
Strategic Performance Measures for Telcos



Presented by:

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What's the Need

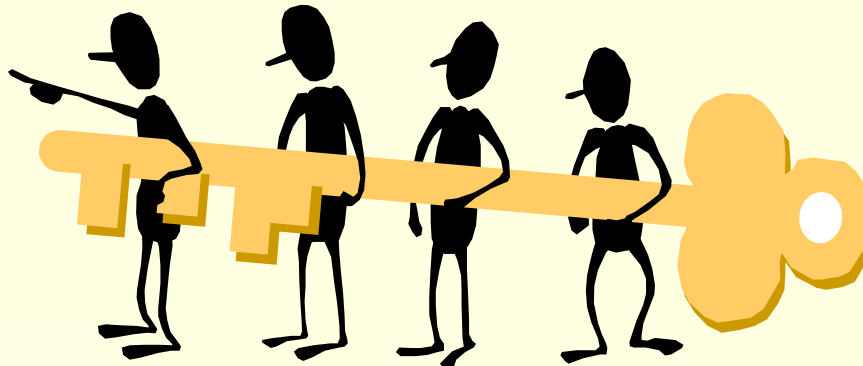
- Shrinking support mechanisms
- Competition
- Lower margin activities
- Tough economic times
- Strategic thinking and planning for the future

Tools to Analyze Financial Data

- Trend Analysis
- Comparison to Benchmarks/Industry Averages
- Analyze Business Units/Segments/Product Lines
- Monitor Ratios
- Forecasting

Tools to Analyze Financial Data

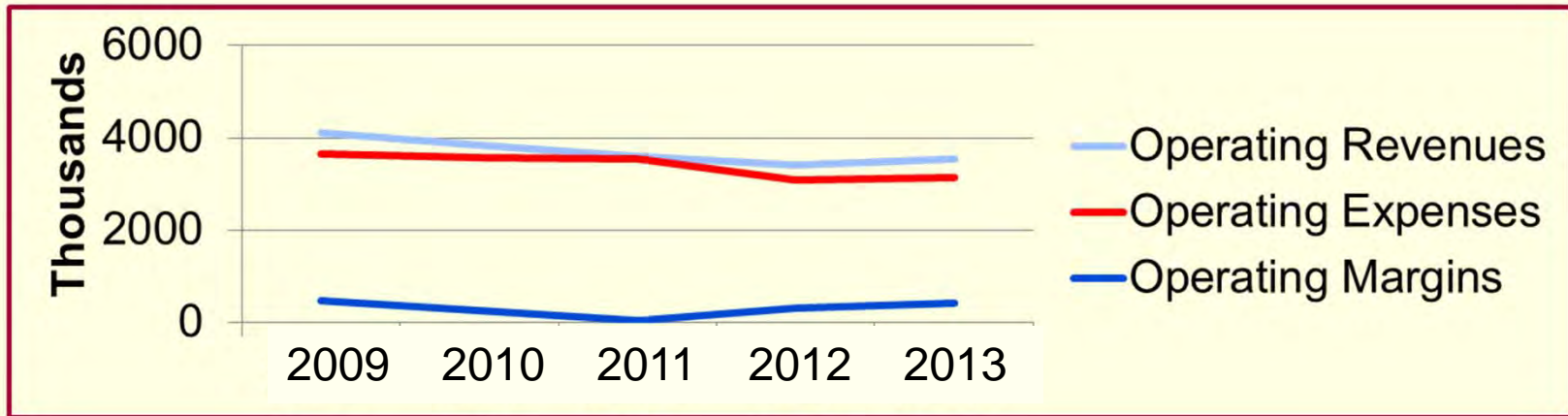
The tools to analyze financial data are most useful when used in combination with one another.



