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MEMORANDUM

TO: Dianne Stoddard, Assistant City Manager

FROM: Tony Schertler, Senior Vice President
Julian Bradshaw, Analyst

DATE: October 4, 2013

SUBJECT: Community Wireless Communications Corporation. – Financial Review

Summary

At the request of the City of Lawrence, Springsted has undertaken a financial review of Community Wireless Communications Corporation (Wicked Broadband). According to the company, Community Wireless Communications is a high speed internet provider whose goal is to provide broadband wireless to rural and urban cities throughout Kansas. It is our understanding that Community Wireless Communications plans to create a fiber optic internet network in the City of Lawrence to facilitate the expansion of its customer base and strategically position itself for future growth in this type of service. Community Wireless Communications is requesting financial assistance with the first stage of this expansion (the pilot project) which would include installation of fiber to 1,000 homes. As a part of the financial request the applicant has also requested the ability to perform future splicing work for the City and the waiver of the first $20,000 in franchise fees each year for the next five years retroactive to the third quarter of 2012.

Springsted has reviewed the following materials with regard to the above referenced project:

- Balance sheets & Income statements for 2010, 2011 and 2012
- Tax Returns for 2010, 2011 and 2012
- Financial Projections for 2013 - 2017
- Dun & Bradstreet Report

Analysis

The applicant has proposed that the City provide the following financial incentives to support expansion in Lawrence, KS:

- Grant
  Amount - $500,000
  Performance metrics – Unknown

Please reference application from May 9, 2013 for detailed incentive requests concerning the following:

- Franchise Fee Waiver
- Splicing Permissions
- Buffer Tube Lease Conditions

Financial Analysis Approach

Community Wireless Communications provided Springsted with financials including balance sheets and income statements for the years 2010 – 2012 and projections for the years 2013 – 2017. Financial statements provided by Community Wireless are reported using a calendar year ending on December 31. The company also provided partial statements (through the second quarter of 2013) for the current calendar year. Springsted has compiled this information into a financial overview. Springsted is not offering an opinion on the applicant's intent to proceed with the project or honor any commitment made to the City of Lawrence. The following is meant to provide a snap shot of the above referenced financial information and in combination with the Dun & Bradstreet report should be used as one tool to enable the City to form an opinion as to the applicant's financial health.

Earnings Before Interest, Taxes, Depreciation and Amortization (EBIDTA)

Community Wireless Communications manages its operations based upon EBIDTA (Earnings Before Interest, Taxes, Depreciation and Amortization) accounting methodology. EBIDTA is a non GAAP (Generally Accepted Accounting Principles) method of showing profits with the above mentioned expenses stripped out. For this reason EBIDTA statements show higher profits than GAAP statements. EBIDTA is often used as a quick and general measure of a company's ability to service debt. Although EBIDTA can be useful, we have utilized GAAP compliant financial statements to calculate ratios and percentages in our report.

Cash and Cash Equivalents:

Cash and cash equivalents are the most liquid assets represented on a company's balance sheet. Liquidity refers to an assets availability to be converted into cash to pay current debts. Changes in a company's cash reserves should not be utilized exclusively as an indicator of financial strength.

Community Wireless keeps very little cash on hand as a percentage of their gross sales. While the company has reduced their cash position from 2010 to 2012, it is showing positive cash growth in the first half of 2013.

Gross Profit:

Gross profit is net sales less costs of goods sold. Cost of goods sold is the cost of the productive input to manufacture and distribute a product. Gross profit is a snap shot of a company's revenue stream and is indicative of the efficiency and profitably of generating a product line.

Community Wireless's gross profit dropped 6% from 2010 to 2012. This decrease in gross profit is due to an increase in costs of goods sold not a decline in fees or services. Income from fees and services increased approximately 9% over the time period while cost of goods sold increased by approximately 137%.

Net Income:

Net income is total revenues less total expenses. Fluctuations in net income occur when revenues increase/decrease or operational expenses increase/decrease or a combination of both. Evaluating the changes in net income is an important factor in determining the financial health of a company.

Community Wireless has negative net income. Although net income has remained negative it has shown positive growth over the past three years. Net income increased 89% from 2010 to 2012. Over this time span Community Wireless is showing a 9% growth in revenues while expenses decreased by 27%.

Shareholders' Equity:

Shareholders equity is calculated by taking total assets less total liabilities. This measure is sometimes referred to as net worth and is comprised of retained earnings (the company's accumulated earnings over time) and investments into the company.

