



Profitable ILEC of the Future

Clay Sturgis, Partner

MOSS ADAMS_{LLP}

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.



GOAL & GUIDING PRINCIPLES

Goal: “Deliver a thought provoking, at times likely uncomfortable presentation on the following via 2-way means”:

1. What will the ILEC industry look like in 5-10 years?
2. What is your company, and others, doing now to prepare for it?

Guiding Principles

1. Create a 2 part seminar – report back in '14?
2. Focus only on topics, questions and data key to profitability in the future
3. Avoid bias (unlikely) and do not skirt big issues
4. Don't stink up the place



WHY THIS:

- **Topic?**
 - Industry landscape has changed and continues to be uncertain.....duh!
 - Push remains needed. There is a danger in not embracing change, thus we fall back on what we know and do what we have always done.
- **Presentation Method?**
 - 1-way presentations are the norm
 - People want to know what others are doing
 - People are often reluctant to share in class settings
 - People love clickers

WHERE ARE WE GOING – PULSE OF THE INDUSTRY



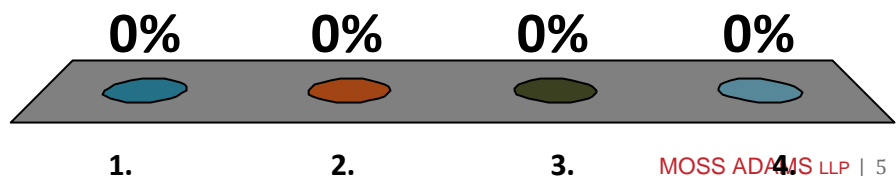
MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

WARM UP QUESTION – REGARDING THE RATE OF CHANGE IN THE INDUSTRY

1. I'm caught up, understand it all, and know exactly what to do
2. I feel good about my knowledge level and directionally we are in ok shape
3. I feel like I'm drinking from the fire hose and am uncomfortable about our direction
4. I stopped paying attention to reform/changes and started paying more to my retirement date



I CONCEDE THE FACT MORE PEOPLE ARE WIRELESS ONLY AND WE ARE FACING LANDLINE LOSS, AN AGING POPULATION BASE AND REGULATORY CHANGES – THUS SQUEEZING FUTURE PROFITABILITY

1. Yes
2. No



1.



CHANGING LANDSCAPE

- Over one third of American homes are wireless only
- 2011 vs. 2010–
 - Median land line loss 3.7%
 - Broadband internet revenue has increased 4.8% per year
 - Video revenue has increased an average of 5.4% per year
 - Average Access Minutes decreased over 10%
- FCC's Goal - by 2020 at least 100 million U.S. homes should have affordable access to 100 Mbps

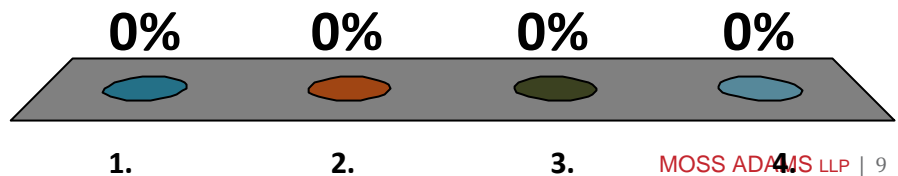


CHANGING LANDSCAPE

- **USF/ICC REFORM – Are we at halftime yet?**
 - Good - Beginning to understand, and seeing the impacts, of the CAF/ICC Changes
 - Bad - Regression state of limbo = unpredictability
 - Ugly? New items include threatened RoR (8%)
 - Unknown - Possibility of Broadband based support

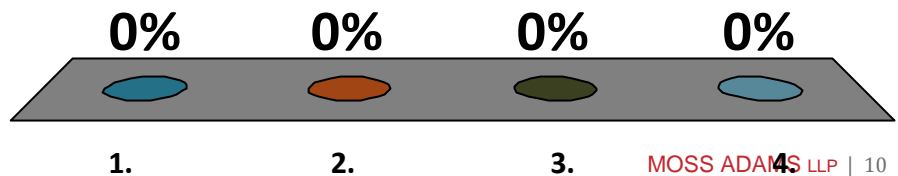
WE FACE CUSTOMER/COMPETITIVE CHALLENGES AND REGULATORY UNCERTAINTY – WE WILL _____ AS AN INDUSTRY IN THE FUTURE:

1. Thrive
2. Hold our own
3. Slowly erode
4. Decline quickly



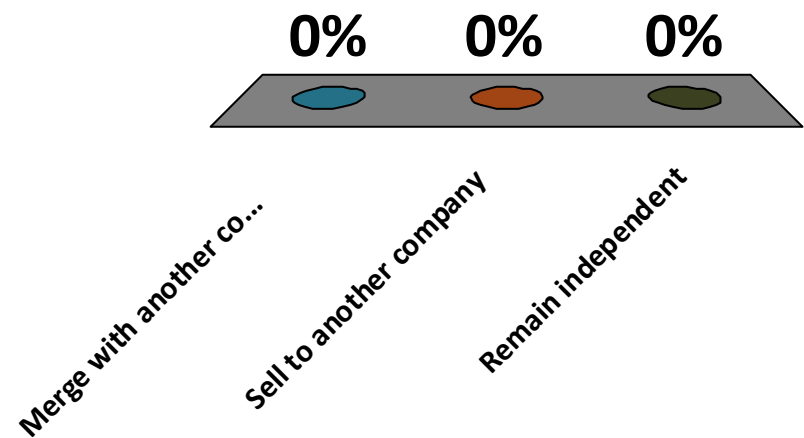
WE FACE CUSTOMER/COMPETITIVE CHALLENGES AND REGULATORY UNCERTAINTY – WE WILL _____AS A COMPANY IN THE FUTURE:

1. Thrive
2. Hold our own
3. Slowly erode
4. Decline quickly



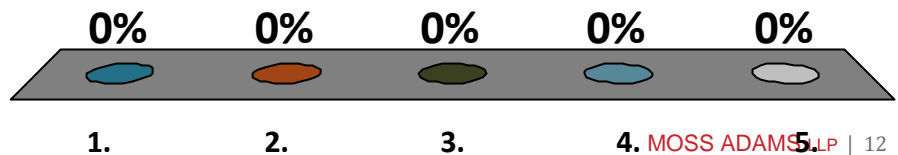
TO BE SUCCESSFUL IN THE FUTURE, I BELIEVE MY COMPANY SHOULD

1. Merge with another company
2. Sell to another company
3. Remain independent



THE FOLLOWING CHARACTERIZES OUR STRATEGY TO BE SUCCESSFUL IN THE FUTURE

1. Minor tweaks. What has worked in the past will work going forward
2. Focus on new sources of revenue
3. Selling the services we already have is key
4. Big ideas such as consolidations to gain economies of scale
5. Cost controls - We will save our way to prosperity



HISTORICAL PROFITABILITY

-MEDIAN VALUES FROM TELERGEE STUDY



MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.