Trend Analysis

- Horizontal trend analysis – year to year comparisons
- Vertical trend analysis – common size item
 - Revenues and expenses per access line
 - Revenues and expenses to total revenues
 - Revenues and expenses to total expenses

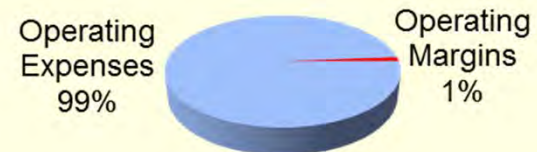
Trend Analysis



2013 Operating Revenues



2011 Operating Revenues

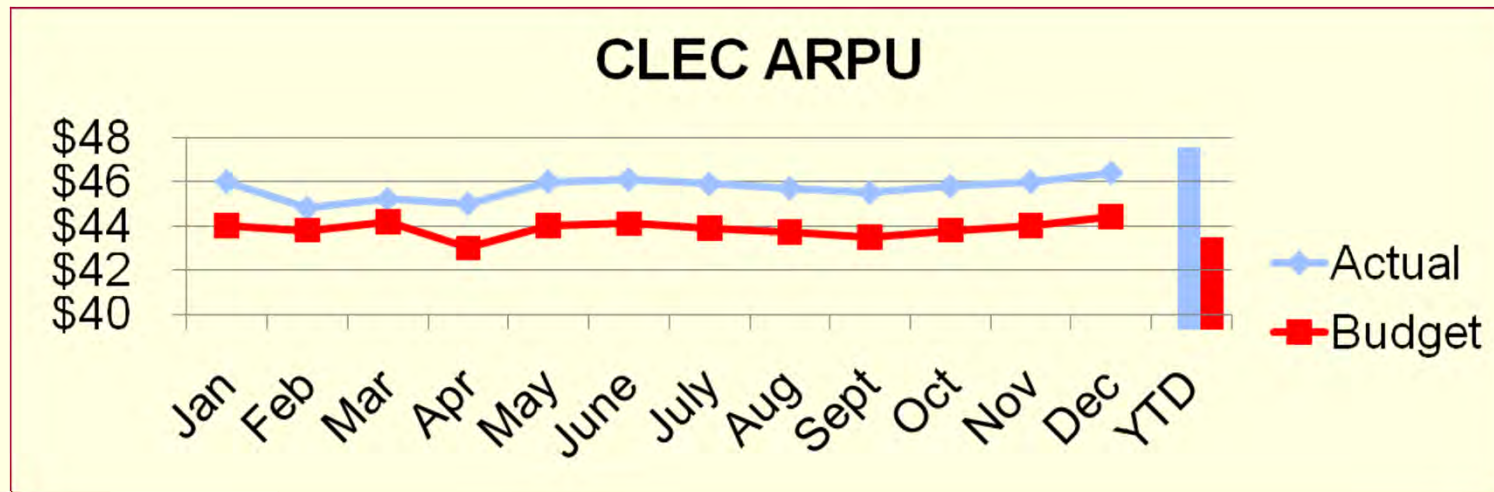


Trend Analysis

- Average Revenue per Unit (ARPU)
 - Provides a per unit basis to track revenue sources
 - With trend analysis, measures growth and change of sources
 - Calculation: total revenue / average number of units
 - Determine level at which you want to measure
 - Line of business – broadband, video, local LD
 - Type of customer – ILEC, CLEC
 - Area

Trend Analysis

- Average Revenue per Unit (ARPU)
 - Typically use access Lines
 - Example is local & LD



Trend Analysis

- Cash Transactions

- Cash Flow

- Free Cash Flow

(Operating Cash Flow – Retirement of Debt – CapEx – Taxes = Free Cash Flow)

- Cash available after payment of mandatory obligations
 - Measures cash generated by a company
 - Consider capital credits to be paid

Trend Analysis

- Debt coverage
 - Times Interest Earned (TIER) or Interest Coverage Ratio
- $\text{EBIT} / \text{interest expense}$
 - Debt Service Coverage Ratio - $\text{EDITDA} / \text{debt principal and interest payments}$

Trend Analysis

- Churn rate
 - Measures loss of customers, or turnover
 - Calculation: $\text{lost customers} / \text{total customers for period}$
 - Customer counts
 - Penetration of services
 - Access line counts
 - To expand, the growth rate must exceed the churn rate