Community Wireless is showing negative total equity for all reported years (2010-2012). Community Wireless's total equity dropped 347% from 2010 to 2012. The negative is being generated from a significant negative retained earnings entry on the balance sheet in addition to negative net income. Retained earnings have decreased approximately 37% from 2010-2012. The applicant contends that this large negative retained earnings entry can be partially explained by legacy costs and recession.

Current Ratio:

Current Ratio can be a measure of a company's ability to pay short term debt. In general, a higher current ratio is the preferred result. A current ratio below one could be a sign that a company may have trouble paying its current debts and is generally a negative indicator of financial health. The current ratio should not solely be used to assess financial health.

The ratio of approximately 0.07 for Community Wireless indicates that for approximately every dollar of current liabilities, they have approximately 0.07 dollars of current assets. This ratio is below the industry median of 2.2 (Industry median provided by Dun & Bradstreet and includes 12 firms that they deem comparable).

Quick Ratio:

Quick Ratio can be a measure of a company's ability to pay short term debt with its most liquid assets. Like the current ratio, a higher quick ratio is generally the preferred result. The ratio is indicative of a company's ability to utilize its liquid assets to meet its current debt obligations. The quick ratio should not solely be used to assess financial health.

Community Wireless is showing an approximate quick ratio of 0.07, meaning they have 0.07 dollars of liquid assets for each dollar of current liabilities. This ratio is below the industry median of 1.6 (Industry median provided by Dun & Bradstreet and includes 12 firms that they deem comparable).

Debt Ratio:

Debt Ratio is a measure of a company's debt load relative to its assets. The debt ratio can be an indicator of the level of financial leverage a company has endured. Unlike the current and quick ratios, a debt ratio below one is the generally preferred result. A debt ratio below one indicates that a company has more assets than debt.

The ratio of approximately 5.48 for Community Wireless indicates that for approximately every dollar in assets they have just over five dollars in liabilities (Industry median unavailable for this ratio).

Ratio Table:

Financial Ratios			
	2010	**2011**	**2012**
Current Ratio	0.41	0.8	0.7
Quick Ratio	0.41	0.8	0.7
Debt Ratio	1.45	6.14	5.48

*The Debt Ratio change was in part caused by increased long term debt and payroll liabilities, in addition to a decrease in accounts receivable and total fixed assets (mainly infrastructure depreciation) from 2010 to 2012.

Assumptions for Financial Projections

The applicant has provided revenue projections for the next five years. Springsted ***has not*** evaluated the reasonableness of any projection submitted by the applicant and makes no conclusion or recommendation.

In preparing projections the applicant utilized the following assumptions (taken directly from applicant's financial information submission):

2013

Sales have been extrapolated based on current sales growth. Expenses have been included based on estimated expenses where known and are extrapolated based on Q4 results where estimates are not available.

2014

Sales estimates are based on 2012 - 2013 Year to year growth.
The new fiber network will be depreciated on a 24 year term. Electronics for the project will be depreciated on a 5 year term. Bank financing is expected to be obtained on a 10 year amortization with a 5 year term. Interest rates are expected to be 5%. Market penetration is expected to be 10% in year 1 (2014) expanding to 30% by year 2.

2015

The company plans to capitalize on the success of the initial pilot project by expanding to another 10,000 households. Expansion will be funded through a private equity round. As part of this round, the company plans to re-capitalize existing debt. Expansion into this many households is expected to take 2 years.

2016

Equity financed expansion continues. Market penetration in target neighborhoods is assumed to reach 10% in year 1 of the expansion (2015) and 30% by the end of year 2.

2017

Final completion of the Lawrence network is expected to be financed through a $20M debt offering. Construction of the remainder of the network is expected to take between 2 and 3 years.

Summary of Financial Projections

Community Wireless Communications has provided financial projections for the time period 2013 through 2017.

- Community Wireless projects that Cash will increase by approximately 4000% from 2013 to 2017. (Note the current cash position is low).
- Community Wireless projects that Net Income will increase 7000% from 2013 to 2017. (Note that net income is currently low).
- Community Wireless projects that the Gross Profit will increase 657% from 2013 to 2017
- Community Wireless projects that Total Equity will increase significantly from 2013 to 2017. An approximate 14 million dollar increase.
- Community Wireless projects that the Debt Ratio will drop from 5.26 in 2013 to 0.001 in 2017.
- Community Wireless projects that the Quick and Current Ratios will increase from 0.07 in 2013 to 7.21 in 2017.

Summary of Dun & Bradstreet Report

Dun & Bradstreet is a provider of corporate credit reports and ratings. Information is a combination of public records, third parties and self-reporting. We have utilized Dun & Bradstreet's credit report based on the company's established track record of providing this type of business credit information.