2011 NET INCOME AS A % OF REVENUE

0%	1. (5%)
0%	2. (1%)
0%	3. Flat
0%	4. 3%
0%	5. 5%
0%	6. 10%
0%	7. 15%
0%	8. 20%

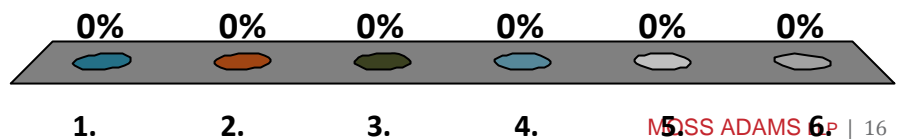


NET INCOME AS % OF REVENUE

- 2011 = 10.1%
- 2008 = 9%

CASH AS A PERCENT OF ASSETS - 2011

1. 1%
2. 5%
3. 8%
4. 10%
5. 15%
6. >20%



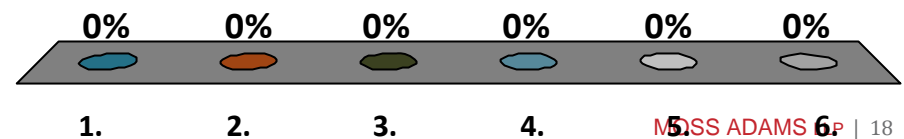


CASH AS A PERCENT OF ASSETS

- 2011 = 8.3%
- 2008 = 7.6%

EQUITY AS A PERCENT OF ASSETS - 2011

1. <30%
2. 30%
3. 50%
4. 60%
5. 70%
6. >70%





EQUITY AS A PERCENT OF ASSETS

- 2011 = 69.8%
- 2008 = 67.9%

Balance sheets are healthy – why all the negativity?

REGULATED REVENUES – CHANGE OVER PRIOR YEAR

0%	1. -3%
0%	2. -1%
0%	3. Flat
0%	4. +1%
0%	5. +3%
0%	6. +5%
0%	7. >5%

NONREGULATED REVENUES – CHANGE OVER PRIOR YEAR

0%	1. -3%
0%	2. -1%
0%	3. Flat
0%	4. +1%
0%	5. +3%
0%	6. +5%
0%	7. >5%

NET INCOME— CHANGE OVER PRIOR YEAR

0%	1. -3%
0%	2. -1%
0%	3. Flat
0%	4. +1%
0%	5. +3%
0%	6. +5%
0%	7. >5%



GROWTH

- Regulated revenues +1.7%
- Nonregulated revenues +5.4%

- Net income +.1%

Revenue growth is positive, yet slowing, and expenses are keeping pace.

UNCERTAINTY.....

- USF/ICC REFORM
 - Average Moss Adams company support is estimated to decrease \$2 million over the next 10 years (\$198,745 annually)
 - Results for the 10 year period ranged from a moderate increase in support to a decrease of over \$22 million
 - This does not factor in the proposed reduction in the RoR or changes to regression model.



ONE CPA'S (FAIRLY UNBIASED) TAKE

- There is good news. Many are in a position of strength in terms of their balance sheet.
- Challenges. There will not be one answer to thrive – but clearly slowing revenue growth/profitability and regulatory reform requires a different approach to the future

“When you are winning, and things are going well, is the time to question yourself”

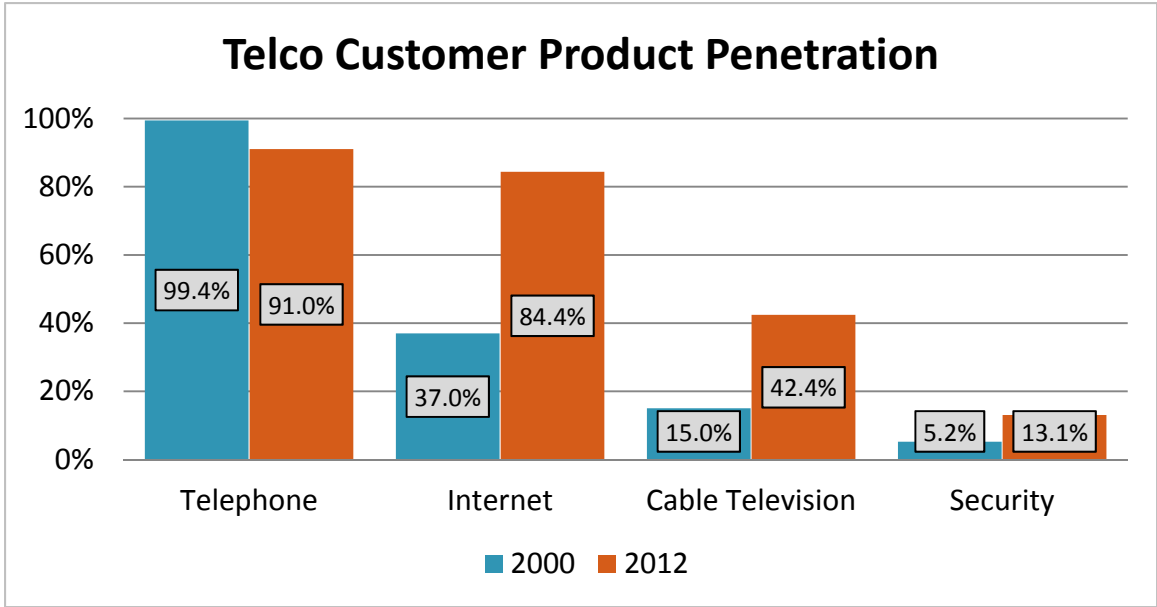
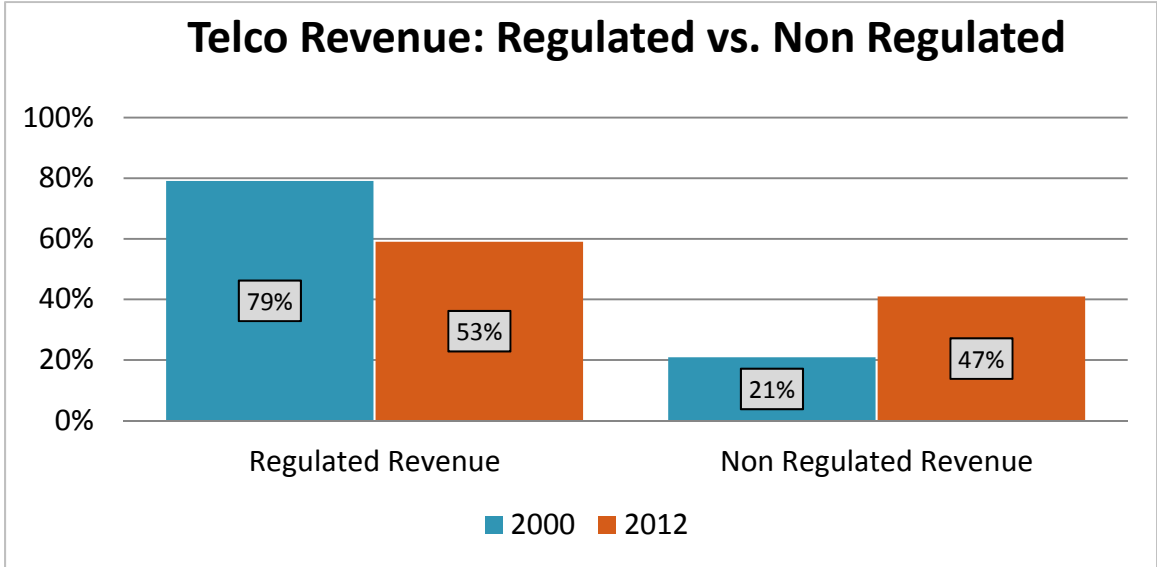
-Roger Federer



