

UNDERSTANDING FINANCIAL DUTIES OF THE DIRECTOR

ICA 2019 DIRECTORS TRAINING CONFERENCE
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GOALS

- Gain an understanding of:
 - Basic financial statements
 - Balance Sheet
 - Statement of Operations (Income Statement)
 - Statement of Cash Flows
 - Relationships within financial statements



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ANALYZING FINANCIAL STATEMENTS

- Balance Sheet
- Statement of Operations (Income Statement)
- Statement of Cash Flows

ANALYZING FINANCIAL STATEMENTS

- Statements frequently show at least two years of data (comparative)
- Telephone companies follow Part 32 Uniform System of Accounts (prescribed by the FCC)

BALANCE SHEET

- A summary of a company's financial condition at a specific point in time
- Parts
 - Assets
 - Liabilities
 - Equity (Net Worth)

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BALANCE SHEET

Total Assets

What the company "owns"



Total Liabilities and Equity

What the company "owes" and the remainder (net worth)

Assets are purchased with either liabilities (debt) or equity (internally generated funds)

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BALANCE SHEET - ASSETS

- Current Assets

- Cash and equivalents
- Temporary investments
- Accounts receivable
- Interest receivable
- Materials and supplies
- Prepayments
- Deferred income taxes

Cash or assets convertible into cash at short notice (within twelve months)



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CURRENT ASSETS

	2019	2018
Assets		
Current Assets		
Cash and cash equivalents	\$ 8,000,000	\$ 8,500,000
Certificates of deposit	1,500,000	1,400,000
Accounts receivable:		
Due from customers	65,000	60,000
Interexchange carriers	225,000	275,000
Other	15,000	12,000
Prepaid income taxes	75,000	115,000
Interest receivable	1,500	1,500
Materials and supplies at average cost	575,000	650,000
Prepayments	95,000	125,000
Deferred income taxes	5,500	5,000
	<u>10,557,000</u>	<u>11,143,500</u>

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RELATIONSHIPS

Current Assets

Cash and cash equivalents	\$8,000,000
Certificates of deposit	1,500,000
Accounts receivable:	
Due from customers	65,000
Interexchange carriers	225,000
Other	15,000
Prepaid income taxes	75,000
Interest receivable	1,500
Materials and supplies at average cost	575,000
Prepayments	95,000
Deferred income taxes	<u>5,500</u>
	<u>10,557,000</u>

Current Liabilities

Current portion of long-term debt	\$750,000
Accounts payable:	
Interexchange carriers	45,000
Other	200,000
Customer deposits	5,000
Accrued taxes	<u>75,000</u>
	<u>1,075,000</u>

RELATIONSHIPS

Current Assets

Cash and cash equivalents	\$500,000
Certificates of deposit	500,000
Accounts receivable:	
Due from customers	65,000
Interexchange carriers	225,000
Other	15,000
Prepaid income taxes	75,000
Interest receivable	1,500
Materials and supplies at average cost	250,000
Prepayments	95,000
Deferred income taxes	<u>5,500</u>
	<u>1,732,000</u>

Current Liabilities

Current portion of long-term debt	\$1,750,000
Accounts payable:	
Interexchange carriers	45,000
Other	500,000
Customer deposits	5,000
Accrued taxes	<u>75,000</u>
	<u>2,375,000</u>

RELATIONSHIPS

CURRENT RATIO

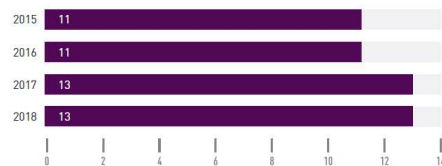
<u>Current Assets</u>	<u>10,557,000</u>	
Current Liabilities	1,075,000	9.82

*Shows ability of an organization to meet
current obligations*

Average Current Ratio

While the current ratio isn't a ratio that garners much attention in the industry, it's still very important for measuring liquidity. An average ratio in the double digits is very good.

