

ROCKISLAND

Rock Island Communications Monthly Report & Q2 Financials

August 2018

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Introduction

It has been an exciting few years for us as we continue to deliver a real broadband solution for our county. Major components laid out in the early inception days of Island Network in 2015 have set us up for today's success. The Rock Island team is excited for this next phase of development and are ready to meet those needs head on. Defining Rock Island as a company that includes unparalleled reliability, customer care and service will ensure the long-term success of our community. This will be the mission for management going into 2019 and beyond. We will look at ways in which we can increase efficiency, optimize expenses, and improve our ability to communicate to our customers and deliver stellar services. It remains the team's focus to grow revenue and to cut expenses to achieve this goal. Our current progression toward this goal is discussed in the sections below in detail.

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Finance

August 2018

Q2 2018 Highlights

Broadband Services	2nd Quarter			Year to Date		
	2017	2018	Growth	2017	2018	Growth
<i>Residential Fiber</i>	\$ 236,000	\$ 265,000	12%	\$ 457,000	\$ 498,000	9%
<i>Institutional Fiber</i>	76,000	175,000	130%	154,000	346,000	125%
	\$ 312,000	\$ 440,000	41%	\$ 611,000	\$ 844,000	38%

Wireless	2nd Quarter			Year to Date		
	2017	2018	Growth	2017	2018	Growth
<i>LTE Fixed Wireless</i>	\$ 296,000	\$ 478,000	61%	\$ 525,000	\$ 937,000	78%

Services	2nd Quarter			Year to Date		
	2017	2018	Growth	2017	2018	Growth
<i>T&M, Hosting, etc...</i>	\$ 52,000	\$ 58,000	12%	\$ 92,000	\$ 115,000	25%
<i>VOIP</i>	3,600	20,000	456%	8,000	37,000	363%
	\$ 55,600	\$ 78,000	40%	\$ 100,000	\$ 152,000	52%

Condensed Financial Results	2nd Quarter			Year to Date		
	2017	2018	Change	2017	2018	Change
<i>Revenue</i>	\$ 855,000	\$1,184,000	38%	\$ 1,597,000	\$ 2,283,000	43%
<i>Net Loss</i>	(607,000)	(662,000)	-9%	(1,439,000)	(1,350,000)	6%
<i>EBITDA</i>	(182,000)	(138,000)	24%	(643,000)	(326,000)	49%

All percentages are calculated on whole numbers. Minor differences may exist due to rounding.

Broadband Services:

- 154 new residential fiber connections were added during the second quarter compared to 68 from the same period last year. This level of onboarding did not necessitate increasing the headcount of our fiber line crew. In fact, we were understaffed on the average for this period.
- Total YTD fiber revenues were \$844k, an increase of 38% year over year, and an increase of 41% compared with second quarter 2017.
- Trends in fiber revenue growth show steady increases among residential customers and strong upward momentum in medium to large-sized businesses.

Wireless

- 284 new LTE connections were added during the second quarter compared to 276 from the same period last year. Please note, no new poles were erected during Q2 2018.
- Total YTD LTE revenues were \$937k, an increase of 78% year over year, and an increase of 61% compared with second quarter.

YTD Financial Update

Revenues:

Gross revenues on a year-to-date basis through Q2 2018 ended up 6% (approximately \$135k) behind our planned targets. The primary drivers that comprise our shortfall stem from slower than planned residential LTE onboarding and the timing of onboarding institutional and large business customers. Our business plan for 2018 set very aggressive LTE sales goals for the company that, in hindsight, assumed a growth model of continuous pole erection as experienced in years prior. The fact that we onboarded more LTE customers during Q2 this year than during the same period last year with no new poles in place is remarkable. As we move into Q3 we are beginning to see the positive effect of our revamped sales and marketing campaign to boost lagging LTE figures. Fiber on boarding continues to increase in speed and stay ahead of plan for connections.

Expenses:

Our overall expenses for the Q2 2018 on a year-to-date basis were behind business plan targets by 12% (approximately \$133k). This variance was driven by several items as follows:

- The incremental costs of updating and rerouting our upstream fiber circuits to increase the scalability and throughput of our network infrastructure has increased our monthly budgeted cost of service beyond planned expectations by approximately \$9k per month (\$30k above plan YTD). We anticipate upstream fiber transport costs should stabilize at their current run rate for the remainder of the year. Additionally, we have identified approximately \$3k of recurring circuit costs that will be discontinued around towards the end of Q3.
- Contracted services with an outsourced call center support team, increased professional services expense by approximately \$27k for the quarter. Our call center vendor helped Rock Island at a crucial time during our email migration which resulted in a significant influx of customer inquiries, and placed a tremendous burden on our front-line staff. Since the end of the Q2, invoicing from this vendor has stabilized at around \$5k a month as they continue to handle regular customer inquiries after hours and on weekends.
- In March, Rock Island hired a full-time Salesforce Developer to replace a previously contracted resource. This change was not accounted for in our original business plan but is anticipated to save the Company money over the remaining months in 2018.