Trend Analysis

■ Penetration of Services

| | <u>Current Year</u> | | | <u>Percent Penetration</u> | | | | |
|-------------------------|---------------------|-----------------|-----------------------|----------------------------|-------------|-------------|-------------|-------------|
| | # Customers | Monthly Rate | Annualized Revenue | CY | PY1 | PY2 | PY3 | PY4 |
| Calling Features | | | | | | | | |
| Call Forward | # | \$ | \$ | % | % | % | % | % |
| Call Waiting | # | \$ | \$ | % | % | % | % | % |
| Etc. | # | \$ | \$ | % | % | % | % | % |
| Class Features | | | | | | | | |
| Caller ID | # | \$ | \$ | % | % | % | % | % |
| Voicemail | # | \$ | \$ | % | % | % | % | % |
| Dial-Up Internet | # | \$ | \$ | % | % | % | % | % |
| Long Distance | # | \$ | \$ | % | % | % | % | % |
| DSL | # | \$ | \$ | % | % | % | % | % |
| Video | # | \$ | \$ | % | % | % | % | % |
| Etc. | # | \$ | \$ | % | % | % | % | % |
| Total | # | | | 100% | 100% | 100% | 100% | 100% |

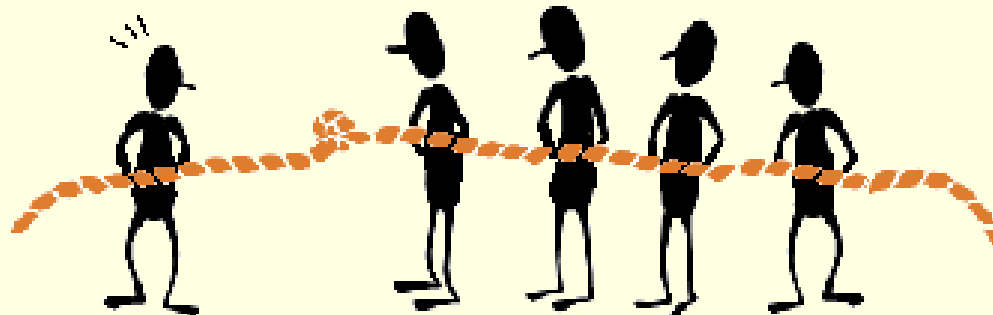
Trend Analysis

- Other significant drivers
 - Payroll and benefit costs per hour
 - Payroll and benefit costs per \$ revenue
 - Cellular partnership distributions
 - Support revenues to total revenues
 - Revenue Generating Units (RGUs)
 - Sources or units of revenue creation
 - With trend analysis, measures change in number of units to generate revenue
 - Versus ARPU which measures revenue generated by the units

Benchmark Comparisons

Don't simply compare your organization to another.

UNDERSTAND why your organization performs better or worse than the other.



Benchmark Comparisons

Why your organization performs differently from others...

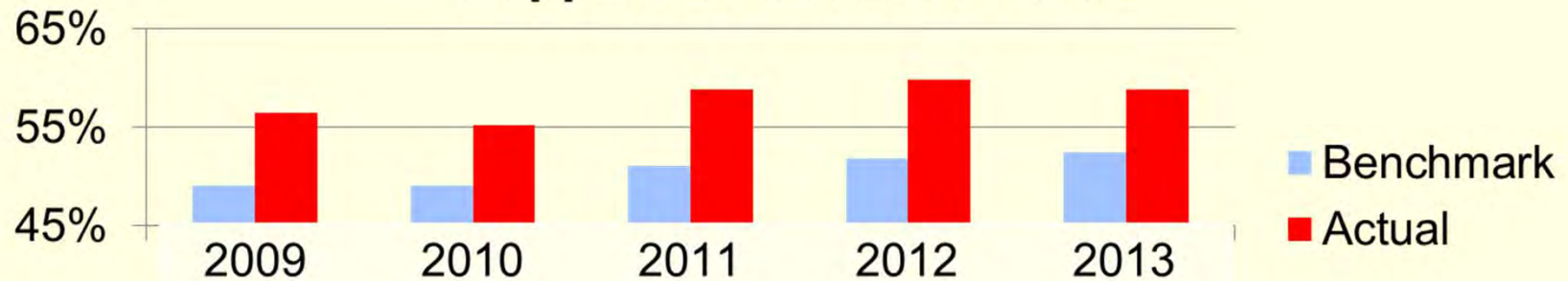
- Consider causes such as:
 - Density
 - Population
 - Demographics
 - Terrain
 - Weather