IT'S EASY FOR THE CONSULTANT TO SAY.....BUT A SUCCESSFUL FUTURE CAN BE BOILED DOWN TO A FEW AREAS

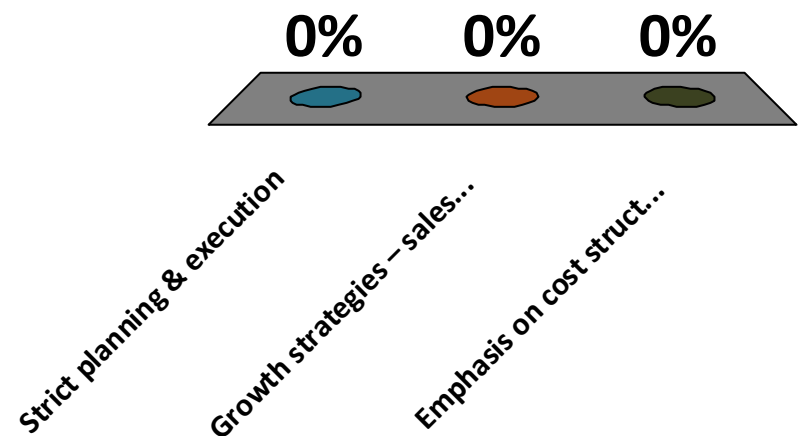
- Vision and a plan – with rigorous focus on execution
- Need to be Efficient
 - Network: Positioned for the future?
 - Cost Structure: Headcount, Compensation, etc.
- Revenue Growth & Diversification
 - Get into profitable service lines and exit others
 - Create a sales/marketing culture
- Robust Business Intelligence – to manage your business

So let's ask questions and see what you have to say



WHAT WOULD THIS ACTUAL COMPANY SAY WAS THE MOST CRITICAL IN INCREASING PROFITABILITY, WHILE DECREASING RELIANCE ON REGULATED SOURCES – ALL IN CHANGING TIMES?

1. Strict planning & execution
2. Growth strategies – sales/services
3. Emphasis on cost structure/efficiency



FIRST YOU NEED TO PLAN – VISION, GOALS AND EXECUTION



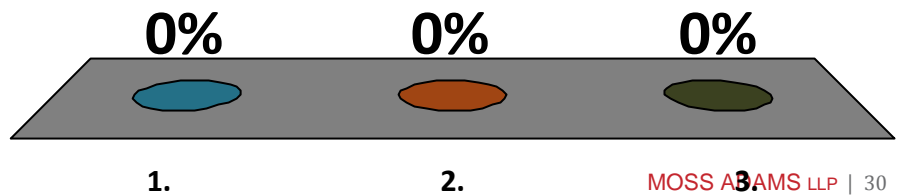
MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

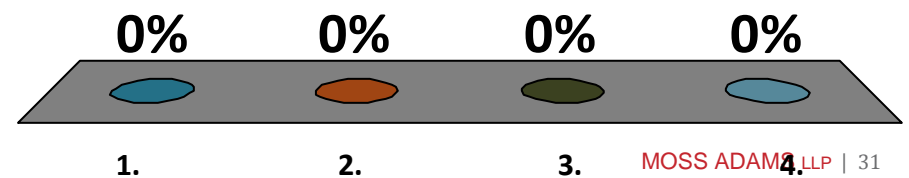
I AM COMFORTABLE THAT MY COMPANY HAS A STRATEGIC PLAN THAT WILL ENABLE US TO THRIVE IN THE FUTURE

1. Yes
2. No
3. Unsure



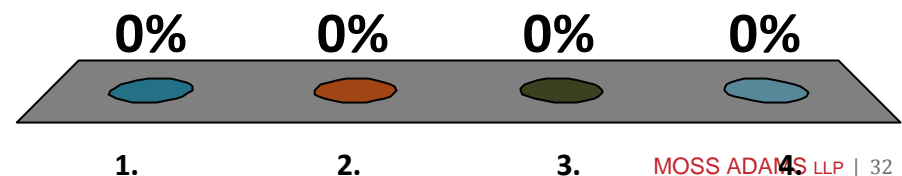
IF POLLED, OUR EMPLOYEES WOULD SAY THEY ARE COMFORTABLE THE COMPANY HAS A STRATEGIC PLAN THAT WILL ENABLE US TO THRIVE IN THE FUTURE

- 1. Yes
- 2. No
- 3. Unsure



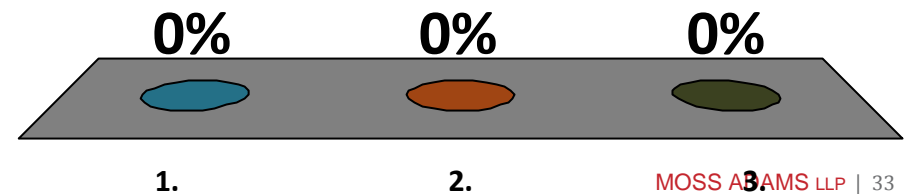
REGARDING PLANNING

1. We spend so much time planning, talking what-ifs, that nothing ever gets done regarding a plan
2. The time spent on planning seems about right
3. Planning is minimal as we are fighting daily fires
4. We don't need a strategic plan