Figure 4



CURRENT ASSETS – COMMENTS/QUESTIONS

- How much in cash is enough?
 - What is needed to cover current liabilities?
 - What is needed to cover construction activities?
 - Interest rates factor in
- Any issues/considerations related to:
 - Accounts Receivable
 - Materials and Supplies

BALANCE SHEET - ASSETS

- Other Noncurrent Assets

- Cellular investments
- Available-for-sale securities
- Other investments
 - Aureon
 - Partnerships
 - Etc.
- Prepayments
- Deferred taxes
- Intangibles/Goodwill

- Assets not expected to be converted into cash, sold, or exchanged within the next operating cycle (twelve months)



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OTHER NONCURRENT ASSETS

Other Noncurrent Assets

Cellular investments	2,000,000	2,250,000
Other investments	525,000	575,000
Available-for-sale securities	6,000	4,500
Prepayments, less current portion	425,000	125,000
Deferred income taxes	125,000	100,000
Intangibles	60,000	60,000
	<u>3,141,000</u>	<u>3,114,500</u>

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OTHER NONCURRENT ASSETS – COMMENTS/QUESTIONS

- Investment considerations
 - Profitable?
 - Impairment considerations if not performing
 - Shift to market value presentation
- Goodwill
 - Assess for impairment
 - Amortize over 10 years

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BALANCE SHEET - ASSETS

- Property, Plant and Equipment
 - Telephone Plant
 - Video Plant
 - Accumulated Depreciation
 - Plant Under Construction
- *Assets that are used to provide services to customers/members and generate revenues*
 - *Total “wear and tear” recognized on PP&E since placed in service*
 - *Projects started but not ready to be placed in service*



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PROPERTY PLANT AND EQUIPMENT

Property, Plant and Equipment		
Telephone plant in service	27,951,700	24,570,375
Video plant in service	<u>1,500,000</u>	<u>1,300,000</u>
	29,451,700	25,870,375
Less accumulated depreciation	<u>16,500,000</u>	<u>15,000,000</u>
	12,951,700	10,870,375
Plant under construction	<u>750,000</u>	<u>1,250,000</u>
	<u>13,701,700</u>	<u>12,120,375</u>

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PP&E – COMMENTS/QUESTIONS

- Gross plant includes
 - Cost of materials and equipment
 - Cost of contractor
 - Cost of engineer
 - Cost of internal workforce working on project
- Depreciation
 - Each asset class is depreciated over its estimated life
 - Computers – 5 year
 - Cable – 20 year
 - Important that estimated life coincides with plant replacement plans
- Impairment

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RELATIONSHIPS

RATE OF RETURN ON GROSS PLANT


<u>Net Operating Income</u>	<u>1,070,000</u>	
Average Gross Plant + PUC	28,661,038	 3.73%

*Measure of operating performance –
shows how well plant is utilized*

	Revenue <u>\$5M - \$10M</u>	Connections <u>1.5K - 4K</u>	All Participating <u>Companies</u>
BKD Telecommunications SnapShot	2.80%	3.50%	3.20%

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BALANCE SHEET - LIABILITIES

- Current Liabilities
 - Current portion of debt
 - Accounts payable
 - Customer deposits
 - Accrued taxes
-  *Obligations that are due within the next 12 months*



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CURRENT LIABILITIES

Current Liabilities

Current portion of long-term debt	\$ 750,000	\$ 725,000
Accounts payable:		
Interexchange carriers	45,000	40,000
Other	200,000	50,000
Customer deposits	5,000	4,500
Accrued taxes	<u>75,000</u>	<u>85,000</u>
	<u>1,075,000</u>	<u>904,500</u>

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CURRENT LIABILITIES – COMMENTS/QUESTIONS

- Do we have enough cash/current assets available to pay for debts coming due?
- Any unrecorded claims/assessments due to A-CAM obligations or carrier disputes?