Benchmark Comparisons

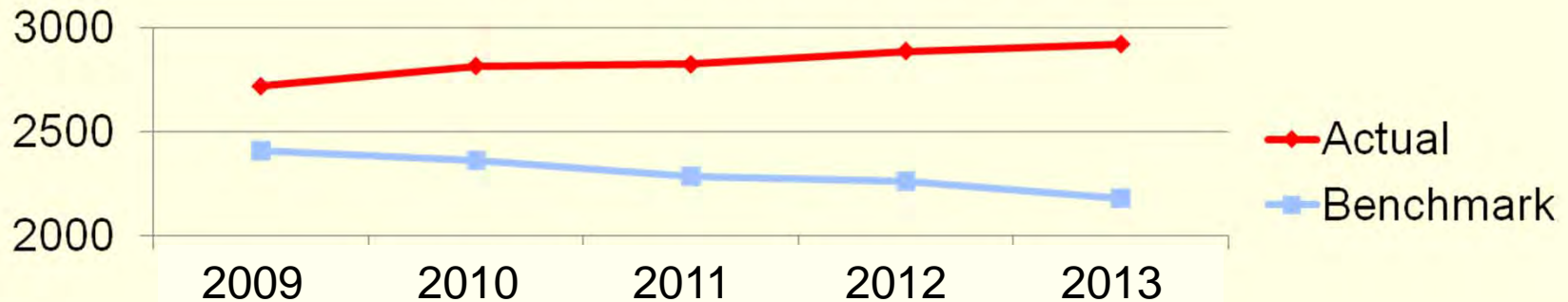
- Fiber deployment
- Broadband percentage of revenues
- Churn: access lines or broadband customers
- Revenue growth or decline
- Average remaining life of plant

Benchmark Comparisons

Support to Revenue Ratio

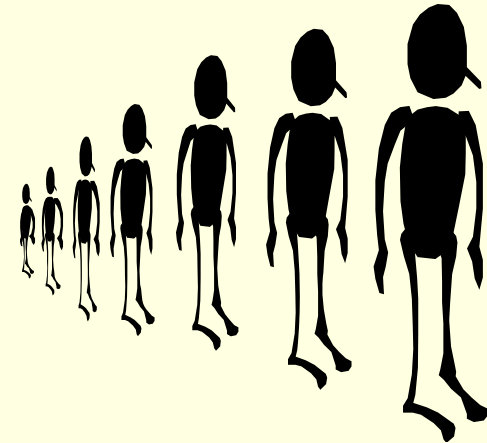


Number Access Lines



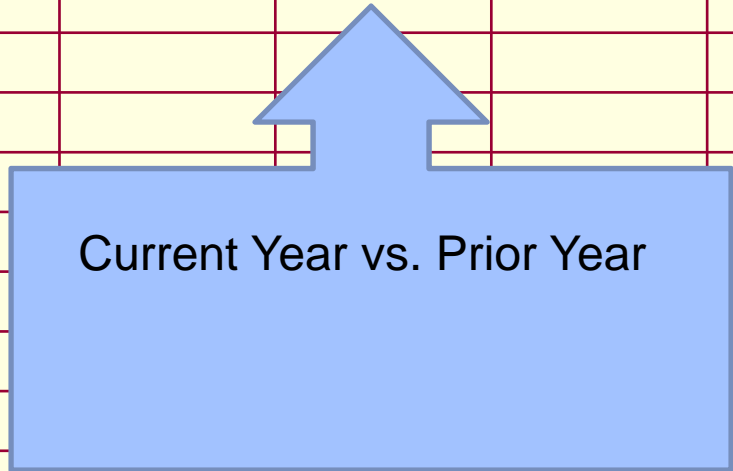
Business Units

- Examine contributions to margin by product line
- Subtotal by unit:
 - Direct and indirect expenses
 - Selling general and administrative
 - Fixed and variable expenses
 - Depreciation
- Consider effects of bundled services



