



Projecting the Financial & Regulatory State of the Industry in 2024

October 23, 2019

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Introductions & Agenda

- Sara Yocum, Audit Senior Manager (Financial)
- Chad Duval, Consulting Partner (Regulatory)
- Together We Will Focus on 5 Primary Issues
 - The Future of Competition
 - Regulatory & USF Changes
 - Focus on Services
 - Potential for Consolidation/Partnerships
 - Financial Performance



Seeing Into the Future



- Never rely on a fortune teller. By the time you know she was wrong, it is too late to get your money back...
- Our goal is not to predict the future, but to get you thinking about what it may hold...



The Future of Competition

- At some point, voice may no longer be a requirement
 - Broadband only will be the industry norm
 - Customers have access to OTT VoIP
- Cable Modem providers will continue to be a major competitor
 - Will offer retail voice, if they don't today, to meet voice requirement (OTT VoIP?)
 - No problems meeting public interest standards (speed, latency, price, etc.)
 - Will they get access to funding through reverse auctions?



The Future of Competition

- **WISPs will face significantly greater scrutiny**
 - Reporting requirements will pose challenges (mapping, geo location, HUBB, etc.)
 - BarrierFree & MFII challenges shine spotlight on deployment reporting
- **5G Wireless as a potential competitor**
 - FCC has yet to consider mobile wireless as a qualifying competitor
 - Complement, not replacement, to landline service; could 5G change that view?
 - Claims of up to 1 Gbps “peak speeds” & very low latency
 - Rely on very small cell sites & fiber transport
 - There are environmental challenges
 - # of sites & transport could prove cost prohibitive in rural areas
 - **Timing still a significant question mark**
 - Metropolitan coverage has begun, but if/when will it reach rural America?
 - Widespread coverage not likely by 2024



The Future of Competition

- Low Earth Orbit (LEO) satellite providers could be an issue
 - Constellation of satellites able to provide “ubiquitous” coverage
 - Multiple large players: Amazon, OneWeb, SpaceX, & Telesat
 - Claims of 500 Mbps-10 Gbps “peak speeds” & latency far below the 100ms standard
 - No problems meeting public interest standards (speed, latency, price, etc.)
 - Timing of deployment is uncertain, but many are currently testing
 - Cost & pricing still significant question marks



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The Future of Competition

- Other Issues & Key Takeaways

- Competitive coverage is built into model-based support
 - No changes until the end of the funding term
- FCC still considering implications of competitive overlap for Legacy RoR
 - Reverse auctions for “entirely and almost entirely overlapped” study areas
 - No indication when it will be resolved, but likely before 2024
- Will voice remain a requirement for qualifying competitors?
 - Likely so in 2024, but 2029 could be a different story...
- Cable competition is likely to ramp up
- WISP competition may dial back
- LEOs & 5G are competitive wild cards
- 5 years is a long time for technology to evolve



Regulatory & USF Changes

- **Near term focus on reform implementation & network related issues**
 - Location Identification, Mapping & Reporting
 - Broadband Performance Testing
 - Competitive Overlap for Legacy RoR Carriers
 - Overall Cap on USF Budget
 - Rural Development Opportunities Fund (RDOF)/CAF Phase III
 - Intercarrier Compensation
 - Traffic Stimulation/Mileage Pumping
 - Intrastate Originating Switched Access (?)
 - Robocalling



Regulatory & USF Changes

- USF for model-based carriers locked in for 10 years
 - No changes to support for next 7-9 years
 - Focus will be on compliance – network deployment & testing
- What happens to Legacy RoR when current funding cycle ends in 2023?
 - Most likely scenario is a new 5-year funding cycle of HCLS & CAF BLS
 - New deployment obligations @ then current broadband standard
 - Entirely & Almost Entirely Overlapped study areas subject to reverse auction
 - FCC has indicated a willingness to revisit the budget starting in 2024
 - Competitive overlap & inflationary factor mitigate against an increase
 - Broadband Only conversions mitigate for an increase
 - Is A-CAM III a possibility?
 - I don't see it; wreaks havoc with reform of all RoR USF starting in 2029