Debt

As of July 31st, 2018 we are on track with our planned debt draw schedule as approved in our 2018 Business Plan. Borrowed funds used for construction and operations by the company thus far in 3rd Quarter are \$570k leaving the Company with \$530k left to borrow through the end of September. Given the expedited pace of construction we have experienced thus far in 2018, actual debt draws may necessitate drawing in advance of our planned timeline per the business plan for the remainder of the year. At this time we still believe our first major financial milestone of positive cashflow from operations will occur late in the fourth quarter of 2018.

Bottom Line:

We ended Q2 with a net loss year-to-date of \$1.349 million, approximately 25% or \$269k behind plan. Our performance this quarter has sharpened our focus towards eliminating future variances between planned performance and actual results. Looking ahead to the rest of the year we anticipate an overall reduction of operating expenses.

Q2 2018 Financial Statements

Balance Sheet		Actual 3/31/2018	Actual 6/30/2018
1	CURRENT ASSETS	\$ 2,338,132	\$ 2,573,202
2	PROPERTY, PLANT, AND EQUIPMENT	11,343,589	12,486,469
3	OTHER NONCURRENT ASSETS	222,674	214,905
4	Total assets	<u>\$ 13,904,395</u>	<u>\$ 15,274,576</u>
5			
6	CURRENT LIABILITIES	1,049,496	1,538,138
7	NONCURRENT LIABILITIES		
8	CoBank Debt	17,700,000	19,400,000
9	Other Non-Current Liabilities	2,912,403	2,756,377
10	Total Liabilities	<u>21,661,899</u>	<u>23,694,515</u>
11			
12	EQUITIES AND MARGINS	<u>(7,757,504)</u>	<u>(8,419,939)</u>
13	Total Liabilities and Equity	<u>\$ 13,904,395</u>	<u>\$ 15,274,576</u>

Income Statement		A. Business Plan Period End YTD Q2 2018	B. Actual Period End YTD Q2 2018	C. Variance (A - B)
1	I OPERATING REVENUES	\$ 2,418,501	\$ 2,282,725	\$ 135,776
2				
3	II OPERATING EXPENSES			
4	COST OF GOODS SOLD	381,772	431,692	(49,920)
5	GENERAL AND ADMINISTRATIVE	2,693,767	2,737,038	(43,271)
6	SELLING AND MARKETING	31,500	30,746	754
7	TOTAL OPERATING EXPENSES	<u>3,107,039</u>	<u>3,199,476</u>	<u>(92,437)</u>
8	TOTAL NET OPERATING MARGINS	<u>(688,538)</u>	<u>(916,751)</u>	<u>(228,213)</u>
9				
10	III OTHER INCOME (EXPENSE)	(392,214)	(433,236)	41,022
11				
12	GRAND TOTAL NET (LOSS) MARGIN DETAIL BREAKOUT	<u>\$ (1,080,752)</u>	<u>\$ (1,349,987)</u>	<u>\$ (269,235)</u>

	YTD Ended 6/30/2018
Statement of Cash Flows	
Cash Flows from Operating Activities:	
1 Net income (loss)	\$ (1,349,987)
2 Adjustments to reconcile net income (loss) to net cash	1,048,221
3 Net cash provided by (used in) operations:	<u>(301,766)</u>
4	
5 Cash Flows from Investing Activities:	(3,203,233)
6	
7 Cash Flows from Financing Activities:	3,593,942
8	
9 Net change in cash	<u>88,943</u>
10	
11 Cash and cash equivalents, beginning of period	<u>33,551</u>
12 Cash and cash equivalents, end of period	<u><u>122,494</u></u>
13	
14 SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION	
15 Cash paid during the year for interest	<u><u>\$ 176,633</u></u>

2018 YTD Financial Dashboards

2018 Approved Financing

	Q1-2018	Q2-2018	Q3-2018	Q4-2018	Totals
Debt Draw for Operations	800,000	400,000	200,000	-	1,400,000
Debt Draw for Investment	1,500,000	1,100,000	1,000,000	1,000,000	4,600,000
Total Financing	2,300,000	1,500,000	1,200,000	1,000,000	6,000,000

Debt Draws Q2-2018 (as of July 31, 2018)

We are right in line with our planned financing needs for both operations and construction/investment.