Business Units

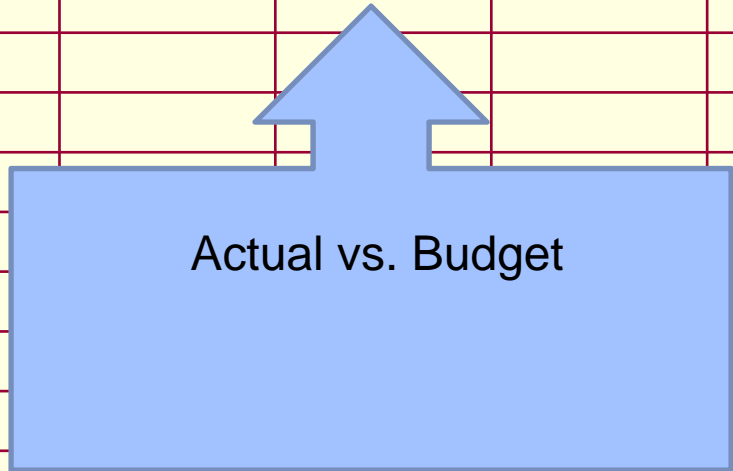
| Description | Current YTD Actual | % of Revenue | Prior YTD Actual | % of Revenue | Fav/(Unfav) Variance |
|----------------------------------|--------------------|--------------|------------------|--------------|----------------------|
| Total Revenue | | | | | |
| Direct Costs | | | | | |
| Contribution Margin | | | | | |
| Indirect Costs | | | | | |
| Gross Margin | | | | | |
| Selling, General, Administrative | | | | | |
| Depreciation, Amortization | | | | | |
| Operating Income (Loss) | | | | | |
| Other Income (Expense) | | | | | |
| Income (Loss) Before Taxes | | | | | |
| Income Tax Expense | | | | | |
| Total Net Income | | | | | |



 Current Year vs. Prior Year

Business Units

| Description | Current Year Actual | % of Revenue | Current Year Budget | % of Revenue | Fav/(Unfav) Variance |
|----------------------------------|---------------------|--------------|---------------------|--------------|----------------------|
| Total Revenue | | | | | |
| Direct Costs | | | | | |
| Contribution Margin | | | | | |
| Indirect Costs | | | | | |
| Gross Margin | | | | | |
| Selling, General, Administrative | | | | | |
| Depreciation, Amortization | | | | | |
| Operating Income (Loss) | | | | | |
| Other Income (Expense) | | | | | |
| Income (Loss) Before Taxes | | | | | |
| Income Tax Expense | | | | | |
| Total Net Income | | | | | |



Business Units

- More specific units will be more beneficial

- Business units to consider:
 - ILEC
 - CLEC
 - Internet
 - Cable TV
 - Security
 - Fiber Transport
 - Long Distance
 - Other Non-Regulated

Monitor Ratios

- What results are desired?
 - Trend analysis
 - Industry comparisons
 - PUC recommended levels
 - Comparison to other business segments

- Limitations of ratios
 - Hard to get “apples to apples” comparison
 - Distortion based on timing



Monitor Ratios – Key Ratios (1)

| <u>Ratio</u> | <u>Measures</u> | <u>Calculation</u> | <u>Benchmark</u> |
|-------------------------|--|--|------------------|
| Liquidity Ratios | Solvency and ability to meet short-term obligations; ability to take on new short-term obligations | | |
| Current Ratio | Ability to pay short-term debts | Current Assets / Current Liabilities | 3.94:1 |
| Quick Ratio (Acid Test) | Ability to pay short-term debts with most readily available liquid assets (inventory is difficult to turn into cash) | (Cash + Marketable Securities + Accounts Receivable) / Current Liabilities | N/A |
| A/R Turnover | How quickly firm collects its accounts receivable | Sales / Average Accounts Receivable | N/A |
| Inventory Turnover | Number of days worth of inventory on hand | Cost of Goods Sold / Average Inventories | N/A |