D&B Rating: --

The Dun & Bradstreet report provides a D&B rating of the company, which in this case is --. The rating is meant to be reflective of both the financial strength of the company, and Dun & Bradstreet's composite credit appraisal of the company. A blank rating only indicates that the information available does not permit D&B to classify the company within its rating key. A rating of – can be assigned for any of the following reasons: deficit net worth, bankruptcy proceedings, insufficient payment information, or incomplete history information.

D&B Commercial Credit Score: 548 (101 – 670)
D&B Credit Score Class: 2

The commercial credit score predicts the likelihood that a company will pay its bills in a severely delinquent manner (90 days or more past terms), obtain legal relief from creditors or cease operations without paying all creditors in full over the next 12 months. D&B commercial credit scores range from 101 (highest risk) and 670 (lowest risk).

Community Wireless Communications score of 548 places it in the credit score percentile of 79 (while the industry median is 32) and a credit score class of 2 (Ranges from 1-5 with 1 being low incidence of delinquent payment and 5 being high incidence of delinquent payment). The credit score class of 2 indicates the "likelihood this company will not pay on time over the next 12 months" is "low". According to D&B companies within the credit score class of 2 have a delinquency rate of 2.5%.

<u>D&B Financial Stress Score:</u> 1540 (1001 – 1875)
<u>D&B Financial Stress Class:</u> 2

The D&B Financial Stress Class measures the "likelihood this company will experience financial stress in the next 12 months" as "low" with a stress class rating of 2 on their scale of 1-5. According to D&B a financially stressed company is defined as one that: "Ceased operations following bankruptcy or assignment, ceased operations with loss to creditors, voluntarily withdrew from business operations leaving unpaid obligations, is in receivership or reorganization." The financial stress class of 2 "indicates that this firm shares some of the same business and financial characteristics of other companies within this classification. It does not mean the firm will necessarily experience financial stress." Community Wireless Communications financial stress score of 1540 corresponds to a financial stress percentile of 84 (industry median 43), which according to D&B equates to a probability of failure of 0.09%.

<u>D&B Paydex Score:</u> 80 (1 – 100)

The D&B Paydex scale measures the company's average payment trend when weighted by dollar amount. Scores range from 1 – 100, higher scores equate to better payment performance.

The score of 80 is equal to generally within terms, and per the D&B industry benchmark is considered average for the industry (average score: 80)There are 7 total payment experiences on file with 100% of those payments made within terms and 0 placed in collections.

<u>Additional D&B Findings:</u>

- UCC Filings: 6
- No evidence of bankruptcy
- 0 - Judgments
- 1 – Liens – Federal Tax
- 0 - Suit

Liens and other litigation

According to the applicant federal taxes have been paid and liens have been released. According to the applicant the company "has no litigation ongoing".

Risk Mitigation Recommendations

Should the City agree to provide the $500,000 requested by Wicked Fiber, Springsted recommends the following mitigation strategies to ensure that the project is completed and the service expansions occur as planned:

- Funds will be available when the applicant has closed on the loan with Emprise Bank for 50% of the project costs.
- The financing should be structured as a full recourse loan forgivable upon satisfaction of the public purpose outcomes. The loan would have an interest rate of prime + 1 and a term of ten years.
- The City would want to negotiate certain benchmarks that the applicant needs to achieve in order to earn a complete or partial waiver.
- Since the funds will be drawn down as needed during construction, the benchmarks should be projected operating and performance measures.

The applicant states that the project will be implemented in two phases listed in the bullet points below:

- Pilot project – the pilot project will provide service to around 1,000 homes in a specific area. Four fibers will be pulled and terminated at each customer's residence. Total calendar time for this project is expected to be 9 to 12 months.

- Equity Expansion – in 2014 and 2015 the company will pursue an equity investment on the order of $10M to expand the pilot project to an additional 10,000 homes. This expansion is expected to take two years to implement.

- Debt Expansion – As part of the equity round, the company will secure follow-on funding to complete the network. This funding will likely take the form of $20M in bonds. This project is also expected to take two years to implement. At the end of this project, we will have fiber installed or available to all of the households in the community.

The City could forgive a portion of the loan upon satisfaction of the first phase of providing service to 1,000 homes in the selected area. The City would then forgive the balance of the loan upon satisfaction of the second phase, the equity expansion of $10M and the addition of 10,000 homes to the system. To the extent that there are delays in meeting the deadlines, loan would remain in place and interest would accrue.