	YTD 2018 (Plan)	YTD 2018 (Actual)	YTD Variance
Debt Draw for Operations	1,400,000	1,252,396	147,604
Debt Draw for Investment	3,600,000	3,217,604	382,396
Total Financing	5,000,000	4,470,000	530,000

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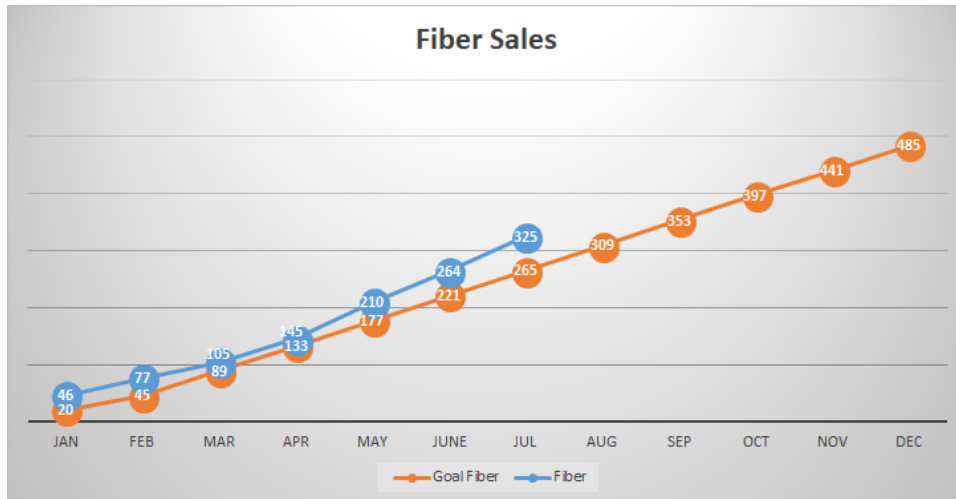
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Sales and Onboarding

August 2018

Customer Onboarding

Here is a look at our current subscriber onboarding compared to plan for 2018.



Fiber

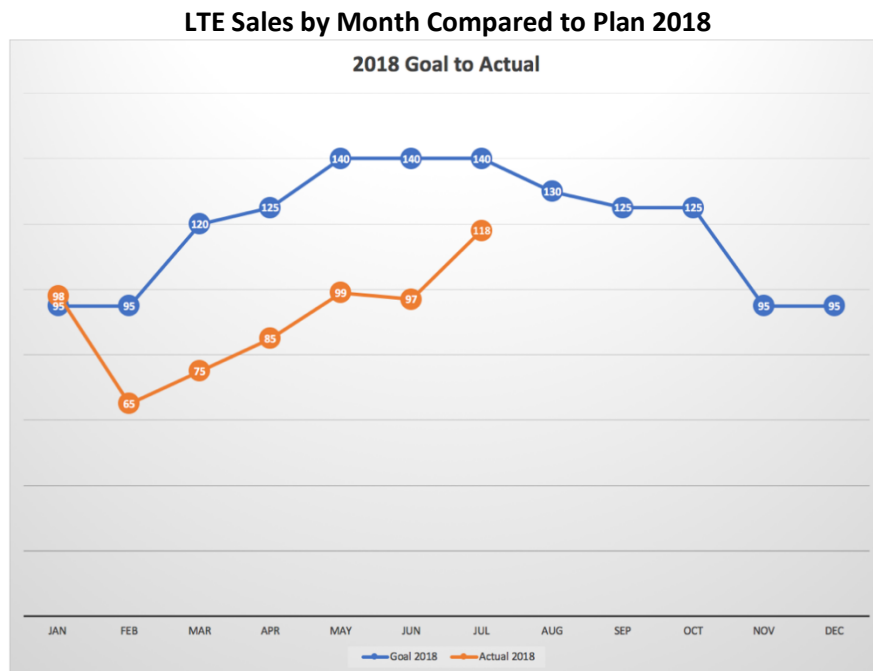
Fiber onboarding continues to gain momentum and produce connections ahead of plan. Interestingly, despite this overage we are just under plan in revenue. A detailed analysis has revealed that the main driver is a shortfall in our Institutional/Large Business revenue line where a small number of circuit connections equate for a large revenue number. The other factor is the increase in the number of discount incentives (-\$20/mo) for last miles that were funded by customers. These reduced rates have kept the ARPU lower than plan. It also correlates with the draws on construction spending as mentioned before.

