

MEMORANDUM

August 14, 2015

TO: Board of Directors
FROM: Foster Hildreth, General Manager
RE: Rock Island Communications; Second Quarter Financial Review

The Q2 (YTD) of full operations of Rock Island Communications was a progressive move towards our full operating model and goals. We are nearing completion for our integration efforts. The Q2 financials are attached.

Our primary focus in Q2 was the construction efforts of Middle Mile infrastructure in Spring Point, The Cape, Mineral Point, Eagle Lake and Alder Cottages. In addition, we continued to fill our pipeline of fiber-hoods and new connections along with supporting all existing revenue streams.

Operational Milestones achieved in Q2 2015

- Managed simultaneous construction efforts on multiple islands completing the development of Eagle Lake, Alder Cottages and numerous individual connections
- County wide engagement of all emergency services to co-develop a data network for county wide use.
- Completed contract and tech specs on SIM cards for LTE Network.
- Completed comprehensive Radio Frequency study for optimal LTE deployment.
- Began development on a county wide fiber/LTE cost estimation model to predicate individual and collective costs of deployment.
- Hired key staff in sales and operations.
- Achieved 2 additional HOA fiber-hood build commitments
 - Alder Forest (Orcas)
 - Whiskey Hill (Lopez)
- Delivered 48 new fiber to the home services.
- Started delivering VoIP services.

Operational Challenges in Q2 2015

- LTE build out is going slower than planned, due to vendor selection and system testing.
- VoIP has been a greater challenge and steeper learning curve than anticipated. The transfer process from CenturyLink is frustrating and overly complex.
- Inquiry and Prospect Volume – Effective county wide communication continues to be a challenge, especially in real-time to various groups and individuals. We expect this to improve significantly throughout the balance of 2015 as we implement our operational platforms and tracking systems.

Financial Highlights for Q2 2015

The budget to actual performance for Island Network overall remains in-line with expectations for the first half of the year.

Revenues came in just above budget for the half at \$811,766 with a variance of \$23,158 from budget. Operating Expenses were lower than budget at \$978,088, \$186,999 under budget.

An important risk-mitigating factor within the business plan is to correlate a significant portion of the tranche investment structure to the take rate as well as the addition of Rock Island legacy revenue stream. We are now accelerating our LTE construction investment in order to deliver approximately 600 fixed wireless subscribers before year end.

Table 1

	Budget Period End	Actual Period End	Variance
Op Revenue	\$788,609	\$811,766	\$23,158
COGS	\$338,511	\$336,409	(\$2,102)
Gross Profit	\$450,098	\$475,357	\$25,259
Op Expenses	\$1,165,087	\$978,088	(\$186,999)
Net Margin	(\$738,121)	\$(522,392)	\$215,729

Borrowings from OPALCO (Nov 14 to Period End)

Borrowings for the year adjusted for the acquisition of Rock Island Technology Solutions is \$3.4M, up from \$2.9M. Through the first eight months (Nov, Dec 14 & Q1 & Q2 15) our borrowings from OPALCO totals \$2.8M for startup costs and connection incentives. The remaining amount is in line with our running operational costs for the balance of 2015.

Staffing

In line with budgeted expectations after the acquisition staffing levels at period end were 17 FTE's compared to a budgeted 19 FTE's.

Positions filled by period end;

1. EVP
2. VP Operations
3. VP Technology
4. VP Engineering
5. VP Sales and Marketing
6. Network Operations
7. Customer Support
8. Retail Sales
9. System Admin
10. GIS Tech
11. Field Tech +5
12. Operations Support +3

Subscriber Highlights for Q1 2015

Our goals planned for a gradual ramp up in subscribers during the initial months of 2015 continues particularly those receiving Fiber to the home. Q2 of 2015 was focused on gearing up and beginning our first group of large fiber-hoods. Initial construction efforts have been a mix of great to moderate. Two major projects (Spring Point & Mineral Point) have had two very different middle mile experiences. The Spring Point middle mile project went exceedingly well, on time and on budget. The Mineral Point middle mile, while on budget, has taken far too long with a significant impact on the homeowners.

Total new fiber subscribers for 2015 were budgeted to be 400. As of end of Q2 we have added 68 new subscribers. We currently have fiber under construction to 278 properties with an expected 255 new connections from these. We are expecting 185 new connections to occur in Q3. The table below lays out our overall progress by subscriber type and compares budget to actual.