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BALANCE SHEET - LIABILITIES

- Other Noncurrent Liabilities
 - Deferred income taxes
 - LT Debt
- Obligations that are due beyond the next twelve months



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NONCURRENT LIABILITIES

Long-Term Debt, less current portion	<u>2,500,000</u>	<u>3,250,000</u>
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RELATIONSHIPS

- Times Interest Earned Ratio (TIER)

$$\frac{\text{Net Margins} + \text{Interest Expense}}{\text{Interest Expense}} = \frac{2,260,000}{160,000} = 14.125$$

Shows how the results of operations cover the costs of external financing

Lenders often require the TIER to be greater than 1.50

	Revenue \$5M - \$10M	Connections 1.5K - 4K	All Participating Companies
BKD Telecommunications SnapShot	66.04	50.8	23.72



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RELATIONSHIPS

- Debt Service Coverage (DSC)

$$\frac{\text{Net Margins} + \text{Interest Exp} + \text{Income Taxes} + \text{Depn}}{\text{Principal} + \text{Interest Pymnts}} = \frac{3,710,000}{885,000} = 4.19$$

Does the cash generated from operations adequately cover debt service requirements?

Lenders often require the DSC to be greater than 1.25

	Revenue \$5M - \$10M	Connections 1.5K - 4K	All Participating Companies
BKD Telecommunications SnapShot	148.82	154.27	54.33



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BALANCE SHEET - EQUITY

- Members'/Stockholders' Equity
 - Memberships
 - Patronage capital assigned
 - Patronage capital assignable
 - Reserves/Permanent capital
 - Unrealized gains/losses
- What the members/owners have provided to the company
- Often referred to as net worth or book value

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MEMBERS' EQUITY/STOCKHOLDERS' EQUITY

Members' Equity

Memberships - \$5 cost, 4,500 and 4,475 issued and outstanding, respectively

Memberships - \$5 cost, 4,500 and 4,475 issued and outstanding, respectively	22,500	22,375
Unrealized gains on certain investments	2,200	1,500
Patronage capital assigned	10,500,000	10,200,000
Patronage capital assignable	2,100,000	2,000,000
Statutory reserves	<u>11,200,000</u>	<u>10,000,000</u>
	<u>23,824,700</u>	<u>22,223,875</u>

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RELATIONSHIPS

- Equity to Total Assets (Net Worth) $\frac{23,824,700}{27,399,700} = 86.95\%$
- $\frac{\text{Total Equity}}{\text{Total Assets}}$

Shows how "reliant" a company is on external financing

Lenders often require that net worth be a minimum of 40% before capital credits can be paid

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STATEMENT OF OPERATIONS (INCOME STATEMENT)

- Financial document showing a company's income and expenses over a given period (monthly, quarterly, annually)
- The "bottom line" of the income statement is the company's earnings for the given period

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STATEMENT OF OPERATIONS

- Operating Revenues
 - Local network access
 - Network access
 - Long distance
 - Video services
 - Internet services
 - Equipment sales
 - Wireless services
 - Miscellaneous
- A presentation of revenues into major categories
- Revenues that are a direct result of what you are in business to do



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OPERATING REVENUES

	2019	2018
Operating Revenues		
Local network services	\$ 740,000	\$ 715,000
Network access services	3,000,000	3,200,000
Long distance services	85,000	87,500
Video services	940,000	900,000
Internet services	820,000	815,000
Equipment sales	25,000	50,000
Wireless services	20,000	30,000
Miscellaneous revenue	100,000	75,000
	<u>5,730,000</u>	<u>5,872,500</u>

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STATEMENT OF OPERATIONS

- Operating Expenses
 - Plant specific
 - Plant nonspecific
 - Cost of services
 - Programming*
 - Internet*
 - Sales*
 - LD*
 - Depreciation
 - Impairments
 - Customer operations
 - Corporate operations
 - General taxes
- A presentation of expenses into major categories
- Expenses incurred to generate the operating revenues