Regulatory & USF Changes

- **Key Takeaways**

- **Model-based funding not likely to change prior to 2029**
 - **When it does, expect A-CAM “X” &/or reverse auctions**
- **Legacy RoR support will continue similar to what we see today**
 - **New deployment obligations @ greater broadband speed**
 - **Competitive overlap may be an issue for some, but not most**
 - **Unless LEOs & 5G considered qualifying competitors, then we have a bigger issue...**
 - **New A-CAM offers unlikely prior to 2029; alignment**
 - **We don't envision the roof caving in on Legacy RoR**
- **Focus over the next 5 years will be implementation of current USF reform & network related issues**



Focus on Services



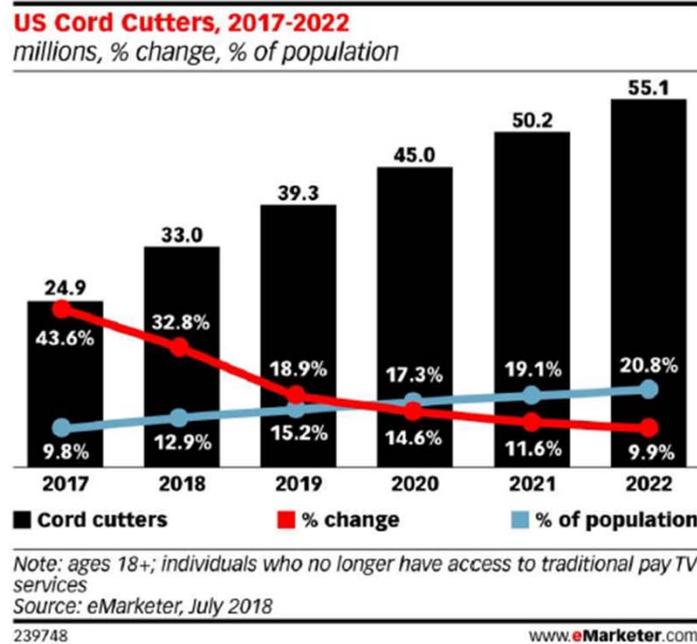
Focus on Services

- **Significant deployment of Broadband Only**
 - > 50% of local loops will be broadband only (75%?)
 - Including growth from new/returning customers
 - Rapid growth in value added OTT services
 - Opportunity to upsell bandwidth to enable OTT services
 - Companies that do not meaningfully adopt will see continued loop loss
- **Elimination/migration of legacy non-regulated services**
 - Cable TV: replaced w/ OTT video
 - Wireless: sold to national carriers
 - Toll Resale: migration to OTT voice