ROCK ISLAND COMMUNICATIONS

Total Subscribers - Budget To Actual

BUDGET	2014	2015 Budget				Comments
	Actual Year-end	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	
Subscribers						
DSL		1,444	1,444	1,444	1,444	
Canopy		174	174	174	174	
Fiber		138	178	328	500	
LTE		100	250	400	608	
Total		1,856	2,046	2,346	2,726	
ACTUAL	2014	2015 Actual				Comments
Subscribers	Actual Year-end	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	
DSL	-	1,444	1,470			Delay in LTE Deployment
Canopy	-	174	174			
Fiber	108	128	176			
LTE	-	-	-			
Total	108	1,746	1,820	-	-	
Variance (Actual - Budget)	-	(110)	(226)	-	-	

*We project that budgeted LTE subscriptions will be connected by year end.

ISLAND NETWORK

STATEMENT OF OPERATIONS BUDGET

	A.	B.	C.
	Rock Island Budget 2015	Island Network Proposed Budget 2015	Island Network Annual Budget 2015 (A + B)
1 I OPERATING REVENUES			
2 Sales	\$ 1,081,518	\$ 1,171,650	\$ 2,253,168
3 TOTAL OPERATING REVENUES	1,081,518	1,171,650	2,253,168
4			
5 II COST OF GOODS SOLD	674,374	292,800	967,174
6 TOTAL COST OF GOODS SOLD	674,374	292,800	967,174
7 Gross Profit	407,144	878,850	1,285,994
8 III OPERATING EXPENSES			
9 Advertising	-	75,000	75,000
10 Depreciation Expense	37,890	187,166	225,056
11 Insurance	-	100,000	100,000
12 Interest Expense	36,000	174,000	210,000
13 Office Expenses	-	-	-
14 Payroll Expenses	395,638	929,500	1,325,138
15 Professional Fees	-	200,000	200,000
16 Rent	-	120,000	120,000
17 Utilities	(42,000)	172,000	130,000
18 Other	(94,695)	94,695	-
19 Travel & Ent	-	20,000	20,000
20 TOTAL OPERATING EXPENSES	332,833	2,072,361	2,405,193
21 TOTAL NET OPERATING MARGINS	\$ 74,311	\$ (1,193,511)	\$ (1,119,199)
22 IV OTHER INCOME (EXPENSE)			
23 Interest Income	-	-	-
24 Other Income (Expense)	-	-	-
25 Taxes: Property Taxes	25,000	(25,000)	-
26 Taxes: State & Local Use Tax	(16,174)	(30,089)	(46,263)
27 TOTAL OTHER INCOME	8,826	(55,089)	(46,263)
28 Federal Income Tax Expense	-	-	-
29 GRAND TOTAL NET MARGIN DETAIL BREAKOUT	83,137	(1,248,599)	(1,165,462)
TOTAL EXPENSES	\$ 998,381	\$ 2,420,249	\$ 3,418,630

ISLAND NETWORK
STATEMENT OF OPERATIONS BUDGET TO ACTUAL
DETAILED BREAKOUT OF NOTABLE DRIVERS

	A. Island Network Budget Annual 2015	B. Island Network Budget Period End 6/30/2015	C. Island Network Actual Period End 6/30/2015	D. Variance (C-B)	I. Comments: Period End Budget To Actual
1 I OPERATING REVENUES	\$ 2,253,168	\$ 788,609	\$ 811,766	\$ 23,158	
2 Operating Revenue - Line 6 Detail Breakout					
3					
4					
5 Other Operating Revenue		788,609	811,766	23,158	
6 TOTAL OPERATING REVENUES	2,253,168	788,609	811,766	23,158	Due to delay deployment of LTE expected shortfall in Revenue compared to full year budget (-\$350k). Connections still expected to be in line with year end goals
7					
8 II COST OF GOODS SOLD	967,174	338,511	336,409	(2,102)	
9 COGS - Line 15 Detail Breakout					
10					
11					
12					
13					
14 Other Cost of Goods Sold		338,511	336,409	(2,102)	
15 TOTAL COST OF GOODS SOLD	967,174	338,511	336,409	(2,102)	
16 Gross Profit	1,285,994	450,098	475,357	25,259	
17					
18 III OPERATING EXPENSES	2,405,193	1,165,087	978,088	(186,999)	
19 Operating Expenses - Line 25 Detail Breakout					
20 Payroll Expenses		662,569	555,651	(106,918)	
21 Professional Fees		100,000	204,499	104,499	Offset between outside contracting versus FTE's
22 Rent		60,000	48,759	(11,241)	
23 Utilities		65,000	3,658	(61,342)	
24 Other		277,519	165,522	(111,997)	Marketing, Depreciation, Insurance, Rent etc
25 TOTAL OPERATING EXPENSES	2,405,193	1,165,087	978,088	(186,999)	
26 TOTAL NET OPERATING MARGINS	\$ (1,119,199)	\$ (714,990)	\$ (502,731)	\$ 212,259	
27					
28 IV NON-OPERATING MARGINS (EXPENSE)	(46,263)	(23,131)	(19,661)	3,470	
29 Non-operating Margins (Expense) - Line 35 Detail Breakout					
30 Interest Income		-	157	157	
31 Other Income (Expense)		-	330	330	
32 Taxes: Property Taxes		-	-	-	
33 Taxes: State & Local Use Tax		(23,131)	(20,148)	2,983	
34 Other Non-operating margins		-	-	-	
35 TOTAL NON-OPERATING MARGINS (EXPENSE)	(46,263)	(23,131)	(19,661)	3,470	
36 Federal Income Tax Expense	-	-	-	-	
37 GRAND TOTAL NET MARGIN DETAIL BREAKOUT	(1,165,462)	(738,121)	(522,392)	215,729	
Total Net Margin	\$ (1,165,462)	\$ (738,121)	\$ (522,392)	\$ 215,729	Risk Model in line with expectations (RI transaction & Deployment Speed)