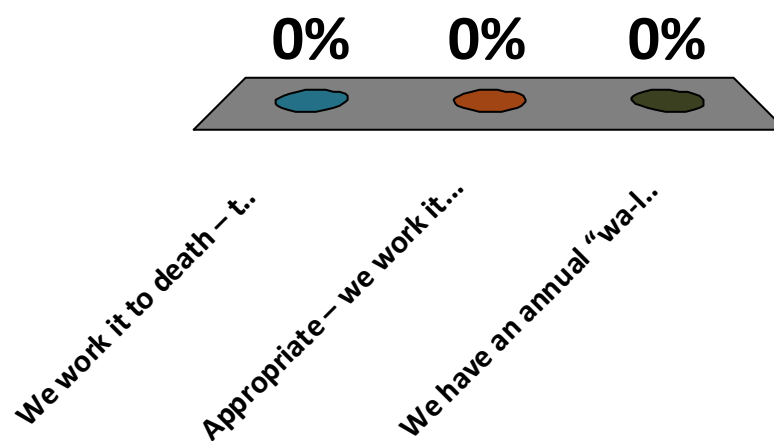
WE HAVE AT LEAST ONE OFFSITE STRATEGIC PLANNING SESSION PER YEAR

1. Yes
2. No
3. We are inconsistent



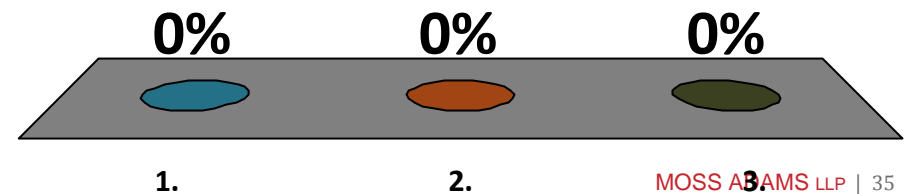
THE FOLLOWING BEST DESCRIBES WHAT HAPPENS AFTER OUR PLAN IS DEVELOPED

1. We work it to death – too much time spent on it
2. Appropriate – we work it frequently and progress is monitored
3. We have an annual “wa-la” approach or don’t look at it again



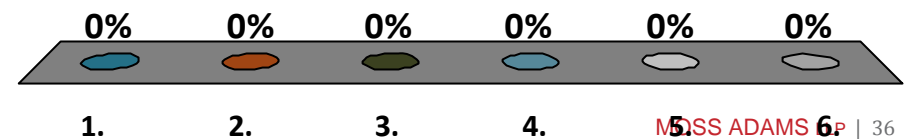
I SEE AT LEAST ONCE A YEAR HOW OUR COMPANY COMPARES TO OTHERS (I.E., BENCHMARKING)

1. Yes
2. No
3. We are inconsistent



WE ACTIVELY USE THE FOLLOWING MULTI-YEAR ITEMS (AT LEAST 3 YEARS)

1. Balance sheet
2. Income statement
3. Cash flow
4. Balance sheet & income statement only
5. All 3 statements
6. None



CONSULTANT THOUGHTS - MACRO

- Median % with strat planning meetings – 66%
- Median % with multi-year forecasts - 39.1%
- What are companies doing that work?
 - Hold offsite planning meetings
 - Develop a few solid core strategies
 - Focus on execution and regularly work the plan
 - Know their numbers & benchmark to others
 - Keep a multi-year forecast
 - Strive to have mission clarity throughout the organization – through communication, reward systems, etc.

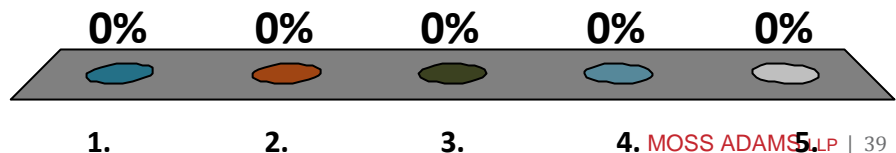
I PERSONALLY HUNGER AND AM EXCITED TO DEAL WITH CHANGE

1. Yes
2. No



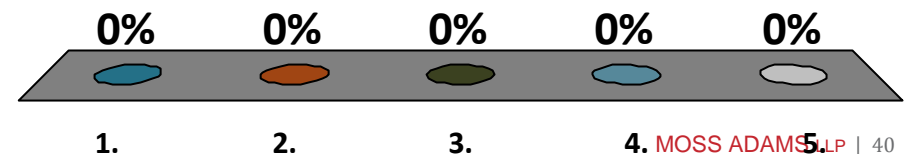
SOME WOULD ARGUE WE NEED TO OPERATE LIKE OUR COMPETITORS TO THRIVE – FROM SALES/MARKETING TO COST CONTROLS

1. I agree and we are actively moving down this path
2. I agree – in preliminary stages
3. I agree but am not sure where to start
4. Don't feel we need to
5. We have to but don't think we will



JIM COLLINS SAYS GREAT COMPANIES HAVE THE RIGHT PEOPLE ON THE RIGHT SEATS

1. We absolutely have it
2. Close and everything will be in place within a year
3. Haven't assessed it
4. We don't have it and not sure where to start to fix it
5. Not sure but the team works for what we need



THE PEOPLE



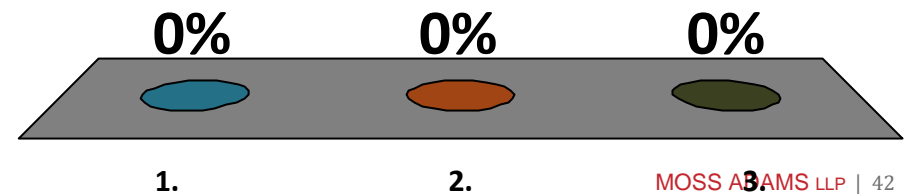
MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