The fiber onboarding crew has been short-handed all year but continues to deliver on connections. As of August, we are fully staffed as budgeted, but will be in need of one replacement this September. Given the current interest in fiber, we are strategically looking at increasing resources around this effort. Re-allocation, and increasing the labor expense for this line of service will be strongly evaluated this fall and built into our budget for 2019 and beyond.

LTE

We ended 2017 way ahead of plan in LTE subscribers closing out a huge year for LTE in terms of connections, new poles and increases to some of the technologies on cell sites. We increased our goals for 2018 substantially and as of yet, we have been shy of hitting those numbers.

Without multiple new poles going up like we had in early 2017, and with a later start date on an aggressive marketing campaign, we are seeing a late onboarding trend for the year. We remain focused on LTE sales for 2018 and are taking hard looks at balancing our budgets for onboarding in 2019 between fiber and LTE. A deeper look into the marketing effort follows this section.



Above you can see how that momentum started to kick in during July as the marketing plan started to get some teeth. We expect more increase in August sales as our marketing effort kicks into high gear.

Closure with Email Partner PEAK

After weeks of post-mortem on email and the outage we experienced in May we have come to the conclusion that PEAK made sound decisions during and after the outage, and have provided an adequate amount of follow-up both verbally and technically in the weeks that followed.

We reviewed the outage scenario and the software and hardware environments where our email lives and gave them some feedback to implement. They have since made those changes and the system appears to be improving to meet our expectations

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Technology

August 2018

Overview

The Rock Island technology team continues to refine and evolve the network and supporting infrastructure through 2018. Major initiatives this year have included the email migration to Peak Internet/Security Coverage, and the ongoing remediation of legacy Rock Island systems to our new server cluster.

We have completed construction of the 80Gb/sec transport core between Orcas, Lopez and San Juan, and have progressed work on the last piece of our mainland backhaul design with a new POP in Mt. Vernon, with completion expected in 2018 Q3.

We have assisted OPALCO with their server and network remediation/upgrade projects, including the commissioning of a DR site in the Lopez POP to provide redundancy for the OPALCO Eastsound datacenter. The network team has also refined a core transport design throughout the year, with a redesign and implementation of a Q-in-Q based VLAN backbone, which has significantly simplified configuration and maintainability – resulting in the ability to make major network changes without impacting service.

For the rest of 2018, we will continue refining, simplifying and optimizing our network and infrastructure systems, as well as building in higher levels of redundancy to meet the reliability and performance demands of being one of the County's primary communications provider.