Monitor Ratios – Key Ratios (2)

| <u>Ratio</u> | <u>Measures</u> | <u>Calculation</u> | <u>Benchmark</u> |
|--|---|--|---|
| Working Capital Ratio | Assets tied up in working capital, or amount of assets required to run operations | $(\text{Current Assets} - \text{Current Liabilities}) / \text{Total Assets}$ | 16.5% |
| Operating Cash Flow to Current Liabilities | Current cash availability to current obligations | $\text{Cash Flow from Operations} / \text{Average Current Liabilities}$ | N/A |
| Activity Ratios | Measure success of a business unit | | |
| Average Revenue per Unit (ARPU) | Revenue sources and growth | $\text{Total Revenue} / \text{Average Number of Units}$ | Local - \$20 BB – \$45 Video - \$65 LD - \$9 |
| Operating Revenue per Employee | Work force size and efficiency | $\text{Operating Revenues} / \text{Number Full-Time Employees}$ | \$68 |
| Operating Revenues per Access Line | | $\text{Operating Revenues} / \text{Access Lines}$ | \$2,101 Telco only |

Monitor Ratios – Key Ratios (3)

| <u>Ratio</u> | <u>Measures</u> | <u>Calculation</u> | <u>Benchmark</u> |
|---|---|---------------------------------------|------------------|
| Operating Income before Interest, Taxes, Depreciation, and Amortization (OIBTDA) per Connection | Operating income per connection (excludes non-operating income) | OIBTDA / Connections | \$410 |
| Earnings before Interest, Taxes, Depreciation, and Amortization (EBITDA) per Connection | Net income per connection | EBITDA / Connections | \$644 |
| Access Lines per Route Mile | | Access Lines / Route Mile | 3.43 TO |
| Plant in Service per Access Line | | Gross Plant in Service / Access Lines | \$10,955 TO |

Monitor Ratios – Key Ratios (4)

| <u>Ratio</u> | <u>Measures</u> | <u>Calculation</u> | <u>Benchmark</u> |
|--------------------------------|-----------------------------|---------------------------------------|---|
| Net Investment per Access Line | | Expense category/average access lines | PS \$508 PNS \$215 Depr \$485 Cust \$180 Corp \$334 CapX \$470 C&W \$198 COE \$196 TO |
| Support to total revenue | Support - NECA, FUSF, state | Support/operating revenue | 59% TO |

Monitor Ratios – Key Ratios (5)

| <u>Ratio</u> | <u>Measures</u> | <u>Calculation</u> | <u>Benchmark</u> |
|---|-----------------|--|------------------|
| Telephone revenue to other revenue | Diversification | Telephone service related rev/ other revenue (BB, video, etc) | 1.62 |
| Equity to total assets | Leverage | Equity/total assets | 69% |
| Support per Access Line | | Total Support Revenue / Access Lines | \$1,212 |
| Operating margin per access line | | Operating margin/avg access lines | \$289 TO |
| Cellular Income to Margin Ratio | | Cellular Partnership Income After Tax / Net Margin | 50.78% |
| Return on Assets Before Partnership Income | | (Net Income - Partnership Income) / Total Assets | 2.97% |

Monitor Ratios – Key Ratios (6)

| <u>Ratio</u> | <u>Measures</u> | <u>Calculation</u> | <u>Benchmark</u> |
|-------------------------|---|---|------------------|
| Overall Cash Flow Ratio | Whether business is generating enough cash from its business to sustain itself, grow, and return capital to its owners | Cash inflow from Operations / (Cash outflow from Investing + Cash outflow from Financing) | N/A >1 |
| Cash Flow to Earnings | In addition to Overall Cash Flow Ratio to measure quality of cash flow generation (does cash flow increase accompany earnings increase) | Operating Cash Flow / Net Earnings | N/A |
| | | | |