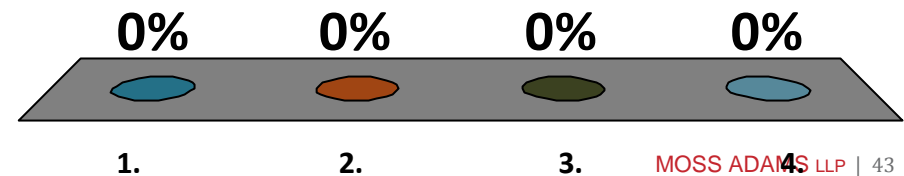
PERFORMANCE MANAGEMENT

1. We have a rigorous system, with a minimum of annual evaluations.
2. We are inconsistent
3. We are very informal



SUCCESSION PLANNING AT THE GM AND TOP MANAGEMENT LAYER

1. We have a solid succession plan for the GM & mgt
2. We are in the early stages of succession planning
3. Uncomfortable topic for my company
4. Never discussed or considered it



THE CUSTOMER EXPERIENCE



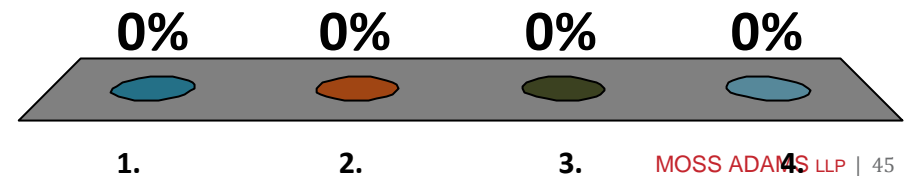
MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

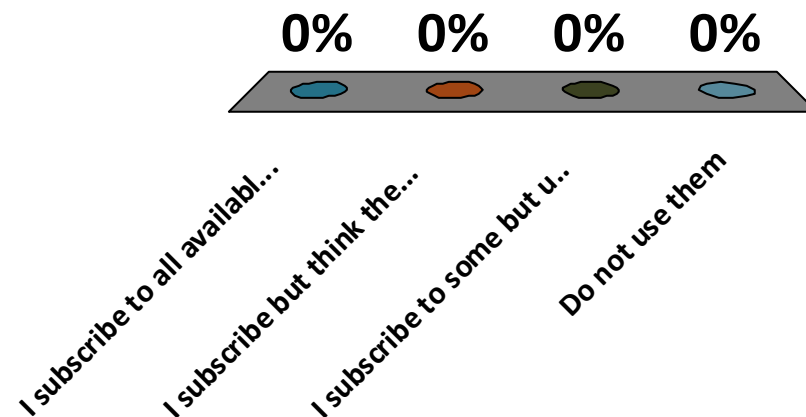
CUSTOMERS WOULD RATE THEIR EXPERIENCE

1. Cutting edge and would likely pay us more than a competitor due to the quality and service they receive
2. Good, but we are commoditized and its all about price
3. Likely behind the times but customers loyal due to company history
4. Needs improvement



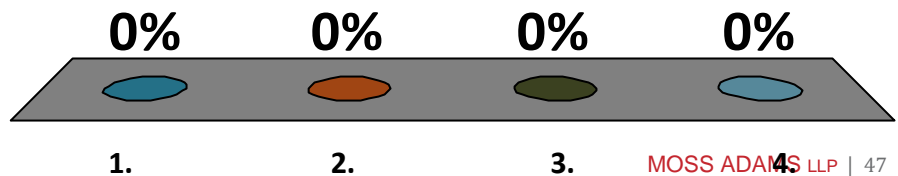
FOR THOSE IN YOUR COMPANIES SERVICE AREA

1. I subscribe to all available ILEC services and would even if it wasn't discounted. The experience top notch
2. I subscribe but think the experience could be improved
3. I subscribe to some but use a competitor for others
4. Do not use them



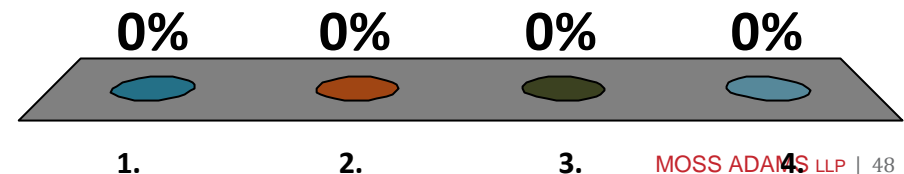
OUR SERVICES

1. We have implemented significant new service lines such as security, cloud computing in the last 2 years
2. We are actively modeling advanced services – yes/no decision by year end
3. We talk about it, but no real action
4. Our market does not require or demand it



WHAT BEST DESCRIBES OUR SERVICE STRATEGY

1. Always looking for new ones and actively research/adopt them
2. Jump into anything our neighbors are doing
3. Really don't consider them – either due to lack of profitability or believe customers won't buy them
4. Feel we will do the best job just focusing on voice and broadband



GROWTH



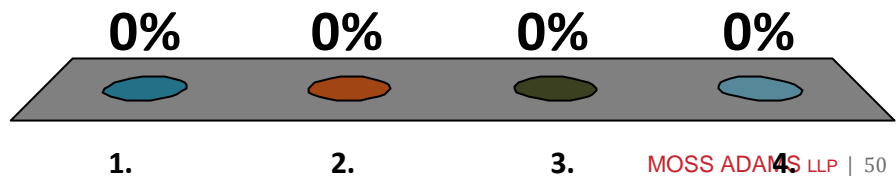
MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

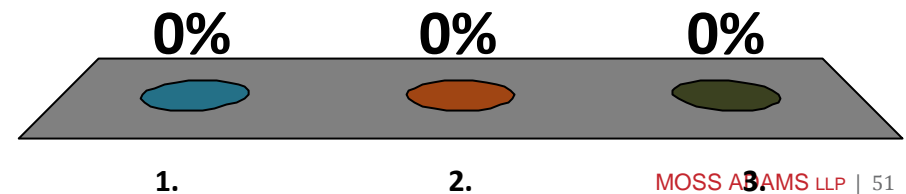
SOMEONE MOVES INTO THE AREA.....

