

TIME WARNER CABLE INC.

Form 10-Q

October 27, 2011

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## UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

### Form 10-Q

☐ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended September 30, 2011 or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-33335

## TIME WARNER CABLE INC.

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of  
incorporation or organization)*

**84-1496755**

*(I.R.S. Employer  
Identification No.)*

**60 Columbus Circle**

**New York, New York 10023**

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*(Address of principal executive offices) (Zip Code)*

**(212) 364-8200**

*(Registrant's telephone number, including area code)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

## Shares Outstanding

### Description of Class

Common Stock \$0.01 par value

### as of October 25, 2011

319,111,613

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**TIME WARNER CABLE INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS**

**OF OPERATIONS AND FINANCIAL CONDITION**

**INTRODUCTION**

Management's discussion and analysis of results of operations and financial condition ( MD&A ) is a supplement to the accompanying consolidated financial statements and provides additional information on Time Warner Cable Inc.'s (together with its subsidiaries, TWC or the Company ) business, recent developments, financial condition, cash flows and results of operations. MD&A is organized as follows:

*Overview.* This section provides a general description of TWC's business, as well as recent developments the Company believes are important in understanding the results of operations and financial condition or in understanding anticipated future trends.

*Financial statement presentation.* This section provides a summary of how the Company's operations are presented in the accompanying consolidated financial statements.

*Results of operations.* This section provides an analysis of the Company's results of operations for the three and nine months ended September 30, 2011.

*Financial condition and liquidity.* This section provides an analysis of the Company's financial condition as of September 30, 2011 and cash flows for the nine months ended September 30, 2011.

*Caution concerning forward-looking statements.* This section provides a description of the use of forward-looking information appearing in this report, including in MD&A and the consolidated financial statements. Such information is based on management's current expectations about future events, which are susceptible to uncertainty and changes in circumstances. Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2010 (the 2010 Form 10-K ) for a discussion of the risk factors applicable to the Company.

**OVERVIEW**

TWC is among the largest providers of video, high-speed data and voice services in the U.S., with technologically advanced, well-clustered cable systems located mainly in five geographic areas—New York State (including New York City), the Carolinas, Ohio, Southern California (including Los Angeles) and Texas. As of September 30, 2011, TWC served approximately 14.4 million residential and business services customers who subscribed to one or more of its three primary services, totaling approximately 26.9 million primary service units.

TWC offers its residential and business services customers video, high-speed data and voice services over its broadband cable systems. TWC's business services also include networking and transport services and, through its wholly owned subsidiary, NaviSite, Inc. ( NaviSite ) (discussed further in Recent Developments ), managed and outsourced information technology ( IT ) solutions and cloud services. During the nine months ended September 30, 2011, TWC generated total revenues of approximately \$14.7 billion. Of this total, approximately \$12.8 billion and \$1.1 billion were from the provision of residential and business services, respectively. TWC also sells advertising to a variety of national, regional and local advertising customers, resulting in advertising revenues of \$638 million during the nine months ended September 30, 2011. Additionally, TWC generated \$175 million of revenues from other sources during the nine months ended September 30, 2011.

As of September 30, 2011, TWC had approximately 11.9 million residential video subscribers, 9.8 million residential high-speed data subscribers and 4.5 million residential voice subscribers, as well as approximately 170,000 business video subscribers, 375,000 business high-speed data subscribers and 149,000 business voice subscribers. TWC markets its services separately and in bundled packages of multiple services and features. As of September 30, 2011, 60.0% of TWC's customers subscribed to two or more of its primary services, including 26.2%

of its customers who subscribed to all three primary services.