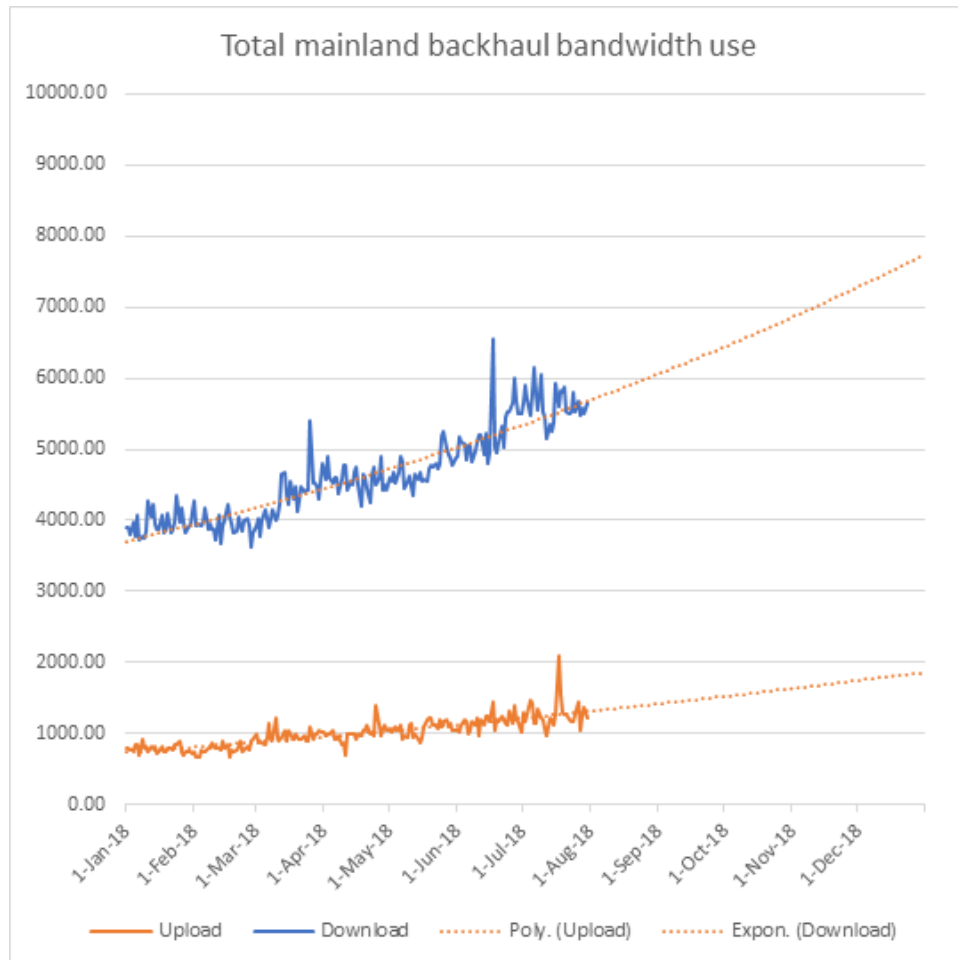
Overall Network Capacity

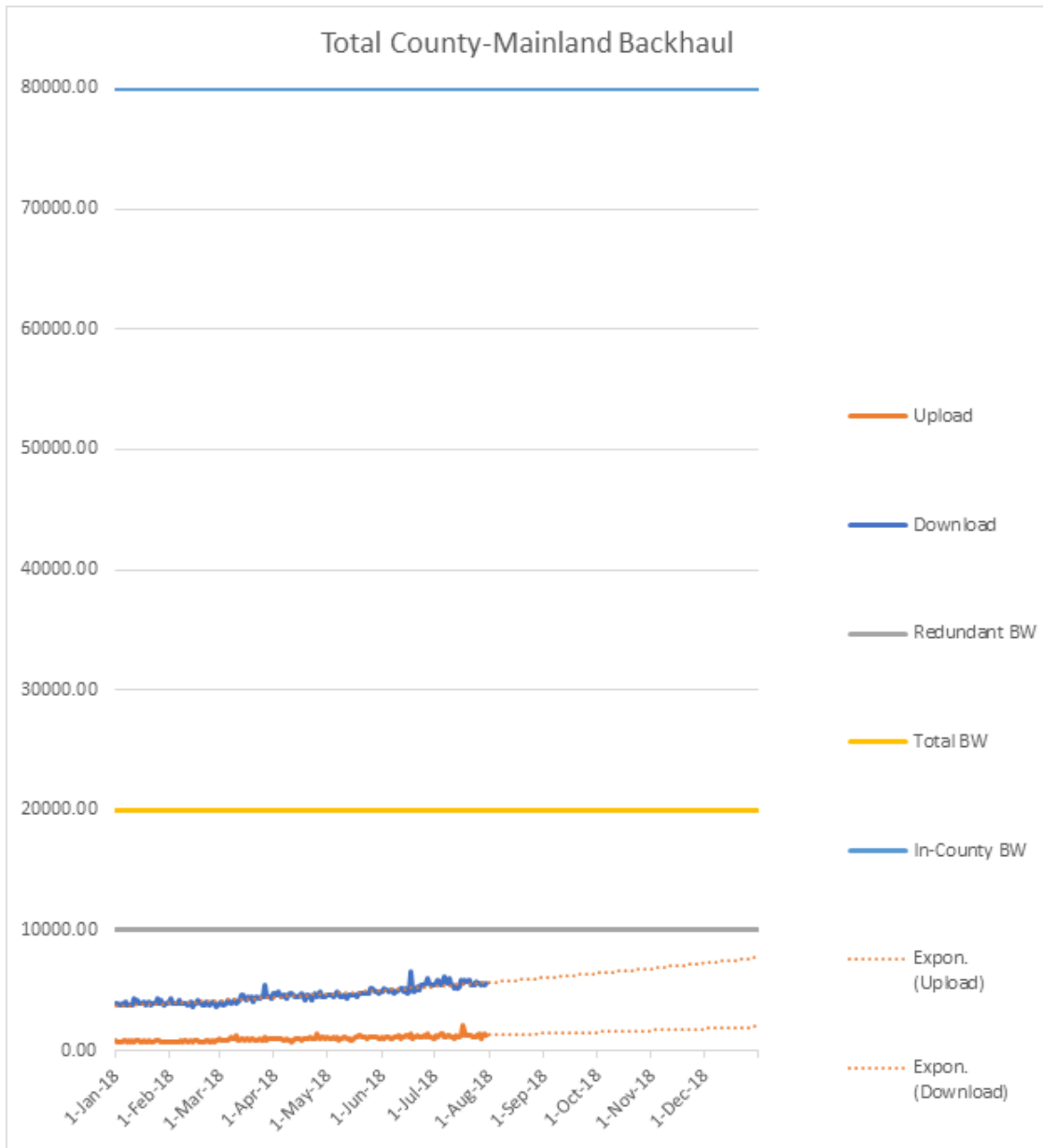
At this stage, our capacity forecast indicates that we will be nearing our single-link capacity of 10Gb/sec early in 2019. Within the next 3 months, we will commission our tertiary mainland path via Mt Vernon, which will add another 10Gb circuit to Seattle, bringing our aggregate mainland backhaul capacity to 30Gb/sec over 3 paths, and three different providers, allowing us to balance traffic over multiple circuits, providing n+1 redundancy for a total of 20Gb/sec.