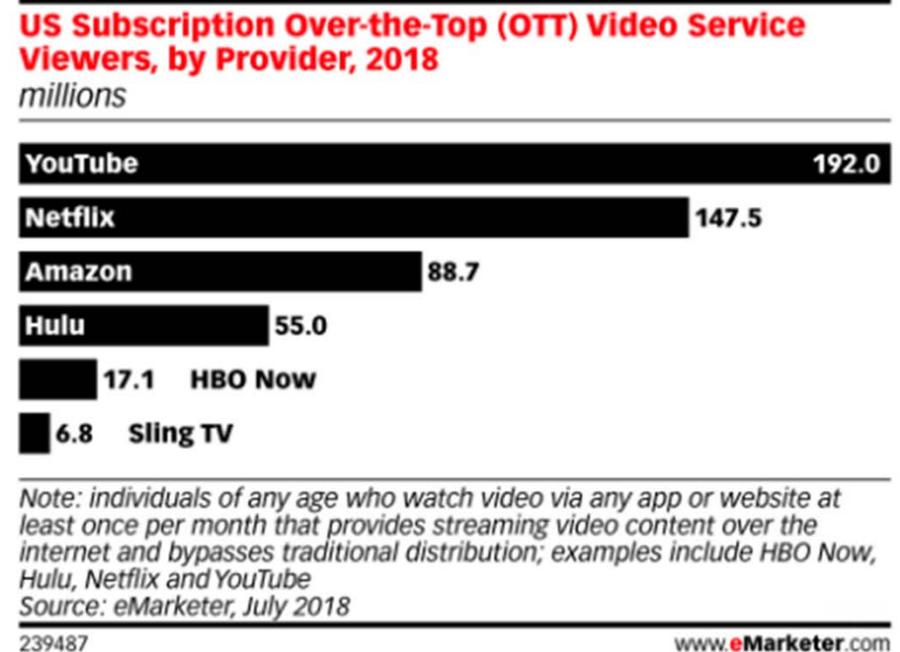


Focus on Services

- Customers are Rapidly Cutting the Video Cord



- OTT Video Subscriptions



Focus on Services

- **Migration to OTT & Managed Services**
 - **OTT VoIP as a replacement for regulated voice**
 - Hosted or affiliate CLEC provisioned
 - **Hosted IP-based services in lieu of facilities based**
 - Reduction/elimination of existing costs
 - Savings on new costs through economies of scale
 - Rapid development and implementation of new services
 - **Focus on value-added Managed Services**
 - Managed WiFi/Routers
 - Data Centers
 - Fiber Transport



Focus on Services

- **Key Takeaways**

- The decline in voice lines will pick up & continue through 2024
- Broadband only will be the dominant service by 2024
 - Don't wait to adopt, but make sure you do it right
- Many legacy non-regulated services are unprofitable & will be eliminated
- Customers will purchase value-added OTT services from their local provider
 - Must be sales & marketing focused
 - Replace existing services & revenues
- ILECs will be key players in providing Managed Services
 - Utilize additional capacity & resources to your benefit



Potential for Consolidation/Partnerships

- **The industry is ripe for consolidation/partnerships over the next 5 years**
 - **Regulatory/USF certainty attracts capital**
 - We are seeing more activity from Private Equity based on stability of USF
 - Traditional & non-traditional lenders are showing increased interest
 - ILECs w/ cash reserves seeing a prime opportunity to invest
 - **Competition appears to be driving values up**
 - Diversification is a key component in valuation
 - Fiber/CLEC Opportunity/Mix of Reg & Non-Reg EBITDA/Access to Business Customers
 - Multiple bidders in most open-market sales
 - Recent valuations in the 6-8x EBITDA range for diversified ILECs



Potential for Consolidation/Partnerships

- The industry is ripe for consolidation/partnerships over the next 5 years
 - Regulatory changes provide incentive for economies of scale
 - Model based support; no longer tied to actual costs
 - Frozen Intercarrier compensation; no longer tied to actual costs
 - Expense limitations not recoverable through USF
 - Optional incentive regulation of BDS for model-based carriers
 - Market realities pose challenges for many rural carriers
 - Family succession issues; is the next generation prepared/interested?
 - Baby Boomers are retiring in droves; is there succession in place/available in key roles?
 - Economies of scale are difficult for small, rural carriers to create



Potential for Consolidation/Partnerships

• Key Takeaways

- The industry is likely to have meaningful consolidation and a growing number of partnerships between now and 2024
 - Regulatory certainty is creating interest, but it may only last so long
 - What happens in 2029 and beyond?
 - Consolidation will likely pick up in the short term (through 2023?), and then slow until there is greater regulatory certainty for 2029 and beyond
 - Valuations, access to capital and competition for acquisitions will follow the same path
 - Regulatory changes will drive some companies to consolidate/partner
 - Model & incentive-based support present opportunity for those that can create scale
 - Cost limitations will force others to seek economies of scale to preserve earnings
 - Family & market dynamics will drive “neighbor” consolidations/partnerships
 - Family/key employee succession & need for scale will create opportunities