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TWC believes it will continue to increase residential services revenues for the foreseeable future through growth in residential high-speed data and voice subscribers, an increasing percentage of residential high-speed data subscribers purchasing higher-priced tiers of service, price increases, the offering of incremental video services (e.g., digital video recorder (DVR) service and additional programming tiers) and an increase in video equipment rentals, partially offset by a decline in residential video subscribers. Additionally, TWC believes it will continue to increase its business services revenues for the foreseeable future through growth in business services subscribers, an increasing percentage of business services subscribers purchasing higher-priced tiers of service, price increases, an increase in wholesale transport revenues and the offering of incremental services to business services customers, including the services offered by NaviSite. However, future growth rates for both residential and business services revenues will depend on the Company's ability to retain and attract subscribers and increase pricing, which can be impacted by competition, the state of the economy and regulation.

TWC's operations have been affected by the challenging economic environment. The Company believes that trends in new home formation, housing vacancy rates, unemployment rates and consumer spending levels have negatively affected its residential services subscriber, revenue and profit growth.

TWC faces intense competition for residential services customers from a variety of alternative communications, information and entertainment delivery sources. TWC competes with incumbent local telephone companies, including AT&T Inc. and Verizon Communications Inc., across each of its primary residential services. Some of these telephone companies offer a broad range of services with features and functions comparable to those provided by TWC and in bundles similar to those offered by TWC, sometimes including wireless service. Each of TWC's residential services also faces competition from other companies that provide services on a stand-alone basis. TWC's residential video service faces competition from direct broadcast satellite services, and increasingly from companies that deliver content to consumers over the Internet. TWC's residential high-speed data service faces competition from wireless internet providers, and competition in residential voice service is increasing as more homes in the U.S. are replacing their wireline telephone service with wireless service, over-the-top phone service or other alternatives.

TWC also competes with incumbent local exchange carriers, or ILECs, and competitive local exchange carriers, or CLECs, across each of its business high-speed data, networking and voice services. TWC's business video service faces competition from direct broadcast satellite providers. TWC's cell tower backhaul service also faces competition from ILECs and CLECs, as well as other carriers, such as metro and regional fiber providers. Technological advances and product innovations have increased and will likely continue to increase the number of alternatives available to TWC's current and potential residential and business services customers, further intensifying competition. The Company believes the more competitive environment has negatively affected its residential and business services subscriber, revenue and profit growth.

TWC faces intense competition in its advertising business across many different platforms and from a wide range of local and national competitors. Competition has increased and will likely continue to increase as new formats for advertising seek to attract the same advertisers. Depending on the advertiser in question, TWC competes for advertising revenues against, among others, local broadcast stations, national cable and broadcast networks, radio, newspapers, magazines and outdoor advertisers, as well as Internet companies, both those that operate nationally and those seeking to expand into local media.

For the nine months ended September 30, 2011, video programming and employee costs represented 34.9% and 32.8%, respectively, of the Company's total operating expenses. Video programming costs are expected to continue to increase, reflecting rate increases on existing programming services, growth in video subscribers taking tiers of service with more channels and the expansion of service offerings (e.g., new network channels), partially offset by a decline in total video subscribers. TWC expects that its video programming costs as a percentage of video revenues will continue to increase as the rate of growth in programming costs outpaces the rate of growth in video revenues. Additionally, the more competitive environment discussed above may increase TWC's cost to obtain certain video programming. Employee costs are also expected to continue to increase as a result of many factors, including higher compensation expenses and headcount, reflecting the Company's investment in business services and other areas of growth.



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**OF OPERATIONS AND FINANCIAL CONDITION (Continued)**

