

Broadband Network Financial Analysis – Factors to Consider

By Thomas Asp, Principal Engineer and Analyst, February 2006

The state of broadband communications has significantly changed over the past few years. With the Telecommunications Act of 1996 allowing competition, many local municipalities began to investigate offering broadband connectivity as an added service to their customers, to create competition and enhance economic development. Any municipality interested must consider key competitive and market growth assumptions.

In completing studies for over 50 municipalities, reviewing financial forecasts developed by other parties, and monitoring the market for broadband products and services, we have observed that many of the financial projections for broadband network overbuilds are optimistic – potentially causing cash flow issues down the road. Economic development benefits to the community may justify the connectivity expenditures. Understanding the potential need for additional cash sources will enhance the overall long-term benefits to the community.

A Balanced Approach

It's important to keep the following in mind when reviewing a broadband financial analysis:

- Effect of alternatives on overall market size and growth potential
- Influence of content fees on net margins
- Impact of competition on market share

Effect of Alternatives on Overall Market Size & Growth Potential

Many projections are based on the assumption that the market size and margins for Internet, telephone, and cable television will increase. Although growth in Internet use is anticipated, a decline in traditional cable television and telephone services is likely. In addition, margins on Internet, cable television, and telephone are likely to decline.

With the growth of wireless phones, the local and long distance telephone markets will continue to see decreased market size. In the cable television market, new subscriber growth is flat, and satellite television options are putting pressure on “wired” cable. In addition, content fees for cable programming have been rising, and evolving broadband options will likely erode the need for a middle person to deliver content.

Taken together, these market forces can reduce the revenue potential for a municipal broadband network and an adjustment for this should be considered in the financial analysis.

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Influence of Content Fees on Net Margins

Many forecasts project that the net margins for each product will increase. In reality, the opposite is likely to occur. The cost of cable television programming has risen by over 10% per year for the past 5 years. This trend is expected to continue. For Internet services, as more subscribers are added and uses of the Internet increase, the need for additional circuits or capacity to the Network Access Provider (NAP) increases. The industry trend is for declining net margins for all connectivity services.

Impact of Competition on Market Share

Historically, the overbuild market for communication services has worked when the municipality is the first to market for a new service. In many communities, private sector options are already available, but the overbuild market share projections often assume that the municipal network will be the first to market for high-speed Internet access. Ignoring the competition will lead to unrealistic cash flow projections.

The Bottom Line

While it is true that public ventures do not require the same rate of return as the private sector, they do require timely debt retirement via new revenue sources and realized community benefits. Financial forecasts which do not take into consideration the above three issues can lead to unreasonable expectations.

Development of a broadband network may be viable in many situations, but careful review of the assumptions, sensitivity analysis, and a realistic understanding of the market can lead to better decisions and selection of a business model that makes sense for your community and that no “hidden” cash flow surprises lurk around the corner.

For more information on financial analysis of broadband networks or an independent review of your community’s financial forecast, contact Thomas Asp 410.964.5700 or tasp@internetCTC.com.

About the author: Thomas Asp has been serving public power systems for over 20 years. Tom is recognized as an expert in evaluating and offering recommendations regarding municipal broadband communications systems. He has been actively involved with telecommunication market research and feasibility analysis for over a decade.

About CTC: CTC is a public interest communications consulting firm. We provide engineering and financial analysis for public sector and non-profit clients throughout the United States.