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OPERATING EXPENSES

Operating Expenses		
Plant specific operations	750,000	700,000
Plant nonspecific operations	600,000	625,000
Cost of programming, services and sales	1,275,000	1,200,000
Depreciation	1,100,000	950,000
Impairments	-	250,000
Customer operations	250,000	235,000
Corporate operations	600,000	625,000
General taxes	85,000	90,000
	<u>4,660,000</u>	<u>4,675,000</u>

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STATEMENT OF OPERATIONS

- Operating Margins (Loss)
 - Remaining/(Deficit) after revenues generated from operations pay for expenses incurred

Operating Margins

1,070,000 1,197,500



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STATEMENT OF OPERATIONS

- Other Income (Expense)
 - Interest and dividend income
 - Income from cellular partnerships
 - Interest expense
 - Other, net
- Record of the results of transactions, events and other circumstances affecting the company which are "nonoperational" in nature



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OTHER INCOME (EXPENSE)

Other Income (Expense)

Interest and dividend income	105,000	160,000
Income from cellular investments	1,445,000	1,122,500
Interest expense	(160,000)	(165,000)
Other, net	<u>(10,000)</u>	<u>10,000</u>
	<u>1,380,000</u>	<u>1,127,500</u>

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STATEMENT OF OPERATIONS

- Income Taxes
 - Cooperative – tax associated with non-member business and nonoperating income
 - C-corp – tax associated with current period's operations
- Net Margins (Net Income)

Margins Before Income Taxes	2,450,000	2,325,000
Income Taxes	<u>350,000</u>	<u>325,000</u>
Net Margins	<u>\$ 2,100,000</u>	<u>\$ 2,000,000</u>

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RELATIONSHIPS

- EBITDA (Cash Flow) to Operating Revenue

$$\frac{\text{NI} + \text{IE} + \text{IT} + \text{D} + \text{A}}{\text{Operating Revenue}} = \frac{3,710,000}{5,730,000} = 64.75\%$$

Another measure of operating performance

	Revenue \$5M - \$10M	Connections 1.5K - 4K	All Participating Companies
BKD Telecommunications SnapShot	45.8%	49.1%	41.3%



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RELATIONSHIPS

- Return on Assets

$$\frac{\text{Net Income}}{\text{Average Assets}} = \frac{2,100,000}{26,889,038} = 7.81\%$$

Indicator of profitability; shows how well a company utilizes its assets

	Revenue \$5M - \$10M	Connections 1.5K - 4K	All Participating Companies
BKD Telecommunications SnapShot	4.0%	4.3%	3.9%



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RELATIONSHIPS

- Return on Equity

$$\frac{\text{Net Income}}{\text{Average Equity}} = \frac{2,100,000}{23,024,288} = 9.12\%$$

Indicator of profitability

	Revenue	Connections	All Participating
	<u>\$5M - \$10M</u>	<u>1.5K - 4K</u>	<u>Companies</u>
BKD Telecommunications SnapShot	6.1%	7.3%	6.3%

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STATEMENT OF CASH FLOWS

- A financial statement listing how a company has obtained its funds and how it has spent them in a certain time period
- Provides insights into the manner in which the company raises and invests its money
- Reconciles the change in cash and cash equivalents from the beginning to the end of the accounting period presented



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CASH EQUIVALENT

- Short-term (generally less than three months), highly liquid investments that are convertible to known amounts of cash
 - Checking accounts
 - Savings/MM accounts
 - T-bills or CDs with a term of less than 90 days

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STATEMENT OF CASH FLOWS

- | | |
|--|---|
| <ul style="list-style-type: none"> • Net cash provided (used) by operating activities • Net cash provided (used) in investing activities • Net cash provided (used) in financing activities | <ul style="list-style-type: none"> • Cash generated by operations
<i><u>How cash was used</u></i> • How much was put back into assets that provide a return • How much was paid back to and/or received from owners and/or lenders |
|--|---|



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QUESTIONS?

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THANK YOU!

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