**Recent Developments**

***Cable System Acquisitions***

On August 15, 2011, TWC entered into an agreement (the *Merger Agreement*) with Insight Communications Company, Inc. (*Insight*) and a representative of its stockholders to acquire Insight and its subsidiaries, which operate cable systems in Kentucky, Indiana and Ohio that served approximately 1.5 million primary service units as of the date of the *Merger Agreement*. Insight reported revenues of approximately \$1.1 billion for the year ended December 31, 2010. Pursuant to the *Merger Agreement*, a subsidiary of TWC will merge with and into Insight, with Insight surviving as a direct wholly owned subsidiary of the Company. TWC agreed to pay \$3.0 billion in cash for Insight, as reduced by Insight's indebtedness for borrowed money and similar obligations (including amounts outstanding under Insight's credit agreement and senior notes due 2018, which totaled approximately \$1.8 billion as of the date of the *Merger Agreement*) and subject to customary adjustments, including a reduction to the extent the number of Insight's video subscribers at the closing is less than an agreed upon threshold, as well as a working capital adjustment. The transaction, which is expected to close in the first half of 2012, is subject to various customary closing conditions, including (i) receipt of Federal Communications Commission approvals and the consent of certain state and local franchising authorities to the change in ownership of the cable systems operated by Insight and (ii) the number of video subscribers served by Insight's cable systems as of a specified date prior to the closing exceeding an agreed upon threshold. During the third quarter of 2011, the Federal Trade Commission's review of the proposed merger concluded with the early termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. There can be no assurances that the conditions to closing the transaction will be satisfied or waived, that the transaction will be completed or that the anticipated cost savings and other financial and operating benefits of the transaction will be fully realized or realized within the anticipated time frame. See Note 4 to the accompanying consolidated financial statements for additional information on the Insight acquisition.

On June 13, 2011, TWC entered into an agreement with NewWave Communications (*NewWave*) to acquire certain cable systems in Kentucky and western Tennessee serving roughly 130,000 primary service units for approximately \$260 million in cash. The transaction, which is subject to certain regulatory approvals and customary closing conditions, is expected to close in the fourth quarter of 2011.

***2011 Bond Offerings***

On May 26, 2011, TWC issued £625 million (approximately \$1.0 billion) in aggregate principal amount of 5.75% senior unsecured notes due 2031 in a public offering under a shelf registration statement on Form S-3 (the *May 2011 Bond Offering*). As described further in Note 7, the Company has entered into cross-currency swap arrangements to convert its fixed-rate British pound sterling denominated debt, including annual interest payments and the payment of principal at maturity, to fixed-rate U.S. dollar denominated debt.

On September 12, 2011, TWC issued \$2.250 billion in aggregate principal amount of senior unsecured notes and debentures in a public offering under a shelf registration statement on Form S-3 (the *September 2011 Bond Offering* and, collectively with the *May 2011 Bond Offering*, the *2011 Bond Offerings*). The *September 2011 Bond Offering* consisted of \$1.0 billion principal amount of 4.0% notes due 2021 and \$1.250 billion principal amount of 5.5% debentures due 2041.

TWC's obligations under the debt securities issued in the *2011 Bond Offerings* are guaranteed by its subsidiaries, Time Warner Entertainment Company, L.P. (*TWE*) and TW NY Cable Holding Inc. The Company expects to use the net proceeds from the *2011 Bond Offerings* for general corporate purposes, which may include the repayment of debt. See Note 6 to the accompanying consolidated financial statements for further details regarding the debt securities issued in the *2011 Bond Offerings*.

***NaviSite Acquisition***

On April 21, 2011, TWC completed its acquisition of NaviSite for \$263 million, net of cash acquired. At closing, TWC also repaid \$44 million of NaviSite's debt. NaviSite's financial results have been included in the Company's consolidated financial statements from the acquisition date. See Note 4 to the accompanying consolidated financial statements for additional information on the NaviSite acquisition.





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***Common Stock Repurchase Program***

On October 29, 2010, TWC's Board of Directors authorized a \$4.0 billion common stock repurchase program (the "Stock Repurchase Program"). Purchases under the Stock Repurchase Program may be made from time to time on the open market and in privately negotiated transactions. The size and timing of the Company's purchases under the Stock Repurchase Program are based on a number of factors, including price, as well as business and market conditions. From the inception of the Stock Repurchase Program through October 25, 2011, the Company repurchased 41.0 million shares of TWC common stock for \$2.882 billion. As of October 25, 2011, the Company had \$1.118 billion remaining under the Stock Repurchase Program.