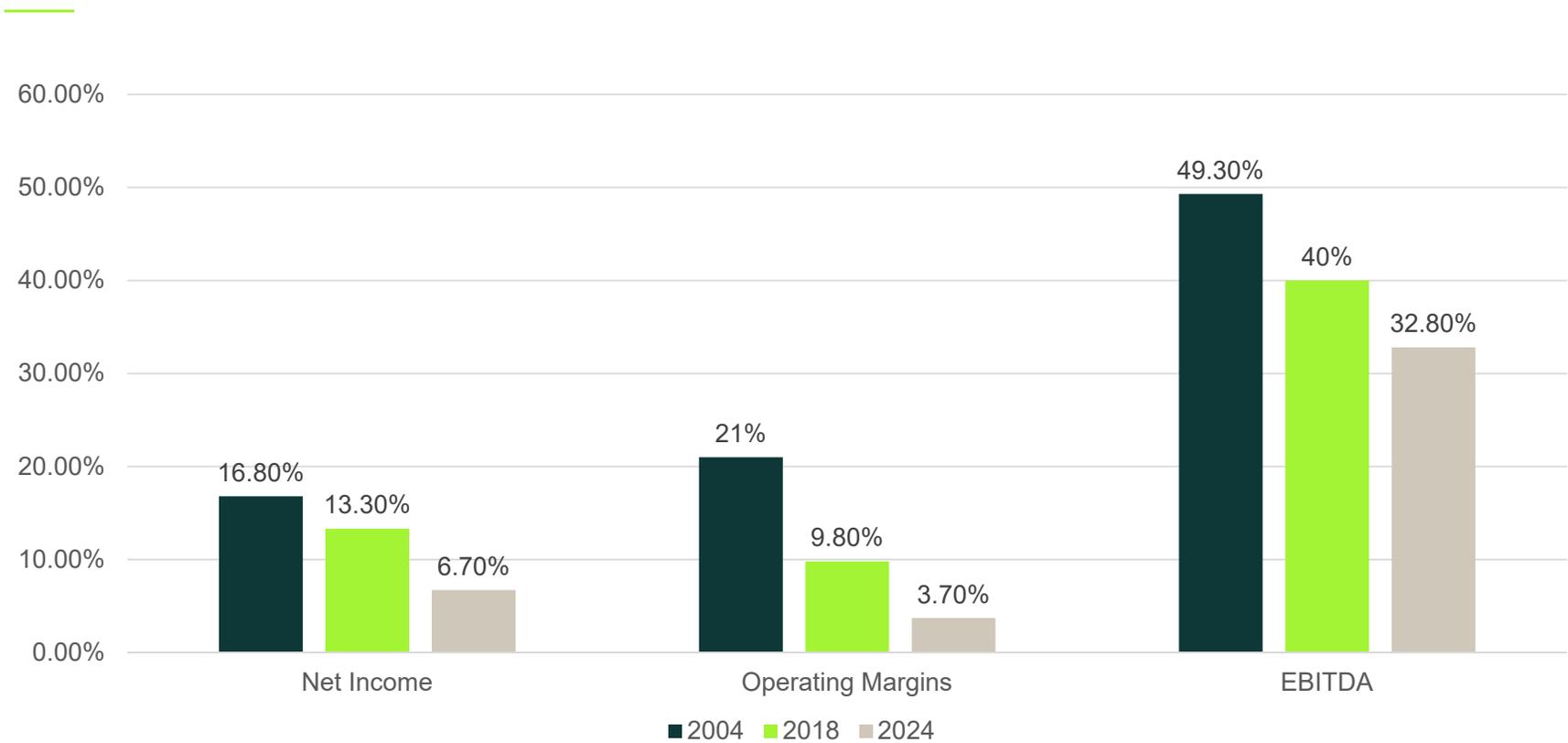


Financial Performance

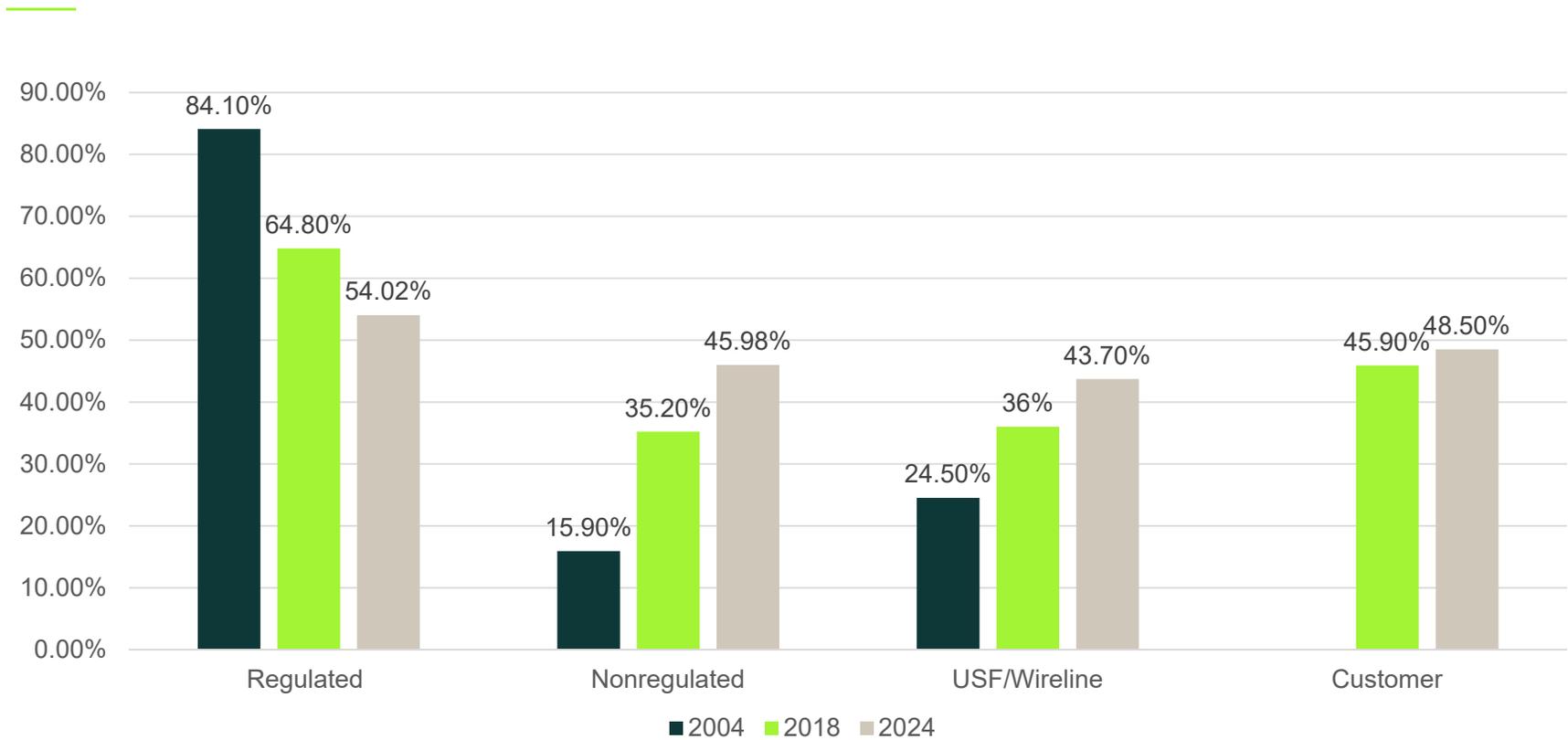
- Forecasted 2024 based on historic 2004 – 2018 results from the Telergee & Moss Adams Benchmark Studies
 - Do we believe the Excel projections?
 - My initial reactions to the results were mixed
 - Nostalgic for the good old days
 - Profitability points to need for efficiency and growth in revenue
 - Reliance on USF continues to be strong
 - Personnel will change
 - Customers will continue to bear a larger burden of revenue
 - Nonregulated services will continue to evolve
 - How do we modify practices if we aren't satisfied with the projections?