Monitor Ratios – Key Ratios (7)

| <u>Ratio</u> | <u>Measures</u> | <u>Calculation</u> | <u>Benchmark</u> |
|-----------------------------|---|-----------------------------------|--------------------------|
| Debt to Equity | Percentage of the assets provided by owners | Long-Term Debt / Equity | 45% |
| Debt to Assets | Percentage of the assets provided by debt obligations | Total Debt / Total Assets | 31% |
| Profitability Ratios | Rates of profit for the company | | |
| Net Profit Margin | Profit generated per \$ revenue | Net Income / Revenue | N/A higher the better |
| Return on Assets (ROA) | Profit generated per \$ assets | Net Income / Average Total Assets | 6.88 |
| Return on Equity (ROE) | Profit generated per \$ equity | Net Income / Equity | 9.97 |

Monitor Ratios – Key Ratios (8)

| <u>Ratio</u> | <u>Measures</u> | <u>Calculation</u> | <u>Benchmark</u> |
|--|---|---|------------------|
| Access Line Trend | Percentage AL increase or decrease from PY | AL increase or decrease/beg AL | -5.2% |
| Return on Rate Base (Invested Capital) | Ratio monitoring the return on invested capital | Net Income / ((TPUC + Plant in Service + Plant Held for Future Use + Telephone Plant Acquisition + Materials and Supplies + Prepayments + Other Invested Capital Additions) – (Accum. Depr. and Amort. + Deferred Federal Income Taxes + Contributions in Aid of Construction + Customer Deposits + Other Invested Capital Deductions)) | N/A 10% |

Monitor Ratios – Key Ratios (9)

| <u>Ratio</u> | <u>Measures</u> | <u>Calculation</u> | Benchmark |
|---------------------|---|------------------------------------|---|
| Benefits to Wages | Benefits as a percentage of total wages | Benefits / Total wages | 60% |
| Average annual wage | Annual wage per employee | Annual wages/average number of FTE | \$59,355 Coops only \$65,568 With IOUs |

Forecasting

- Use to determine what performance drivers are relevant
- Know what drives changes
- Consider methods to measure impact of changing factors
- Set goals or performance standards
- Know where your biggest dollars come from



Forecasting

- Consider changing factors
 - Known access line increases or decreases
 - Changing accounting rules
 - Operating vs. Capital leases
 - Revenue or expense changes
 - Rate changes
 - Regulatory and legislative changes
 - Tax effects
 - Fully depreciated assets

Forecasting

- Know what your drivers are:
 - Support mechanisms dependent on expenses and investment decisions
 - Cost saving measures may not flow to bottom line completely or there may be a delayed effect

Other Evaluations



- Capital expenditure activity
 - Interim orders to date
 - BOD approved or budgeted
 - Remaining orders anticipated v. budgeted
- Loan/Grant fund usage
 - Consider time constraints of program
- Capital credit rotation v. cash flow
- Financial results v. budget

Other Evaluations

EBITDA Margin – EBITDA/Total revenue –
Median wireline industry EBITDA margin
decreased from 39.5% in 4Q13 to 38.1%1Q14.

Trends



- Access line loss continues
- Wireline broadband growth has slowed as penetration increases. Now 70%
- Cable broadband market share continues to increase (59%)

Trends

■ Video

- Satellite and telco subs increasing in 2014 while cable decreasing
- Market Share
 - Cable – 55%
 - Satellite – 35%
 - Telco – 10%
- Overall video growth is slowing mainly due to OTT
 - Netflix, Hulu, Amazon

Trends

■ Wireless

- AT&T has 28% of market share, VZW 33%
- Connection growth rate slowing as penetration exceeds 100% driven by growth in connected devices
- VZW reports 2.8 connections per account
- VZW “LTE in Rural America” plan enables VZW to partner with rural wireless carriers and rapidly expand its LTE network to smaller markets

Opportunities

- Additional broadband penetration
- Business focused opportunities
- Fiber transport/wireless backhaul
- Data centers/cloud computing
- Acquisitions

Challenges

- Regulatory reforms
- Cable and wireless competition for voice and data
- Increasing cost of capital
- Decreasing credit availability

Winner of “It’s Not My Job” Contest



Questions?

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