BBC Financial Models Tackle New Questions

Use Broadband Communities' free financial modeling tools to navigate the startling changes in broadband's financial environment. And don't trust Wall Street.

By Steven S. Ross / *Broadband Communities*

I usually get a call per week from users of **Broadband Communities**' financial models, but in the past few months, the call volume has almost doubled. This got me thinking about the path of the broadband business.

Don't worry. Things are doing great. But the definition of "great" may be changing for investors, potential and current business partners, and organizations thinking about entering the network deployment or content business. Regulatory changes, accounting changes, tax changes and technology evolution all reached new peaks last year and show no signs of slowing down.

- Corporate taxes were cut. That means more incentive for some companies to start new builds or extend existing ones. There's more money in the till to pay for expansion. But there's also less incentive for mature broadband deployers, because new capital spending doesn't provide as big a tax deduction as it used to. Lower rates also reduce the effects of various government incentives, especially for economic development in rural and low-income areas.
- Interest rates are rising, making overall construction costs higher for borrowers but giving high-income lenders, especially individuals, tax breaks.
- GAAP rules – generally accepted accounting practices – have become looser with regard to booking revenue. Now vendors can offer easier financial terms without having to distinguish between GAAP numbers (for the SEC) and non-GAAP (for everyone else).
- Every dollar buys more network. Less money is spent on set-top boxes, more money is spent reusing partially depreciated copper and much more money is spent on software and cloud services to replace equipment for Wi-Fi management or network reconfiguration. Wireless gateways have replaced in-unit wiring in recent deployments.
- Network operators tend to expense software to cut taxes. But new operators seeking to show a profit or at least cash flow break-even tend to depreciate software. Expensing lowers the value of a deployer's balance sheet even as it improves cash flow.

Large national carriers, learning an important lesson from newspapers (which did not invest in synergistic lines of business when they had money to invest) have sold network assets even as they build more and have used their cash to buy content. My guess is they will end up being mainly content providers. There will be hundreds of regional carriers with monopolies on networks they will rent to all comers.

The mind reels. But I emphatically suggest you not trust Wall Street to decide for you. I remember what happened after the recession hit. Unheralded except in business magazines and the Federal Register, the IRS helped Main Street by massively reducing tax liabilities for 2008 and 2009. For instance, retailers once had to depreciate store fixtures such as shelving over 40 years. The Feds helped by letting them expense the shelving retroactively. The effect was to make their income look worse, their current cash flow look better and their future tax bills look worse – until tax rates were cut this year. Retailer stock prices reflected what the bookkeeping showed rather than reality.

If Wall Street and populist candidates can't understand shelving, do you really think they understand broadband?

Wall Street rarely calls me. Wall Street is like men when it comes to asking directions. But Tier-3 incumbent local exchange carriers, real estate developers and muni system builders call all the time. So do regional bankers who have been approached by all of the above and by electric co-ops thinking about broadband deployments.

Because I designed the models with capital coverage ratios as the end point, and because I could not possibly take all tax situations into account, I often guide the models' users to build off the EBITDA (earnings before interest, taxes, depreciation and amortization) that the models calculate before considering the "ITDA." Of course, the models are also great tools for calculating the replacement value of the network a deployer has built. Traditional methods still count. But borrowing coverage becomes a new yardstick for valuations in partnerships as balance sheets and "real" profits lose some of their meaning.

Broadband Communities' financial models are available at www.FTTHAnalyzer.com. I will present a workshop on using the models on April 30 at the* Broadband Communities Summit *in Austin. ❖

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