1. Our name is plastered everywhere, and even if they missed it, word of mouth puts us at the top of their needs list for advanced services
2. I fear we would be invisible or only known as the “the phone company”
3. Our visibility is good
4. Not sure



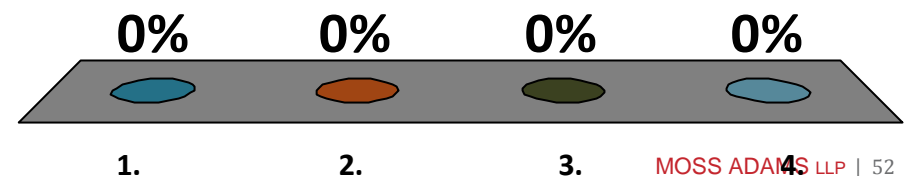
MARKETING

1. Our marketing approach, including branding, is relatively the same as it was 5 years ago.
2. We have made significant changes in terms of the way we market in the last 5 years – it's working
3. We have made changes – no real results



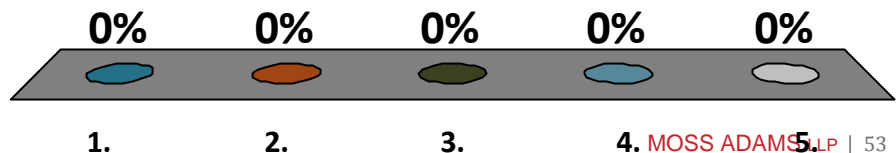
THE INDUSTRY IS LOSING 3% OR SO LINES PER YEAR

1. Nothing we can do about it
2. We are continually upgrading our services/plans to slow or reverse this trend
3. We have a formal win-back strategy that seems to be working
4. Don't have a good strategy for it



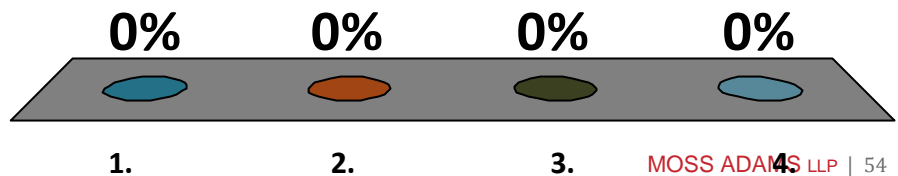
SALES CULTURE

1. Everyone has a sales goal/quota
2. CSR's are the primary sales force
3. We have made sales changes in the last 2 years -that are working
4. Made changes - not working
5. No significant changes



IF WE DEVELOP A PLAN WHERE ALL EMPLOYEES HAVE SOME SALES RESPONSIBILITY

1. The complaining would be deafening
2. People would accept it and thrive
3. Our organization is not equipped to handle it
4. I don't think we need it or it would never work



YOU ARE AN EMPLOYEE. IF YOU WERE TOLD YOU WOULD GET \$250 IF THEY LANDED 5 NEW CUSTOMERS OR FEATURES IN A MONTH, WOULD YOU?

1. Yes
2. No



1.

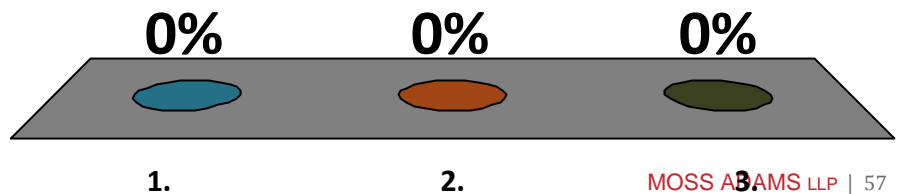
2. MOSS ADAMS LLP | 55

SWITCHING GEARS TO SERVICES – DOES ANYONE ELSE CONSIDER THIS DIFFICULT?

- The numbers. 2011 vs. 2010 (Telergee - median values):
 - Revenue Growth
 - Wireline: 1.7 vs. (.1%)
 - Wireless: .4% vs. 5.5%
 - Video: 5.4% vs. 7.4%
 - Internet: 4.8% vs. 6.8%
 - Non-regulated Margins
 - CLEC: (\$52k) vs. \$37k
 - Wireless: \$12k vs. (\$2k)
 - Video: (\$29k) vs. (\$22k)
 - Internet: \$277k vs. \$228k

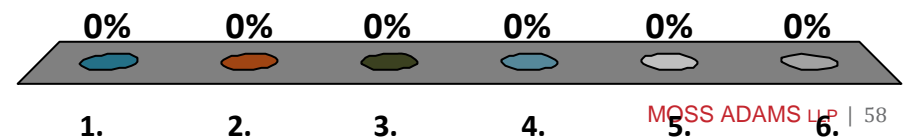
IN GROWING REVENUES, THE MOST CRITICAL IS

