cost, Guest	45.6%	47.4%	47.5%	47.5%	47.5%	47%	48%	48%	48%	48%	48%	48%	48%	48%	48%	48%	48%	48%	48%	48%	48%
Direct Cost, Other	49.4%	61.6%	60.0%	60.0%	60.0%	67%	60%	60%	60%	60%	60%	60%	60%	60%	60%	60%	60%	60%	60%	60%	60%
Guest Pay Operations	12.7%	12.9%	13.0%	13.0%	13.0%	12%	13%	13%	13%	13%	13%	13%	13%	13%	13%	13%	13%	13%	13%	13%	13%
Gen./Admin.	10.1%	12.0%	10.7%	10.3%	10.5%	10%	12%	12%	13%	12%	11%	10%	11%	10%	10%	10%	11%	10%	10%	10%	11%
EBITDA	31.9%	27.6%	28.8%	29.2%	29.1%	30%	27%	28%	27%	28%	29%	30%	29%	29%	29%	30%	29%	29%	29%	30%	29%
Deprec./Amort.	23.0%	26.7%	26.4%	25.2%	24.1%	21%	28%	26%	29%	27%	27%	25%	27%	26%	25%	24%	26%	25%	24%	23%	25%
Total Operating Expense	90.7%	99.1%	97.6%	96.0%	95.0%	92%	101%	98%	102%	99%	98%	95%	98%	97%	96%	94%	97%	96%	95%	93%	96%
Operating Income	9.3%	0.9%	2.4%	4.0%	5.0%	8%	-1%	2%	-2%	1%	2%	5%	2%	3%	4%	6%	3%	4%	5%	7%	4%
Interest Expense	-8.9%	-7.1%	-6.9%	-6.9%	-6.9%	-8%	-7%	-7%	-7%	-7%	-7%	-7%	-7%	-7%	-7%	-7%	-7%	-7%	-7%	-7%	-7%
Other	0.4%	0.1%	0.1%	0.1%	0.1%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Net Income Before Taxes	0.8%	-6.1%	-4.3%	-2.8%	-1.8%	0%	-8%	-5%	-9%	-6%	-5%	-1%	-5%	-4%	-3%	0%	-4%	-3%	-2%	1%	-3%
Taxes	0.1%	0.2%	0.2%	0.2%	0.2%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Net Income After Taxes	0.7%	-6.3%	-4.6%	-3.0%	-2.0%	0%	-8%	-5%	-9%	-6%	-5%	-2%	-6%	-4%	-3%	-1%	-5%	-3%	-2%	0%	-4%