**FINANCIAL STATEMENT PRESENTATION**

**Revenues**

During the second quarter of 2011, the Company revised its presentation of revenues to provide additional detail about the Company's sources of revenues, which had no impact on total revenues for any period presented. The Company's revenues consist of residential services, business services, advertising and other revenues.

***Residential services.*** Residential services revenues consist of revenues from the following residential services:

***Video.*** Video revenues include residential subscriber fees for the Company's three main levels or tiers of video programming service: Basic Service Tier ("BST"), Expanded Basic Service Tier (or Cable Programming Service Tier) ("CPST") and Digital Basic Service Tier ("DBT"), as well as fees for genre-based programming tiers, such as movie, sports and Spanish-language tiers. Video revenues also include related equipment rental charges, installation charges and fees collected on behalf of local franchising authorities and the Federal Communications Commission (the "FCC"). Additionally, video revenues include revenues from premium channels, transactional video-on-demand (e.g., events and movies) and DVR service.

***High-speed data.*** High-speed data revenues primarily include residential subscriber fees for the Company's high-speed data services and installation charges. The Company offers multiple tiers of high-speed data services providing various service speeds and other attributes to meet the different needs of its subscribers. In addition, high-speed data revenues include fees received from third-party internet service providers (e.g., Earthlink) whose on-line services are provided to some of TWC's customers.

***Voice.*** Voice revenues include subscriber fees from residential voice subscribers, along with related installation charges, as well as fees collected on behalf of governmental authorities.

***Other.*** Other revenues include revenues from home monitoring and security services and other residential subscriber-related fees.

***Business services.*** Business services revenues consist of revenues from the following business services:

***Video.*** Video revenues include the same categories described above under residential video revenues for fees received from business video subscribers.

***High-speed data.*** High-speed data revenues primarily include business subscriber fees for the Company's high-speed data service and installation charges. High-speed data revenues also include amounts generated by the sale of commercial networking and point-to-point transport services, such as Metro Ethernet services.

***Voice.*** Voice revenues include subscriber fees from business voice subscribers, along with related installation charges, as well as fees collected on behalf of governmental authorities.

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*Wholesale transport.* Wholesale transport revenues primarily include amounts generated by the sale of point-to-point transport services offered to wireless telephone providers (i.e., cell tower backhaul) and competitive carriers.

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*Other.* Other revenues primarily include revenues from managed and outsourced IT solutions and cloud services provided by NaviSite, revenues from business monitoring and security services and other business subscriber-related fees.

*Advertising.* Advertising revenues include the fees charged to local, regional and national advertising customers for advertising placed on the Company's video and high-speed data services, as well as revenues from advertising inventory sold on behalf of other video distributors. Currently, most advertising revenues are derived from advertising placed on video services, but the Company expects a growing percentage of advertising revenues will be derived from non-video sources in the future.

*Other.* Other revenues primarily include (a) fees paid to TWC by (i) the Advance/Newhouse Partnership for the ability to distribute TWC's Road Runner® high-speed data service ( Road Runner ) and TWC's management of certain functions for the Advance/Newhouse Partnership, including, among others, programming and engineering, and (ii) other distributors of Road Runner, and (b) commissions earned on the sale of merchandise by home shopping networks.

**Costs and Expenses**

Costs of revenues include the following costs directly associated with the delivery of services to subscribers or the maintenance of the Company's delivery systems: video programming costs; high-speed data connectivity costs (including mobile high-speed data service costs); voice network costs; other service-related expenses, including non-administrative labor; franchise fees; and other related costs.

Selling, general and administrative expenses include amounts not directly associated with the delivery of services to subscribers or the maintenance of the Company's delivery systems, such as administrative labor costs, marketing expenses, bad debt expense, billing system charges, non-plant repair and maintenance costs and other administrative overhead costs.

Costs of revenues and selling, general and administrative expenses exclude depreciation expense, which is presented separately in the accompanying consolidated statement of operations.