1. Keeping customers
2. Selling additional services to existing customers
3. Getting new customers

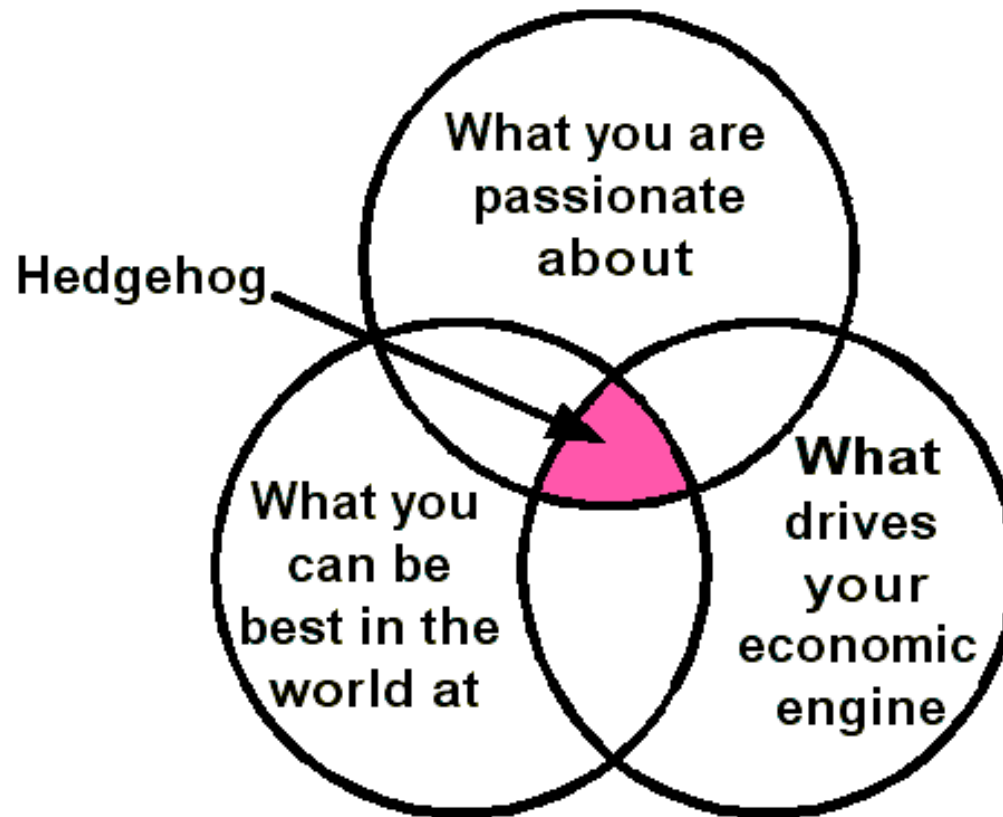


REGARDING THE SERVICES WE OFFER – CATV OR IPTV

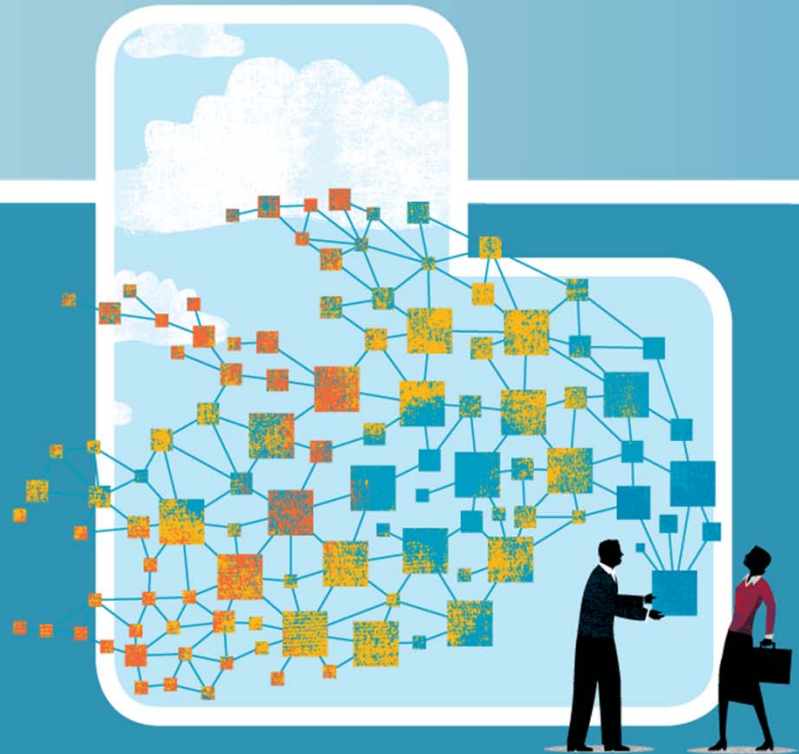
1. We don't do it because it doesn't make money
2. We don't do it because it doesn't fit our skillset
3. We need to, not sure why we don't
4. We do and shouldn't
5. We do it, with low/negative margins, because it makes the customer sticky
6. We do it because it makes money



WHAT COLLINS WOULD SAY.....BUT CERTAINLY A TOUGH CHOICE WITH COMPLIMENTARY SERVICES & “THE SPIRIT OF THE COOPERATIVE”



EFFICIENCY



MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

CONSULTANT – YOU HAVE HEARD THIS BEFORE

- The need for efficiency has been presented to death – no need to discuss why
- The numbers. 2011 vs. 2010 (Telergree median values):
 - Net income as % of revenue: 10.1% vs. 9.8%
 - Plant adds as % of assets: 8% both years
 - Headcount change is zero both years.
 - Payroll \$ change: +.8% vs. +1.6%.
 - Health insurance as % of payroll: 23% vs. 21%.
 - Pensions/401k as % of payroll: 8.6% vs. 9.8%.
 - Total overheads as % of payroll: 45% vs. 42.3%.
 - What will 2012/2013 yield in these areas?
- Many companies making slow progress in:
 - Benefit changes (employees paying more, etc), performance based comp, employee performance and project management.

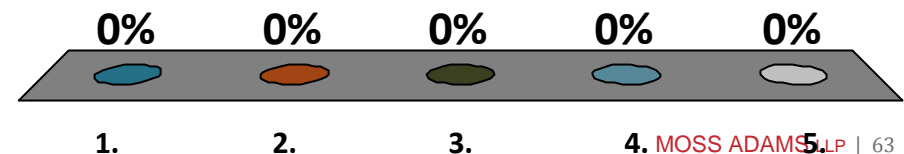
OVER THE LAST 2 YEARS WE HAVE TAKEN SERIOUS COST CONTROLLING MEASURES

1. Yes
2. No



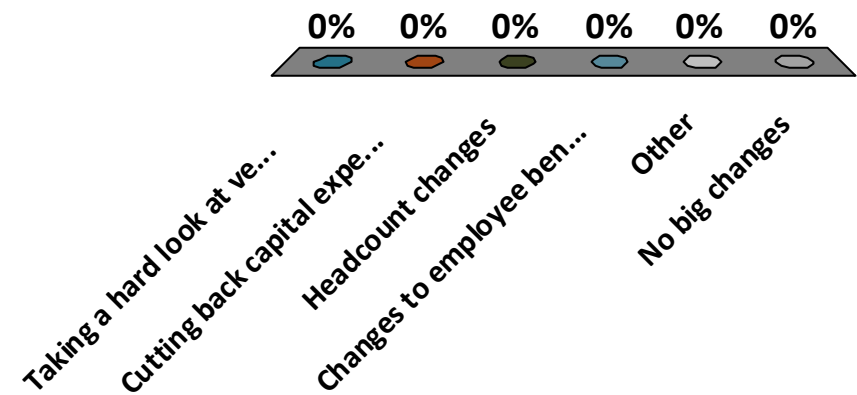
EFFICIENCY

1. We have made big changes and are as efficient as we can be
2. We have not made big changes, but are as efficient as we can be
3. We have really streamlined but are only about half way to where we need to be
4. We know we need to, but whether due to history or culture, we are having a tough time getting started
5. We haven't done much



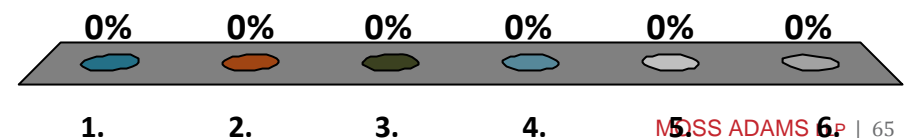
AREAS WE HAVE MADE THE BIGGEST CHANGES IN THE LAST 12 MONTHS

1. Taking a hard look at vendors/prices
2. Cutting back capital expenditures budget
3. Headcount changes
4. Changes to employee benefits and/or pay
5. Other
6. No big changes