The paths we've commissioned are all technology-upgradable to higher bandwidths, which provides a number of options for Rock Island to meet county capacity needs for the foreseeable future, with the ability to negotiate reasonable market prices for transport, rather than be forced to accept uncompetitive pricing from a lack of options.

The following graphs indicate our current data use and capacity overhead. As illustrated, overall network use is well within our current and planned bandwidth capability, and provides large amounts of in-county capacity, which will enable advanced network services in the future.

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Mainland fiber outage – Roundabout construction in Anacortes

WSDOT required a complete fiber cut for our single mainland fiber run to prepare for roadwork construction in Anacortes earlier in the year, with a declared outage of 9 hours. Through negotiation we managed to reduce the outage period to 5 hours.

Rock Island’s continued growth has placed greater reliance on continued communication for the county – we now backhaul nearly all county-to-mainland cable-transport traffic (with the exception of CenturyLink), and provide phone services for more than 2,500 county residents.

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Engineering and Operations

August 2018

Capital Plant

Fiber

Currently we have 139 committed Last Mile Projects in the queue. This means that as of now we have our fiber goal for the year of 485 either connected or committed. There are over 150 potential customers engaged in the pipeline with nearly 300 right behind indicating interest. Given our close rate on fiber of 50% we could see as many as 225 additional connections by year end. The massive work load demands resource attention.

Fiber Capital Projects

Over 100,000' of fiber are currently under construction across the county. This is larger than expected due to a joint effort with CenturyLink CAF projects. It is proving to drastically increase our reach on Orcas Island and fills in other locations where power URD replacement is occurring.

LTE

Currently we are constructing the Orcas West Site and should be online in mid-August. Another site on Decatur Island is in the final material process and once we have the material we will schedule the build. One more site is in negotiation in the Three Corner Lake area. We are working on filling in the remaining section along Roche Harbor Rd.

Small Cell LTE

An exciting feature coming in August is the introduction of Small Cells. We have a pilot project location in the Tree Streets on Orcas to test out and deploy LTE into an area that is underserved with LTE and Fiber is not economically feasible. Based on this project we look at deploying small cells in other congested or under-served areas. These sites provide short-haul, high capacity connections to isolated areas.

Concluding Summary

Rock Island remains in good standing financially and maintains strong growth each quarter. The ability to deliver on the number of connections we have, given the drastic decrease in the number of new poles, and the lack of employee resources in the fiber positions has been resilient. Our team has increased dramatically in efficiency and continues to refine its procedures and methods. Fiber onboarding has never had so much momentum and potential and we intend to take full advantage of that. It certainly helps that we have laid the foundation to establish a reliable and scalable network. Thanks to the efforts of a very capable technology team we see our network growing at whatever rate San Juan County demands. Sales is engaging new marketing and outreach techniques that have shown signs of increased response and effectiveness bringing services to community at a rapid clip.

We are dedicated to our goal of seeing this company become a mature business that our cooperative can be proud of. Making our milestone of being operationally cash flow positive is the priority of the team and with our strategies surrounding trimming expenses needed for startup and maintaining our onboarding we feel confident in making that milestone.

We have not forgotten the principal perception that got this whole thing started. Our county needs better access to essential, reliable services. Rock Island and its team will continue to work with the leadership group in realizing that goal.

Sincerely,

Rock Island Management Team