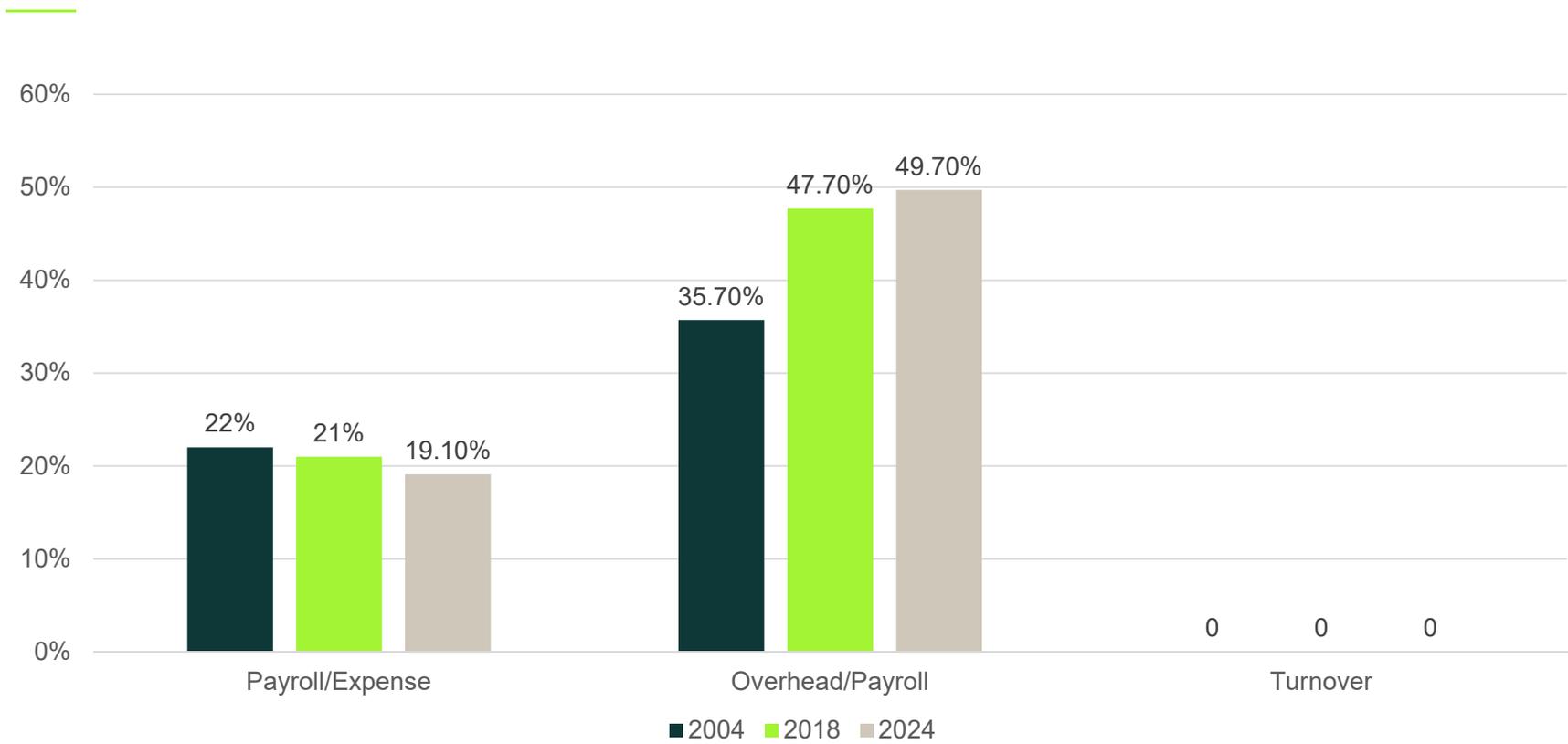
Profitability (% of total revenues)