**Use of Operating Income before Depreciation and Amortization and Free Cash Flow**

In discussing its performance, the Company may use certain measures that are not calculated and presented in accordance with U.S. generally accepted accounting principles ( GAAP ). These measures include OIBDA and Free Cash Flow, which the Company defines as follows:

*OIBDA (Operating Income before Depreciation and Amortization)* means Operating Income before depreciation of tangible assets and amortization of intangible assets.

*Free Cash Flow* means cash provided by operating activities (as defined under GAAP) excluding the impact, if any, of cash provided or used by discontinued operations, plus any excess tax benefit from equity-based compensation, less (i) capital expenditures, (ii) cash paid for other intangible assets (excluding those associated with business combinations), (iii) partnership distributions to third parties and (iv) principal payments on capital leases.

Management uses OIBDA, among other measures, in evaluating the performance of the Company's business because it eliminates the effects of (1) considerable amounts of noncash depreciation and amortization and (2) items not within the control of the Company's operations managers (such as net income attributable to noncontrolling interests, income tax provision, other income (expense), net, and interest expense, net). Management believes that Free Cash Flow is an important indicator of the Company's ability to generate cash, reduce net debt, pay dividends, repurchase common stock and make strategic investments, after the payment of cash taxes, interest and other cash items. Performance measures derived from OIBDA are also used in the Company's annual incentive compensation programs. In addition, both of these measures are

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commonly used by analysts, investors and others in evaluating the Company's performance and liquidity.

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These measures have inherent limitations. For example, OIBDA does not reflect capital expenditures or the periodic costs of certain capitalized assets used in generating revenues. To compensate for such limitations, management evaluates performance through, among other measures, Free Cash Flow, which reflects capital expenditure decisions, and net income attributable to TWC shareholders, which reflects the periodic costs of capitalized assets. OIBDA also fails to reflect the significant costs borne by the Company for income taxes and debt servicing costs, the share of OIBDA attributable to noncontrolling interests, the results of the Company's equity investments and other non-operational income or expense. Management compensates for these limitations by using other analytics such as a review of net income attributable to TWC shareholders. Free Cash Flow, a liquidity measure, does not reflect payments made in connection with investments and acquisitions, which reduce liquidity. To compensate for this limitation, management evaluates such investments and acquisitions through other measures such as return on investment analyses.

These non-GAAP measures should be considered in addition to, not as substitutes for, the Company's Operating Income, net income attributable to TWC shareholders and various cash flow measures (e.g., cash provided by operating activities), as well as other measures of financial performance and liquidity reported in accordance with GAAP, and may not be comparable to similarly titled measures used by other companies.

**Basis of Presentation****Reclassifications**

Certain reclassifications have been made to the prior year financial information to conform to the current year presentation, primarily including, as previously noted, the revised presentation of the Company's revenues during the second quarter of 2011. This reclassification had no impact on the Company's total revenues for the three and nine months ended September 30, 2010. Additionally, the Company reclassified certain sales-related customer care costs from costs of revenues to selling, general and administrative expenses. This reclassification had no impact on the Company's Operating Income or net income attributable to TWC shareholders for the three and nine months ended September 30, 2010.

**Recent Accounting Standards**

See Note 2 to the accompanying consolidated financial statements for accounting standards adopted in 2011 and recently issued accounting standards not yet adopted.

**RESULTS OF OPERATIONS****Three and Nine Months Ended September 30, 2011 Compared to Three and Nine Months Ended September 30, 2010**

The following discussion provides an analysis of the Company's results of operations and should be read in conjunction with the accompanying consolidated statement of operations, as well as the consolidated financial statements and notes thereto and MD&A included in the 2010 Form 10-K.