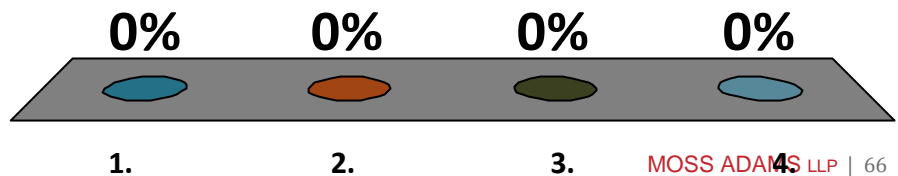
AREAS WE NEED TO FOCUS ON IN THE NEXT 12 MONTHS – BIGGEST IMPACT

1. Taking a hard look at vendors/prices
2. Cutting back capital expenditures budget
3. Headcount changes
4. Changes to employee benefits or pay
5. Other
6. No big changes needed



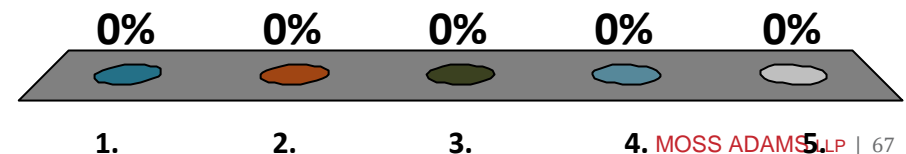
CAPITAL EXPENDITURES

1. We continue a steady pace of build outs
2. We have drastically cut our budget - for fear of the unknown
3. We have drastically cut our budget – as network is built
4. We have accelerated our build out plans



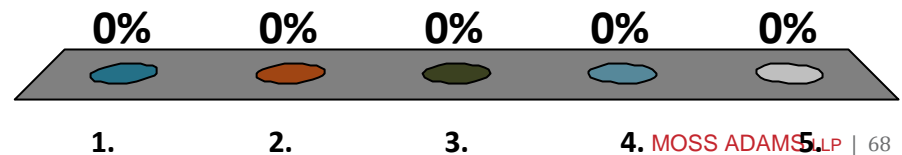
USE OF DEBT

1. We will use general funds only going forward
2. We plan to use minimal debt
3. We plan on using significant debt – due to accelerated plans
4. We plan on using significant debt – as was always the plan
5. Not sure



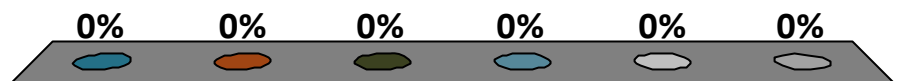
HEADCOUNT

1. We basically are operating the same
2. Strategy attrition without replacement
3. We are contemplating big measures such as RIF's or layoffs
4. Operating the same but making big changes in next 12 months
5. Not sure



SALARIES

1. Our salary programs are relatively unchanged
2. We have frozen salaries
3. We have moved to a performance comp (PC) structure – its working
4. Moved to PC and its not working
5. Are strongly considering PC and actively pursuing
6. Unsure



1.

2.

3.

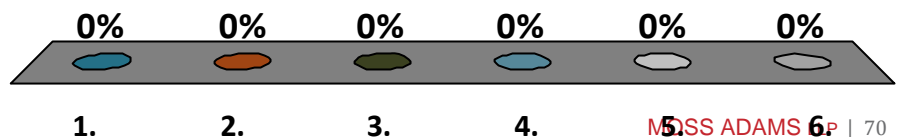
4.

5. **MOSS ADAMS** 6.

69

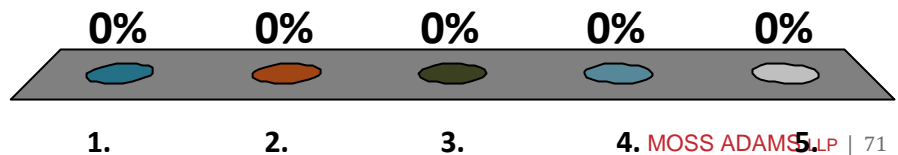
BENEFITS

1. Our structure is largely unchanged and will remain so
2. We have cut back retirement plans
3. We have cut back health care plans
4. Cut back both retirement and healthcare plans
5. Will be changing them in the next 12 months
6. Unsure



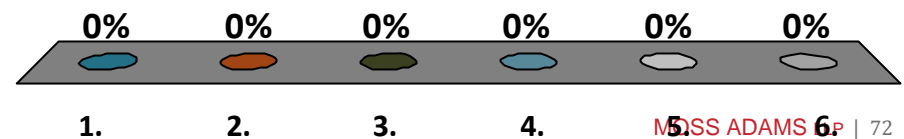
REGARDING EMPLOYEE HEALTH CARE COSTS

1. We pay 100% of employee and family costs
2. We pay 100% of employee and some portion of family
3. We pay 90%
4. We pay 80%
5. We pay 70% or less



OUTSIDE OF THE ILEC INDUSTRY, WHAT IS THE US AVERAGE OF HEALTH CARE COVERAGE?

1. Employer pays 100%
2. Employer pays 90%
3. Employer pays 80%
4. Employer pays 70%
5. Employer pays 60%
6. Employer pays <60%



CLOSING



MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

AFTER LISTENING TO THIS - THE FOLLOWING WILL CHARACTERIZE OUR STRATEGY TO BE SUCCESSFUL IN THE FUTURE

1. Minor tweaks. What has worked in the past will work going forward
2. Focus on new sources of revenue
3. Selling the services we already have is key
4. Big ideas such as Consolidation or merger to gain economies of scale
5. Cost controls. We will save our way to prosperity
6. Other



1.

2.

3.

4.

5. **ROSS ADAMS 6P** | 74



REMEMBER - WHY THIS PRESENTATION:

- Industry landscape has changed and continues to be uncertain
 - **However, balance sheets are strong – time to analyze our game**
- Cannot operate as we have in the past
 - Growth is slowing, we need to **embrace this** and either reverse the trend (sales of existing services, new ones, etc.) and/or revisit the way we do things
- The danger is we fall back on what we know and do what we have always done.
 - **What will your company do?**



I REMAIN CONVINCED....

- Vision and a plan – with rigorous focus on execution
- Need to be Efficient
 - Network
 - Cost Structure
- Revenue Growth & Diversification
 - Get into profitable service lines and exit others
 - Create a sales/marketing culture



Thank You

Clay Sturgis
clay.sturgis@mossadams.com

[www .mossadams.com/industries/telecom](http://www.mossadams.com/industries/telecom)
www.mossadamstelecom.blogspot.com/