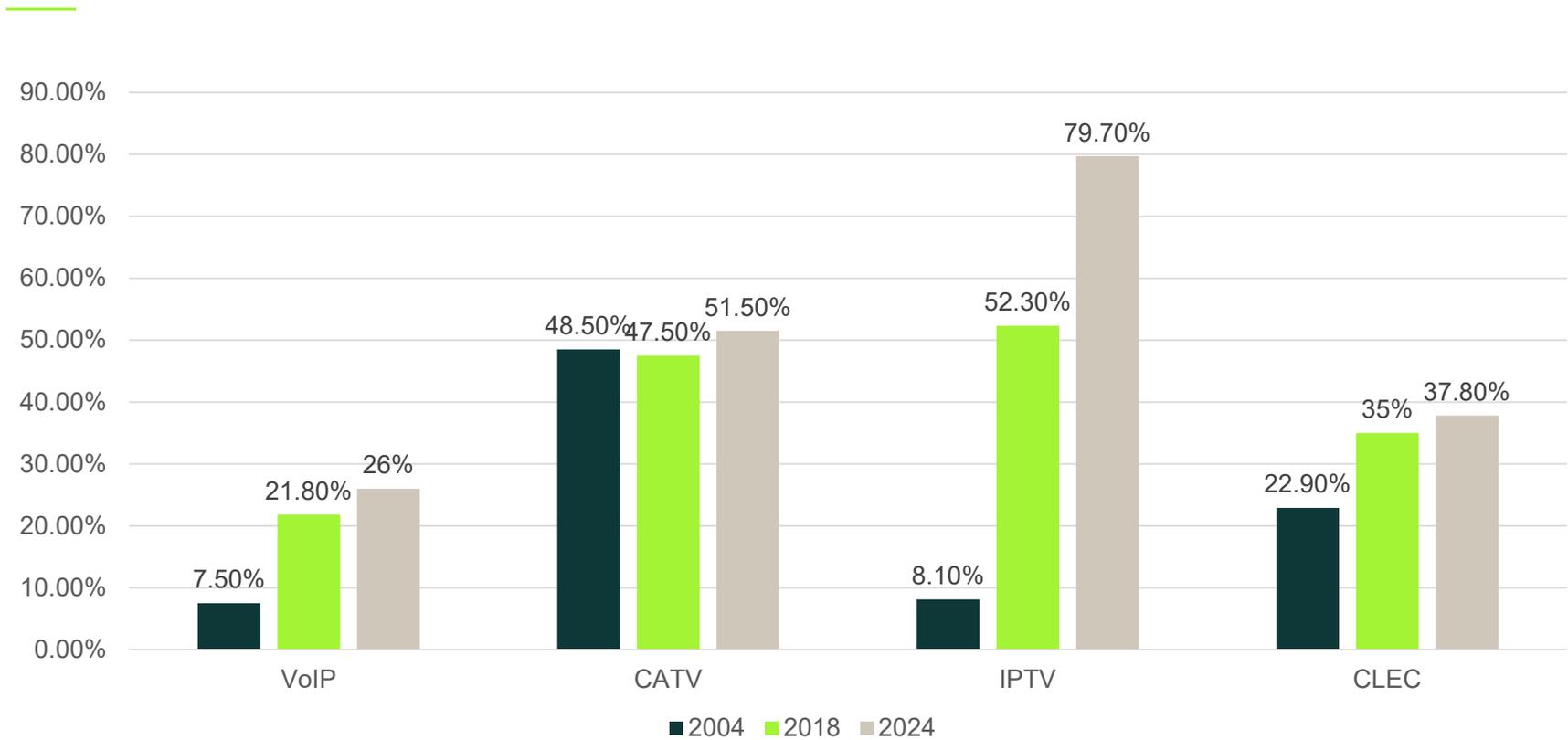
Revenue Mix



Personnel



Nonregulated Services



Closing Thoughts

- **Need to be proactive as we look forward and determine strategic plan**
 - Prepare to compete, potentially with a variety of technologies
 - Understand how USF drives your operation, and project best/worst cases
 - Focus on the services that will drive maximum profitability
 - Generate efficiencies through partnerships/consolidation
 - Create a financial future that does not follow the historic trend line





Questions?

Thank you!

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