**Revenues.** Revenues by major category were as follows (in millions):

	Three Months Ended			Nine Months Ended		
	September 30,		% Change	September 30,		% Change
	2011	2010		2011	2010	
Residential services	\$ 4,250	\$ 4,167	2.0%	\$ 12,809	\$ 12,476	2.7%
Business services	387	287	34.8%	1,060	809	31.0%
Advertising	216	223	(3.1%)	638	612	4.2%

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Other		58	57	1.8%	175	170	2.9%
Total		\$ 4,911	\$ 4,734	3.7%	\$ 14,682	\$ 14,067	4.4%

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Selected subscriber-related statistics were as follows (in thousands):

	<b>September 30,</b>		
	<b>2011</b>	<b>2010</b>	<b>% Change</b>
<b>Residential services:</b>			
Video <sup>(a)(b)</sup>	11,939	12,386	(3.6%)
High-speed data <sup>(b)(c)(d)</sup>	9,792	9,386	4.3%
Voice <sup>(d)(e)</sup>	4,481	4,324	3.6%
<b>Primary service units<sup>(b)(f)</sup></b>	<b>26,212</b>	<b>26,096</b>	<b>0.4%</b>
<b>Business services:</b>			
Video <sup>(a)</sup>	170	165	3.0%
High-speed data <sup>(c)(d)</sup>	375	324	15.7%
Voice <sup>(d)(e)</sup>	149	102	46.1%
<b>Primary service units<sup>(f)</sup></b>	<b>694</b>	<b>591</b>	<b>17.4%</b>
<b>Total primary service units<sup>(b)(f)</sup></b>	<b>26,906</b>	<b>26,687</b>	<b>0.8%</b>
<b>Customer relationships<sup>(b)(g)</sup></b>	<b>14,446</b>	<b>14,438</b>	<b>0.1%</b>
Double play <sup>(b)(h)</sup>	4,881	4,904	(0.5%)
Triple play <sup>(i)</sup>	3,789	3,672	3.2%

(a) Video subscriber numbers reflect billable subscribers who purchase at least the BST video programming tier. The determination of whether a video subscriber is categorized as residential or business is based on the type of subscriber purchasing the service.

(b) During the second quarter of 2011, the Company acquired cable systems, resulting in an increase of 6,000 residential video subscribers, 3,000 residential high-speed data subscribers, 9,000 residential and total primary service units, 6,000 customer relationships and 3,000 double play subscribers. The acquired subscribers are reflected in the Company's subscriber numbers as of September 30, 2011.

(c) High-speed data subscriber numbers reflect billable subscribers who purchase any of the high-speed data services offered by TWC. High-speed data subscriber numbers do not include 27,000 and 10,000 mobile high-speed data subscribers as of September 30, 2011 and 2010, respectively.

(d) The determination of whether a high-speed data or voice subscriber is categorized as residential or business is generally based upon the type of service provided to that subscriber. For example, if TWC provides a business service, the subscriber is classified as business.

(e) Voice subscriber numbers reflect billable subscribers who purchase an IP-based telephony service.

(f) Primary service unit numbers represent the sum of video, high-speed data and voice subscribers.

(g) Customer relationships represent the number of subscribers who purchase at least one of the Company's primary services. For example, a subscriber who purchases only high-speed data service and no video service will count as one customer relationship, and a subscriber who purchases both video and high-speed data services will also count as only one customer relationship.

(h) Double play subscriber numbers reflect customers who subscribe to two of the Company's primary services.

(i) Triple play subscriber numbers reflect customers who subscribe to all three of the Company's primary services.

*Residential services revenues.* The major components of residential services revenues were as follows (in millions):

**Three Months Ended  
September 30,**

**Nine Months Ended  
September 30,**



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	2011	2010	% Change	2011	2010	% Change
<b>Residential services:</b>						
Video	\$ 2,624	\$ 2,638	(0.5%)	\$ 7,961	\$ 7,954	0.1%
High-speed data	1,119	1,038	7.8%	3,328	3,064	8.6%
Voice	494	479	3.1%	1,484	1,422	4.4%
Other	13	12	8.3%	36	36	
<b>Total residential services</b>	<b>\$ 4,250</b>	<b>\$ 4,167</b>	<b>2.0%</b>	<b>\$ 12,809</b>	<b>\$ 12,476</b>	<b>2.7%</b>

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