ISLAND NETWORK

BALANCE SHEET

A. B.

Island Network Actual Island Network Actual
 Period End Period End
3/31/15 6/30/15

1	ASSETS			
2	Current Assets			
3	Cash	\$ 671,025	\$ 745,761	
4	Accounts Receivable	60,519	67,561	
5	Inventory	115,393	121,902	
6	Prepays And Other Current Assets	19,107	28,057	
7	Total Current Assets	866,045	963,280	
8	PROPERTY, PLANT, AND EQUIPMENT			
9	Fixed Assets	1,534,364	2,560,579	
10	Accumulated Depreciation	(1,128,988)	(1,160,175)	
11	Total Property & Equipment - Other	405,375	1,400,404	
12	Investments in Affiliated Co.	900,000	707,731	Fine tuning acquisition figures
13	Other assets	-	-	
14	Goodwill	352,050	544,319	Fine tuning acquisition figures
15	Total Assets	2,523,470	3,615,734	
16				
17	CURRENT LIABILITIES			
18	Accounts Payable	395,667	24,774	
19	Other Payables	92,949	91,967	
20	Total Current Liabilities	488,616	116,742	
21	NONCURRENT LIABILITIES			
22	Long-term Debt Startup Capital (OPALCO)	1,548,579	2,876,943	
23	Long-term Obligation on Leased Equipment	-	454,431	
24	Total Liabilities	2,037,195	3,448,115	
25				
26	EQUITIES AND MARGINS			
27	Common Stock	10,000	10,000	
28	Preferred Stock	100	100	
29	Retained Earnings	679,912	679,912	
30	Net Income (Loss)	(203,737)	(522,392)	
31	Total Equity	486,275	167,620	
32	Total Liabilities and Equity	\$ 2,523,470	\$ 3,615,734	

**ISLAND NETWORK
STATEMENT OF CASH FLOW
NON GAAP**

	A. 2015 Island Network Updated Annual Budget	B. Actual Island Network Period End 6/30/2015
1 OPERATING ACTIVITIES		
2 Margins	\$ (1,165,000)	\$ (522,392)
3 Depreciation/Amortization	245,000	25,647
Adjustments to reconcile net earnings to net cash		
4 provided/(used) by operating activities:		
5 Change in Inventory	-	(121,902)
6 Change in Accounts Receivable	-	(22,835)
7 Change in Prepaids and Other Current Assets	-	(21,797)
8 Change in Accounts Payable	-	(318,523)
9 Change in Other Current and Noncurrent Liabilities	-	89,301
10 Cash Flow Operations	(920,000)	\$ (892,502)
11		
12 PLANT INVESTMENT (NET)		
13 Investment in affiliate, net of cash acquired ¹	-	(707,731)
14 Purchases of property and equipment	(2,050,000)	(530,948)
15 Cash Flow From Operations and Plant Investment	(2,970,000)	(2,131,181)
16 Cash Flow Before Borrowing	(2,970,000)	(2,131,181)
17		
18 NET BORROWING		
19 Debt borrowings, net	2,641,000	2,876,943
20 Cash Increase (Decrease) After Net Borrowing	(329,000)	745,761
21		
22 TOTAL OUTSTANDING DEBT BALANCE ¹	\$ (2,641,000)	\$ (2,876,943)
23		
24 NOTE: 1. Excludes Rock Island Purchase		